



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

Rulemaking 06-02-013

**MOTION OF DIVISION OF RATEPAYER ADVOCATES
TO STRIKE PORTIONS OF SAN DIEGO GAS & ELECTRIC
COMPANY'S LONG-TERM PROCUREMENT PLANS ON
DEBT EQUIVALENCE AND FINANCIAL ACCOUNTING
STANDARDS BOARD INTERPRETATION (FIN) 46(R)¹**

I. INTRODUCTION

Pursuant to Commission's Rules of Practice and Procedure, Rule 11.1, and the Scoping Memo issued on September 25, 2006, the Division of Ratepayer Advocates (DRA) submits this motion to strike portions of San Diego Gas & Electric Company's (SDG&E) testimony in the Proceeding to Integrate Procurement Policies and Consider Long-Term Procurement Plans.

DRA moves to strike the portions of SDG&E's Plan that seek to modify the Debt Equivalence (DE) methodology used in selecting power purchase agreements (PPA) to allow a corresponding recovery for debt equivalency impact in rates and increase SDG&E's equity structure to compensate for the impact of Financial Accounting Standards Board Interpretation (FIN) 46(R) regulations. Although SDG&E couched these requests in ratemaking language to make them seem integral to Assembly Bill (AB) No. 57 and the Long-Term Procurement Planning (LTTP) process, the Commission has twice instructed SDG&E that the issues of DE and FIN 46(R) are Cost of Capital issues

¹ Financial Accounting Standards Board Interpretation Number 46 Resolution.

that should be decided in the Cost of Capital proceedings together with all other issues that impact SDG&E's capital structure. (See D.05-12-043 [Opinion on Test Year 2006 For The Major Energy Utilities], Conclusions of Law [COL] No. 4; D.07-02-011 [Opinion Conditionally Accepting Procurement Plans For 2007 RPS Solicitations], pp. 29-31.).

There is no decisional overlap between the Cost of Capital and the LTPP proceedings that justifies SDG&E's inclusion of testimony concerning the DE methodology. (See Administrative Law Judge's Ruling Denying Moving Parties' Motion to Strike Testimony of Pacific Gas and Electric Company, p. 5.)

II. SDG&E'S PROPOSED COST RECOVERY FOR DEBT EQUIVALENCY IS BEYOND THE SCOPE OF THE LTPP

Any mechanism for mitigating DE costs with rates belongs in the Cost of Capital proceeding. In D.05-12-043, COL 4, the Commission stated, "The impact of SDG&E's debt equivalence should be considered along with its other risks in arriving at a fair and reasonable ROE [Return on Equity]".

SDG&E's proposal also shows that the intended rate recovery mechanism for addressing DE impact in the LTPP will involve adjustments to cost of debt and cost of equity, which are determined in the Cost of Capital proceedings with other financial factors.

Therefore, SDG&E proposes that the specific procedure set forth herein be adopted, which would allow use of the most recent S&P methodology for calculating debt equivalence. By adding equity in an amount equal to the authorized equity factor (currently 49%) of the additional debt and reducing debt by the same amount, SDG&E will resume the authorized capital structure. Using the authorized cost of equity (currently 10.7%), factoring in the gross-up for income tax expense and the authorized cost of debt (currently 5.75%), SDG&E can calculate the revenue requirements associated with rebalancing. In the event changes to the currently authorized capital structure and cost of capital, SDG&E would substitute the future authorized levels in the debt equivalence calculations.

(SDG&E's Long-Term Procurement Plans, Vol. II, pp. 28-29.)

The Commission has never authorized an adjustment to an Investor Owned Utility's (IOU's) cost of debt and cost of equity factors in the long-term procurement or resource planning proceedings because other financial factors necessary to complete such adjustments are never present in these planning proceedings. The Cost of Capital proceeding involves a careful balancing of several credit and finance elements taken together to avoid unintended results from one exaggerated factor. If the LTPP proceeding develops a DE cost recovery mechanism in isolation from other Cost of Capital elements, it will likely upset the balance of SDG&E's capital structure and encourage IOUs to seek Cost of Capital relief in other proceedings.

SDG&E does not dispute that DE belongs in Cost of Capital, but argues that it is more expedient to address it in the LTPP.

While conceptually the implementation of debt equivalence mitigation can be addressed in annual Cost of Capital (COC) proceedings, under SDG&E's MICAM it is likely SDG&E will process a full COC only every five years. Therefore, for SDG&E, it is appropriate that the Commission address debt equivalence mitigation for a PPA at the time the PPA is presented to the Commission for approval. This will allow for timely review and implementation of appropriate mitigation measures.

(SDG&E's LTPP, Vol. II, p. 29.)

This argument is without merit. SDG&E's next Cost of Capital proceeding will be filed this year (in May 2007) not in five years. SDG&E is expected to file its application and testimonies in May 2007, and the Commission held three days of workshops in early February 2007 to better understand the impact that DE and other financial factors might have in the 2007 applications. Given SDG&E admission that DE "mitigation can be addressed in annual Cost of Capital" and the fact that SDG&E's cost of capital application will be filed in May 2007, there is no harm to SDG&E in addressing DE in the upcoming Cost of Capital proceeding.

III. THE LTTP SCOPING MEMO AND OTHER IOU PLANS

The LTTP scoping memo omitted debt equivalency as an issue for this proceeding. Neither Pacific Gas and Electric Company (PG&E) nor Southern California Edison (SCE) have presented any testimony suggesting that cost recovery is necessary for debt equivalence in this planning horizon.

