

Decision 03-05-039 May 8, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Regarding the
Implementation of the Suspension of Direct Access
Pursuant to Assembly Bill 1X and Decision 01-09-
060.

Rulemaking 02-01-011
(Filed January 9, 2002)

**ORDER MODIFYING DECISION (D.) 03-04-030 FOR
PURPOSES OF CLARIFICATION, AND DENYING
REHEARING OF THE DECISION, AS MODIFIED**

I. INTRODUCTION

In Decision (D.) 03-04-030, we rejected a multi-party Settlement Agreement between parties concerning the cost responsibility surcharges (“CRS”) applicable to “Departing Load” (“DL”) served by “Customer Generation” within the service territories of California’s three major electric utilities: Southern California Edison Company (“Edison”), Pacific Gas and Electric Company (“PG&E”), and San Diego Gas & Electric Company (“SDG&E”). (D.03-04-030, p. 1.) After rejecting the Settlement Agreement, we made our determinations regarding the cost responsibility of DL customers of Customer Generation for various components of the CRS (including DWR bond charges, DWR power charges, Edison’s Historical Procurement Cost (“HPC”), and tail CTC). (See generally, D.03-04-030, pp. 43-56 & 64-65.) Although we rejected the Settlement Agreement, we noted that the efforts of the Settlement Parties were useful in helping to define some of the underlying issues and in the determinations we reached. (D.03-04-030, p. 43.)

In D.03-04-030, we exempted customers that began receiving service from customer generation on or before February 1, 2001 and that did not receive bundled service on or after that date from paying all DWR bond charges and ongoing power charges. (D.03-04-030, p. 64 (Ordering Paragraph No. 10.) These are considered continuous departing load customers. Also, based on a need to harmonize various goals and objectives expressed by the Legislature, including those that sought to prevent against shifting of costs between customer classes and those that promote renewal and ultra-clean energy, we provided certain specified customers exceptions from having to pay a portion or all of the CRS components. (See D.03-04-030, pp. 38-40.) For example: Biogas digester generation entities eligible under Assembly Bill No. 2228, Stats. 2002, ch. 845, are not required to pay any CRS. Customer generation, not otherwise continuous DL, that “commenced commercial operation on or before January 1, 2003, or for which (a) an application for authority to construct was submitted to the lead agency under CEQA, not later than August 29, 2001, and (b) commercial operation commences not later than January 1, 2004 are not required to pay DWR ongoing power charges.” Customer generation departing load that is under 1 MW in size and eligible for net metering are required to pay DWR charges based on their net energy consumption, but are not required to pay any of the other CRS components. Customer generation departing load that is over 1 MW in size but that otherwise meets all criteria in Public Utilities Code Section 353.2 as “ultra-clean and low-emissions,” shall pay the Bond Charge and tail Competition Transition Charge (“CTC”), but are not required to pay DWR ongoing power charges or any HPC, except as provided for in the order. D.03-04-030 further set a limit of 3,000 MW, as to the total amount of customer generation departing load eligible for the exceptions. (See generally, D.03-04-030, pp. 64-65 [Ordering Paragraph Nos. 5-11].)¹

¹ Ordering Paragraph No. 5 was modified by D.03-04-041. D.03-04-041 modified D.03-04-030 30 to correct this ordering paragraph so that it would consistent with the dates referenced in the text of D.03-04-030.

Kern Oil & Refining Co. (“Kern”) timely filed an application for rehearing of D.03-04-030. In its rehearing application, Kern alleges: (1) The Commission erred in not conducting additional evidentiary hearings after it rejected the Settlement Agreement; (2) the Commission erred in rejecting the settlement provision related to payment of specific portions of the Bond Charges associated with reserved amounts for future use; and (3) D.03-04-030 is contrary to specific provisions of SB 28X in its establishment of exemption from charges for customer generation of one megawatt, in lieu of the five-megawatt provision in Senate Bill No. 28 of the First Extraordinary 2001-2002 Session (“SB 28X”), Stats. 2001 (Extraordinary Sess.), ch. 12.)

We have carefully reviewed each and every allegations raised in Kern’s application for rehearing, and are of the opinion that no legal error has been established. Accordingly, good cause does not exist for the granting of rehearing, and the application for rehearing is denied.

While we conclude that rehearing is not warranted, we modify D.03-04-030 for purpose of clarifying our determinations regarding the proposal for a reduced Bond Charge. The modifications are contained in the ordering paragraphs in today’s decision.

II. DISCUSSION

A. **After properly rejecting the Settlement Agreement, additional evidentiary hearings were not required prior to the Commission’s determinations of the underlying issues.**

In its rehearing application, Kern alleges that the Commission erred in not ordering hearings to take additional evidence after it rejected the Settlement Agreement. Thus, Kern argues that the Commission erred by not having an evidentiary hearing prior to adopting its determinations regarding CRS for Customer Generation DL customers. (Application for Rehearing, pp. 2-4.) Kern’s allegation of error has no merit.