In fact SCE's testimony argued that Moody's and Fitch credit rating agencies may have abandoned debt equivalency impact determinations for regulated utilities while Standard and Poor is reviewing possible elimination of that element in its credit rating determination. According to SCE, "for utilities that have the ability to pass through the cost of purchasing power under PPAs to their customers, Moody's regards these PPA obligations as operating costs with no long-term debt-like attributes." [SCE's Long-Term Procurement Plan, Vol. II, p. 24.). "Fitch Rating Service's view on PPA obligations is much like that of Moody's...[because it views] purchasing power commitments as a component of the operating expense of a utility or merchant company, not a debt instrument." (Id.)

IV. SDG&E'S PROPOSED FIN 46(R) RECOMMENDATION IS OUTSIDE THE SCOPE OF THE LTTP

FIN 46(R), like DE, is not strictly a ratemaking mechanism but a capital structure component. According to SDG&E, executing a PPA with a company "over which control is achieved by means other than voting rights" will cause the Financial Accounting Standards Board (FASB) to view SDG&E's financial statements as consolidated with the financial statements of the power provider for purposes of evaluating the impact of that PPA. "Therefore, SDG&E requests that the Commission approve the proposal for calculating costs associated with FIN 46(R) consolidation, as well as the associated cost recovery proposal." (SDG&E, LTTP Vol. II, p. 30.) Entities over which control is achieved by means other than voting rights are otherwise known as variable interest entities (VIE).

SDG&E also made this request in Rulemaking 06-05-027 when filing its Renewable Portfolio Standard (RPS) procurement plans for 2007 solicitations. In R.06-05-027, the Commission stated that the issue should be considered in the Cost of Capital proceeding. (D.07-02-011, pp. 29-30.)

SDG&E's 2007 proposed Plan notes that beyond the direct costs of the purchased power there are at least two other costs with RPS contracts. These are costs resulting from debt equivalence and FIN 46(R) requirements. To the extent that individually executed PPAs will impact SDG&E's capital structure, SDG&E's proposes that SDG&E be permitted to seek relief in its Commission advice letter filing for approval of each PPA. (SDG&E 2007 Proposed Plan, p. 20.)

...

Moreover, TURN correctly argues that SDG&E's approach is inconsistent with past Commission orders. We ordered that "IOUs shall justify the debt equivalence factors for PPAs on a case by case basis in the cost of capital proceedings." (D.04-12-048, Ordering Paragraph 23.) We did this because debt equivalence might require the infusion of more equity in the capital structure, for example. This is best assessed in a cost of capital proceeding. This is also true for FIN 46(R), since a consolidated financial statement might affect an IOU's credit profile (e.g., increasing its risk) and resulting cost of equity. ...

(Id.)

For similar reasons, the Commission should address FIN 46(R) in SDG&E's cost of capital proceeding. Doing so will preserve the integrity of Commission decisions and discourage forum shopping.

V. DUPLICATION OF EFFORTS AND COMMISSION RESOURCES

The Commission should recognize that SDG&E clearly intends to pursue DE mitigation and FIN 46(R) proposals in its 2007 cost of capital filing, regardless of how the Commission decides this motion to strike its testimony in the LTTP. DRA expects this duplication of efforts because the Commission directed SDG&E to submit the issues in its next cost of capital filing (D.05-12-043, COL 4.),

Any likelihood that the LTPP decision might subsequently conclude that the DE mitigation and FIN 46(R) proposals should be addressed in SDG&E's cost of capital, which would already be under-way when the Commission issues the LTPP decision, might lead to waste of Commission resources.

VI. CONCLUSION

THEREFORE, DRA requests that the Commission strike all testimony, references and proposals in SDG&E LTPP seeking to develop a rate-recovery mechanism for mitigating the impact of DE and FIN 46(R) consolidation on SDG&E's capital structure.

Respectfully submitted,

/s/ NOEL A. OBIORA

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February 26, 2007

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

Rulemaking 06-02-013

[PROPOSED] ADMINISTRATIVE LAW JUDGE'S RULING

Having reviewed the Motion of the Division of Ratepayer Advocates (DRA) to strike portions of San Diego Gas & Electric Company's (SDG&E) Long-Term Procurement Plans seeking to develop a rate-recovery mechanism for mitigating the impact of Debt Equivalence (DE) and Financial Accounting Standards Board Interpretation (FIN) 46(R) consolidation on SDG&E's capital structure;

And good cause appearing therefore,

IT IS HEREBY RULED that:

DRA's motion to strike is granted and all SDG&E testimony, references to and proposals, on DE and FIN 46(R) in SDG&E's Long-Term Procurement Plans are hereby stricken.

Dated _____, 2007 at San Francisco, California.

Administrative Law Judge

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document
**“MOTION OF DIVISION OF RATEPAYER ADVOCATES TO STRIKE
PORTIONS OF SAN DIEGO GAS & ELECTRIC COMPANY’S
LONG-TERM PROCUREMENT PLANS ON DEBT EQUIVALENCE AND FIN
46(R) and [PROPOSED] ADMINISTRATIVE LAW JUDGE’S RULING”
in R.06-02-013.**

A copy was served as follows:

BY E-MAIL: I sent a true copy via e-mail to all known parties of record who have provided e-mail addresses.

BY MAIL: I sent a true copy via first-class mail to all known parties of record.
Executed in San Francisco, California, on the 26th day of February, 2005.

/s/ Nelly Sarmiento

Nelly Sarmiento

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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