Prior to its issuance of D.03-04-030, the parties presented opening and reply testimony on the cost responsibility issues for Customer Generation DL in April and May 2002. The parties also were permitted to submit supplemental opening and reply testimony in September 2002. Evidentiary hearings were conducted beginning October 7, 2002 and continuing intermittently through October 18, 2002. The evidentiary hearings provided the parties with an opportunity to cross-examine witnesses regarding the prepared testimony, although parties chose to shorten or waive certain cross-examination in view of the Settlement Agreement. The merits of the Settlement Agreement were to be addressed in comments. (See R.T. Vol. 16, pp. 1993-2009.) Testimony of the witnesses on the underlying Customer Generation DL issues were received into evidence without objections. In the absence of any party raising any other matter to consider, the case was submitted. (R.T. Vol. 16, p. 2014.) Opening and reply comments to the Settlement Agreement were filed. Opening and reply briefs on the Customer Generation DL issues were filed in November 2002. (See D.03-04-030, pp. 8-9, for a summary of the procedural history.) The parties made no request for evidentiary hearings on the Settlement Agreement, including issues related to its approval or rejection. Also, at no time did any party raise the issue that more evidentiary hearings might be needed if the Commission rejected the Settlement Agreement.

Thus, the merits of the Customer Generation DL issues were ripe for our consideration and disposition, even while we were reviewing the merits of the Settlement Agreement. We had before us a legally sufficient record, and thus, no further evidentiary hearings were required, whether the Settlement Agreement was adopted or rejected. Thus, the Commission issued its determinations regarding the CRS for Customer Generation DL customers based on an adequate record. (See D.03-04-030, pp. 8-9.)

Accordingly, Kern's allegation of error is without merit. After rejecting the Settlement Agreement, we properly made our determinations about

the underlying issues because we had a sufficient evidentiary record before us. Further, Kern cites to no legal authority as to why additional evidentiary hearings were required for the underlying issues. Also, Kern fails to establish what material factual issues would warrant additional evidentiary hearings.

B. The Commission lawfully rejected the settlement provision related to payment of a reduced Bond Charge.

In rejecting the Settlement Agreement, we implicitly rejected the proposal to permit a “Shortfall Charge” that was equal to 72% of the Bond Charge that would be assessed on bundled customers. Kern claims that the remaining 28 percent is an amount attributable to the California Department of Resources (“DWR”) reserve. Thus, the adoption of the surcharge would have meant permitting a “discounting” of the Bond Charge, or a reduced Bond Charge. In its rehearing application, Kern argues that the Commission’s failure to adopt this “Shortfall Charge” resulted in a “inappropriate and unjustified subsidy.” (Application for Rehearing, pp. 4-5.)

Kern’s argument has no merit. In D.02-11-022, we rejected the proposal for a reduced Bond Charge for direct access customers on the basis that such customers were not responsible for any costs associated with the various operating reserves. In that decision, we noted that the reserves were necessary to secure the investment grade rating for the Bonds, and thus, direct access customers receive a substantial benefit from “these set-asides as they would enable the bonds to be issued with favorable ratings.” Further, if the reserves were used to retire debt, direct access customers responsible for paying Bond Charges would “certainly” benefit. (Instituting Rulemaking Regarding the Implementation of the Suspension of Direct Access Pursuant to Assembly Bill 1X and Decision 01-09-060 (“DA CRS Decision”) [D.02-11-022, pp. 49-51 (slip op.)] (2002) ___ Cal.P.U.C.2d ___.) This logic likewise applies to Customer Generation DL customers. Therefore, Kern’s allegation of an inappropriate and unjustified subsidy should be rejected as without merit.

In considering the merits of this issue, we realize that our determinations regarding the “Shortfall Charge” or reduced Bond Charge are implied. Although the D.03-04-030 contains a discussion of the parties’ positions on this issue (D.03-04-030, pp. 13-19), it contains no explicit discussion of our rationale for our determinations on this issue. This was an inadvertent oversight. Thus, we will modify D.03-04-030 to make clear and explicit our disposition of this matter, by adding some discussion, findings of fact and a conclusion of law as set forth in the ordering paragraph of today’s decision.

C. The Commission did not err in establishing a 1MW threshold.

In its application for rehearing, Kern argues that the threshold for the exceptions should be 5 MW rather than 1 MW. Kern relies on SB 28X, which defines “distributed energy resources to mean any initial operation commencing between May 1, 2001 and June 1, 2003, which is located within a city or facility and is five megawatts or smaller in aggregate capacity, among other requirements.” Thus, Kern argues that when the Commission used 1 MW as the threshold, it was acting inconsistently with the specific statutory bases upon which the Commission relied to adopt the exceptions. (Application for Rehearing, pp. 5-6.) We disagree, and find Kern’s argument without merit.

The exceptions adopted in D.03-04-030 constitute our determination of what the “fair share” should be for these DL customers of Customer Generation. The Legislature left the determination of what the “fair share” should be to the Commission. (See D.03-04-030, p. 38; see also, Assembly Bill No. 117 (“AB 117), Stats. 2002 (Reg. Sess.), ch. 838, §4.) Thus, in exercise of this authority, the Commission has made its determinations for what the “fair share” of the CRS should be for these customers. For some customers, the total CRS might be zero or zero for DWR related costs (including Bond Charges and/or Power Charges). As we discussed in D.03-04-030, pp. 38-39, our adoption of the exceptions from paying a portion or 100 percent of the “fair share” was based on

the Commission authority under Assembly Bill No. 117 (“AB 117”), Stats. 2002 (Reg. Sess), ch. 838, §4, and the need and our responsibility to harmonize the Legislature’s expressed intent for preventing cost-shifting while promoting renewable electricity generation and ultra-clean and low emission Customer Generation.

Contrary to Kern’s assertion, we did not arbitrarily choose 1 MW as a threshold. Although the self-generation incentive programs allow for participation of systems over 1 MW, we determined that 1 MW was appropriate for the exceptions to the CRS, because the size limit was created by the Legislature in Public Utilities Code Section 2827. As we explained in D.03-04-030, we wanted to maintain the size threshold to be consistent with the net metering program. This was a policy determination. We further noted our intent to revisit the 1 MW limit for exceptions “no later than three years from the date of issuance of D.03-04-030. (D.03-04-030, pp. 46 & 65 [Ordering Paragraph No. 12].)

With respect to the 5 MW provided for in SB 28X, codified in Public Utilities Code Section 353.1, as a part of the definition of “distributed energy resources,” this language is not controlling. SB 28X does not limit the exercise of our authority to adopt the exceptions to the “fair share” and in the manner that we did, including the use of a 1 MW threshold. Public Utilities Code Section 353.2 provides that the Commission “may consider,” but is not required to adopt a 5 MW threshold. (See Pub. Util. Code, §353.2, subd. (c).)

Moreover, we did provide for exceptions for an opportunity for clean customer generation that is over 1 MW in size. D.03-04-030 provides that within a specified eligibility limitation of 3000 MW, “ultra-clean and low-emission [customer generation] over 1 MW in size will not pay for DWR ongoing power costs, nor will they pay for [Edison’s] HPC.” (D.03-04-030, p. 49.) The fact that we did not provide for exceptions from having to pay all components of CRS,

including the Bond Charges, is a valid choice in exercise of our authority under AB 117 and in harmonizing the Legislature's objectives as described above.

III. CONCLUSION

Therefore, based on the above, the issues raised by Kern in its rehearing application have no merit. Accordingly, the application for rehearing is denied. However, D.03-04-030 is modified for purpose of clarification in the manner set forth below.

THEREFORE, IT IS ORDERED that:

1. For purpose of clarification, D.03-04-030 is modified to add the following discussion, as Section IV.A.5. This discussion is added on page 19 of the decision at the end of Section IV.A.4. of D.03-04-030:

"5. Discussion.

We reject the proposal for a reduced Bond Charge and a recovery methodology, as proposed in the Settlement Agreement, that differs from the approach that we have adopted for applying Bond Charges to bundled and DA customers. Instead of paying a full pro rata share of the full Bond Charge, Customer Generation load would only pay 72% of the requirements otherwise assessed against bundled and DA load.

The Shortfall Charge covers the administrative, financing, and reserve costs associated only with the historic undercollection, but not the remaining reserve and deposit accounts making up the total bond proceeds. Settling Parties argue that to compensate for the upfront discount, Customer Generation would not receive the future benefit from the funds in those reserve accounts to the extent they are used to reduce future power charges or to shorten the term of the Bond Charge. Settling Parties argue that the lower upfront charge is merely an alternative rate design in comparison to that applied to bundled and DA load. Settling Parties portray the proposed treatment merely as a difference in the timing of charges, rather than as any absolute advantage over time.

We find this justification unconvincing. As noted by SDG&E, it is not clear to what extent the bond reserves

would be released at some future date to pay down the Bond obligation or to reduce future ongoing power charges. Reference Exhibit 1a in the Bond Charge Proceeding described what will happen to a large portion of these funds. The majority of the initial deposit to the Operating Account consists of an \$850 million increase to the Minimum Operating Expense Available Balance. This additional cushion in the Operating Account is only required so long as DWR continues to procure the Residual Net Short. As of January 1, 2003, that responsibility has been transferred to the investor-owned utilities, and the Minimum Operating Expense Available Balance requirement must be reduced by \$850 million (even if DWR continues to be responsible for long-term contracts). At that time, the freed-up funds can be used to “either retire the additional debt issued to fund the higher account balance or can be used for more immediate ratepayer relief. The Commission, after consultation with the Department, will be responsible for determining the use of the excess amounts.” (Reference Exhibit 1a is from the Bond Charge Proceeding, A.00-11-038, et al. See also, D.02-11-022, pp. 50-51.) If the funds are used to retire debt, all customers responsible for paying Bond Charges will benefit. If the funds are used for more immediate ratepayer relief, the extent to which customers may benefit will depend on whether that relief comes in the form of a reduction to Bond Charges or Power Charges, or both, an issue that has not yet been decided.

The Operating Reserve referenced in Exhibit 106 of the Bond Charge Proceeding is set aside to cover the contingency that the Operating Account may not be sufficient to fund all operating costs. Absent this contingency, there is no certainty that the sums in the Operating Reserve Account will ever be used to fund DWR’s ongoing power purchases. To the extent that these reserves do not become available to reduce future Bond or Power Charges, the purported benefit associated with Customer Generation’s waiver of any right to the future benefits of any reserves becomes illusory. Given the uncertainty as to how or to what extent current reserves may reduce charges, there is no assurance that bundled customers would ever see offsetting benefits in relation to the upfront benefit accorded Customer

Generation customers through the 28% discount. Customer Generation customers could thereby gain an unfair advantage in relation to bundled customers if they were granted a front-loaded 28% discount excluding these reserves.

Moreover, we disagree that the funding of reserve accounts for ongoing costs represents any improper “commingling” with historic shortfall costs. In D.02-11-022, we previously explained how the reserve accounts relate to the overall DWR Bond financing requirements. As stated by DWR in Exhibit 3, the hypothetical \$8.6 million bond issue “does not reflect the financing of any of the Department’s power purchasing program reserves, the funding of which will be a condition of the rating agencies in order to secure the Department’s desired level of investment grade ratings on the bonds.”

Thus, the funding of the various operating reserves at closing was a pre-requisite to actually issuing the bonds. The rating agencies insisted on the setting aside of such large sums in these accounts in order to give the bonds favorable credit ratings. Without these large set-asides, the bonds would have had lower ratings, or perhaps could not have been issued at all. An investment grade rating on the DWR Bonds is required by Water Code Section 80130. Lower ratings would have increased the interest on these bonds thus increasing their cost to DA customers. In short, customers received a substantial benefit from these set-asides as they enabled the bonds to be issued with favorable ratings, thereby lowering interest charges. Thus, the cost of funding these set-asides form an integral part of the favorable financing terms applicable to the historic shortfall. (See D.02-11-022, pp. 43-53 (slip op.), for a discussion of this issue.) By excluding the funding of these reserve accounts in the derivation of the 72% ratio, the Shortfall Charge does not account for any of the benefits realized by all affected customers, including Customer Generation customers, derived from the reserve accounts.

Finally, as noted by SDG&E, assuming the reserve funds were used to retire the bonds early, the Settlement Agreement fails to explain what regulatory treatment would be applied to revenues collected from Customer Generation customers thereafter, or how the applicable

shortfall charge would be determined when there is no remaining Bond Charge in place from which a 72% ratio can be applied.

Because we have found the Bond Charge to be an integrated whole, it would be improper and unfair to approve any discounted Shortfall charge that assumes such reserves can be severed. We find that this distinction is not supported by the record, nor is it consistent with the approach applied to DA customers in D.02-11-022. Thus, we find persuasive the arguments presented by ORA and SDG&E that the Settlement Agreement does not meet the criteria for approval to the extent that it would impose a discounted Shortfall charge.” Instead, we direct the Bond Charge authorized in this order shall be applied on the same equivalent cents per kWh basis as applies to bundled service customers.”

2. On page 60, D.03-04-030 is modified for purpose of clarification to add the following Findings of Fact:

- “21. The imposition of a “Shortfall Charge” as called for under the Settlement Agreement, which would provide for a reduced Bond Charge is not reasonable.
22. The imposition of a “Shortfall Charge” would be inconsistent with the Commission’s findings in D.02-11-022 regarding the integrated relationship between the reserve accounts and historic shortfall, and would result in Customer Generation customers paying a lesser amount of Bond-related costs in comparison to bundled and direct access customers.”

3. On Page 61, D.03-04-030 is modified for purpose of clarification to insert the following Conclusion of Law between Conclusions of Law Nos. 6 and 7:

- “6A. A Bond Charge of less than 100% for Customer Generation DL customers is not justified, as it would be inconsistent with Commission policy determinations adopted in D.02-11-022.”

4. Rehearing of D.03-04-030, as modified, is hereby denied.

This order is effective today.

Dated May 8, 2003, at San Francisco, California

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners