

Decision **DRAFT DECISION OF COMMISSIONER DUQUE**
(Mailed 9/11/2001)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) for Authority to Increase Its Authorized Level of Base Rate Revenue under the Electric Revenue Adjustment Mechanism for Service Rendered Beginning January 1, 1995 and to Reflect this Increase on Rates.

Application 93-12-025
(Filed December 27, 1993)

Order Instituting Investigation into the Rates, Charges, and Practices of SOUTHERN CALIFORNIA EDISON COMPANY, Establishment of the Utility's Revenue Requirement, and Attrition Request.

Investigation 94-02-002
(Filed February 3, 1994)

OPINION ON SAN DIEGO GAS & ELECTRIC COMPANY'S PETITION FOR MODIFICATION OF DECISION 96-04-059 REGARDING CERTAIN PROVISIONS RELATING TO THE SAN ONOFRE NUCLEAR GENERATING UNITS NOS. 2 & 3

I. Summary

This decision modifies Decision (D.) 96-04-059 to eliminate a revenue sharing mechanism and associated pricing provisions adopted for San Onofre Nuclear Generating Unit Nos. 2&3 (SONGS 2&3), clarifies that San Diego Gas & Electric Company (SDG&E) will have an obligation to serve ratepayers with SONGS 2&3 generation after 2003, and establishes a ratemaking method to reduce the Assembly Bill (AB) 265 Undercollection Balancing Account.

II. The Petition for Modification

On July 16, 2001, SDG&E filed a Petition for Modification of D.96-04-059 in the following respects:

- Commit SONGS 2&3 generation to the benefit of SDG&E's bundled customers from January 1, 2004 through December 31, 2010;
- Return SONGS 2&3 to cost-based ratemaking from January 1, 2004, including eliminating (a) the 50/50 sharing mechanism for post-2003 net benefits; (b) the shifting of cost responsibility for Shutdown Operation and Maintenance (O&M) costs to shareholders; (c) the shifting of cost responsibility for post-2003 increases in decommissioning costs to shareholders; and (d) the shifting of cost responsibility for certain liabilities associated with nuclear or electric magnetic fields (EMF) or other incidents post-2003; and
- Create a \$133 million regulatory asset called the "SONGS Equalization Adjustment" to reduce the AB 265 Undercollection Balancing Account, also called the Energy Rate Ceiling Revenue Shortfall Account, or ERCRSA, by \$146 million.¹

SDG&E makes this request in order to implement SONGS-related provisions of a June 18, 2001 Memorandum of Understanding (MOU) that SDG&E and Sempra Energy have entered into with the California Department of

¹ SDG&E estimates its AB 265 Undercollection Balancing Account at \$750 million. This account represents the difference between the wholesale price of electricity that SDG&E has been entitled to collect from customers since June 30, 1999 (when SDG&E's rate freeze ended according to D.99-05-051) and AB 265's 6.5 cents/kilowatt hour (kWh) cap for residential and small commercial customers.

Water Resources (CDWR).² SDG&E also believes that the SONGS terms in the MOU are both reasonable in and of themselves and as part of the plan described in the MOU for eliminating the AB 265 Undercollection Balancing Account.³

III. Responses to SDG&E's Petition

The Office of Ratepayer Advocates (ORA); the Federal Executive Agencies (FEA); and The Utility Reform Network (TURN), Utility Consumers Action Network (UCAN) and Aglet Consumer Alliance (Joint Respondents) filed responses to SDG&E's motion. SDG&E filed a reply thereto.

A. ORA

ORA supports some of SDG&E's proposed modifications with certain caveats and for reasons independent of the MOU. ORA supports a return to cost-of-service ratemaking for SONGS 2&3 as an appropriate step to implement AB1X-6 to ensure that SDG&E's generating assets, including SONGS, remain dedicated to service for the benefit of California ratepayers at just and reasonable rates. ORA believes eliminating the SONGS 2&3 net revenue sharing mechanism adopted in D.96-04-059 after 2003 is consistent with cost-of-service ratemaking. ORA also points out that SDG&E's petition proposes cost-of-service ratemaking effective until the end of 2010, but recommends that the Commission articulate that it is not addressing ratemaking after 2010.

ORA recognizes that SDG&E's proposed SONGS Equalization Adjustment is not a necessary part of any cost-based ratemaking proposal, but

² The MOU's SONGS-related provisions which SDG&E sets forth are attached hereto as Appendix A.

³ The ALJ granted SDG&E's motion to shorten the time to respond to SDG&E's petition for modification. Briefing was complete on August 7, 2001.

rather is an accounting mechanism to recover undercollections associated with SDG&E's past power purchases. ORA does not oppose the concept of creating a regulatory asset to address part of SDG&E's undercollection, but believes that the rate of return should be set at a level that reflects the low risk associated with the asset, rather than the weighted average cost of capital, as suggested by SDG&E. According to ORA, this would reduce the rate of return by about 8%.

B. FEA

The FEA supports examining all SDG&E MOU-implementation issues in a single proceeding. As to the SONGS issues raised by this petition, the FEA opposes creating the SONGS Equalization Adjustment because it would transfer a significant portion of the burden for collecting the balance in the AB 265 Undercollection Balancing Account from AB 265 customers to non-AB 265 customers who, according to the FEA, did not have a rate cap and who paid actual wholesale prices.

C. The Joint Respondents

The Joint Respondents oppose SDG&E's petition and also believe that the Commission should consider the MOU on a comprehensive basis. They support ratemaking changes to SONGS 2&3 to return SONGS to cost-of-service ratemaking, but argue that because such changes will occur notwithstanding the MOU in order to implement ABX1-6, that SDG&E has overstated the ratepayer benefit of the MOU.

Specifically, the Joint Respondents do not agree that SDG&E should retain Incremental Cost Incentives Procedure (ICIP) ratemaking through 2003, and argue that this issue is being addressed in the utility retained generation

(URG) ratemaking phase of the Rate Stabilization Proceeding.⁴ According to the Joint Respondents, ratepayers would be worse off by paying the “SONGS Equalization Adjustment” than the AB 265 Undercollection Balancing Account, because of the increased rate of return associated with the equalization adjustment. They also argue that creating this equalization adjustment for an asset for which the utility has already obtained its full return on its investment is contrary to cost-of-service ratemaking. The Joint Respondents assert that SDG&E’s strict definition of costs of plant operation which it is entitled to recover in rates through 2010 may conflict with the Commission’s future ability to address SDG&E’s cost-of-service ratemaking, and has the potential to conflict with cost-of-service ratemaking for Edison’s share of SONGS.

IV. Discussion

A. AB1X-6

Under the recently enacted AB1X-6,⁵ the Commission is required to ensure that SDG&E’s generating assets, including SONGS 2&3, “remain dedicated to service for the benefit of California ratepayers.” In D.01-06-041, we recently modified D.96-04-059 for Edison in order to comply with AB1X-6. SDG&E’s requested modifications go beyond Edison’s recent request. However, some of the modifications SDG&E proposes in its petition comply with AB1X-6, and we adopt them as modified by this decision on that basis.

⁴ Application (A.) 00-11-038.

⁵ AB1X-6 was enacted on January 18, 2001 to take effect immediately.

B. Modifications Consistent with AB1X-6

D.96-04-059 adopted, with modifications, a February 5, 1996 joint proposal of Edison and SDG&E with respect to SONGS 2&3. SDG&E is a 20% owner of SONGS 2&3. Some of the modifications proposed by SDG&E are to the joint proposal. SDG&E proposes the following modifications to the joint proposal:

- Eliminate the 50/50 sharing mechanism for SONGS 2&3 post-2003 net benefits (Joint Proposal (JP), Section 4.5.3);
- Shift the cost responsibility for shutdown Operation and Maintenance (O&M) costs from ratepayers to shareholders (JP Section 4.5.6);
- Shift the cost responsibility of decommissioning costs from shareholders to ratepayers (JP Section 4.9.1 (a)); and
- Shift the cost responsibility for certain liabilities associated with nuclear or electric magnetic fields (EMF) or other incidents and exposures at SONGS 2&3 post-2003 (JP Section 4.9.4).

SDG&E also proposes to add a new conclusion of law to D.96-04-059 stating that SDG&E shall have the obligation to serve its CPUC jurisdictional bundled service customers with SONGS 2&3 generation from January 1, 2004 through December 31, 2010.

These modifications are generally reasonable and we adopt them as modified below. SDG&E suggests a cut-off date of December 31, 2010 for its obligation to serve its CPUC jurisdictional bundled service customers with SONGS 2&3 generation, in conformance with the language of its MOU. AB1X-6 provides that no facility for the generation of electricity owned by a public utility may be disposed of prior to January 1, 2006. Consistent with our treatment for Edison in D.01-06-041, we modify SDG&E's request and do not impose a cut-off

date for this modification because AB1X-6 does not require a utility to dispose of any of its assets after January 1, 2006. We make this conforming modification to other proposed conclusions of law discussed below. As we stated in D.01-06-041, if appropriate at a later time, we have the discretion to determine whether to modify further the ratemaking treatment for SONGS 2&3.⁶

C. Cost-Based Ratemaking

SDG&E proposes several modifications to D.96-04-059 in order to implement cost-based ratemaking for SONGS 2&3. In our recent decision addressing Edison's SONGS interest, we stated that the "Commission retains the discretion to further define the appropriate cost-of-service ratemaking for SONGS 2&3 in future decisions."⁷ Here, SDG&E proposes that we adopt much more specific language on this issue. We adopt SDG&E's proposed language as modified below.

SDG&E proposes that its operating costs associated with SONGS 2&3 from January 1, 2004 through December 31, 2010 should be defined in advance through a list of specifically delineated accounts.⁸ As pointed out by the Joint

⁶ SDG&E does not suggest a separate conclusion of law to clarify that the modifications will not change the SONGS 2&3 ratemaking plan, the ICIP plan, approved by the Legislature for continuation through December 31, 2003 in Pub. Util. Code § 367(a)(4). Consistent with our treatment of Edison in D.01-06-041, we do not address this issue here. However, we note that TURN is raising issues concerning continued ICIP pricing through 2003 in the URG ratemaking phase of the Rate Stabilization Proceeding, A.00-11-038.

⁷ D.01-06-041 at pp. 5-6.

⁸ SDG&E lists the following costs: fuel costs (fixed and variable), operations and maintenance expenses (including shutdown O&M), costs of emissions credits, direct, joint and common administrative and general (A&G) costs (excluding non-site specific

Footnote continued on next page

Respondents, the Commission has set the cost-of-service revenue requirement for plant in the past by determining the total revenue requirement for the plant, allocated among its owners based on their proportionate share. We cannot and will not bind the hands of future Commissions to modify the customary categories of operating costs recoverable in rates. Furthermore, we do not want to conflict with any cost-of-service ratemaking we establish for Edison's share of the plant.⁹

Therefore, we modify SDG&E's proposed Conclusion of Law 24 to provide that the utility's costs associated with its interest in SONGS 2&3 shall include all customary categories of operating costs as determined by the Commission in SDG&E's general rate cases or other appropriate proceedings which determine the costs of plant operation, and that the categories delineated by SDG&E are ones, among others, that the Commission may consider in determining SDG&E's operating SONGS costs after January 1, 2004.

SDG&E also proposes a new Conclusion of Law 25 which provides that the utility will recover all reasonable and prudent capital investments for SONGS 2&3 put into service after December 31, 2003, depreciated over the remaining life of the plant. This is consistent with principles of cost-of-service ratemaking and we adopt it.

general plant, which shall be treated as a capital cost, but including operating and maintenance costs and A&G costs charged to Utility by the operator of the plant), taxes, scheduling and dispatch costs, congestion cost, ancillary service costs, and other transmission-related costs charged to generators, and decommissioning costs.

⁹ Edison owns a 75.05% share of SONGS 2&3. The cities of Anaheim and Riverside own 3.16% and 1.79%, respectively.

D. AB 265 Regulatory Account

In order to implement the MOU, SDG&E also proposes to create a \$133 million regulatory asset it calls the SONGS Equalization Adjustment, and simultaneously to reduce the AB 265 Undercollection Balancing Account by \$146 million. According to SDG&E's proposal, the SONGS Equalization Adjustment would be amortized from January 1, 2002 through December 31, 2010, and SDG&E would earn its full authorized weighted average cost of capital on the unamortized balance of the account. This proposal is not necessary to implement cost-of-service ratemaking, but rather, is an accounting mechanism to recover undercollections associated with past SDG&E power purchases. As ORA observes, the "association with SONGS appears simply to be for convenience and to guarantee SDG&E shareholders' recovery of these undercollections."¹⁰

SDG&E argues that this proposal, as well as the entire MOU, offers significant ratepayer benefits. A significant benefit of the MOU, according to SDG&E, is that it would eliminate the AB 265 Undercollection Balancing Account without an increase in base rates. Under the proposal, SDG&E believes that its shareholders would forego at least \$100 million in profits that they would otherwise be entitled to under the post-2003 profit sharing mechanism that D.96-04-059 provides. SDG&E also argues that generation from SONGS 2&3 will

¹⁰ August 2, 2001 ORA Response at p. 5. Under the MOU proposal, if SONGS were shut down permanently before the SONGS Equalization Adjustment was fully amortized, SDG&E would still be allowed to recover the remaining portion of the equalization adjustment, as well as any undepreciated capital additions after December 2003, and any other reasonable costs associated with shut down and decommissioning, similar to the Commission's ratemaking for SONGS 1 when it was decommissioned.

be now be devoted to the benefit of SDG&E's bundled service customers after 2003, and that D.96-04-059 provided that SDG&E could sell such generation on the open market.

We find the primary benefit associated with SDG&E's proposal is that it avoids rate shock of otherwise paying off a significant portion of the AB 265 Undercollection Balancing Account more quickly. For example, if the \$146 million portion of the undercollection is paid off in a short period of time (i.e., 3 years), ratepayers would pay on average about \$ 53 million a year for the next three years to reduce this undercollection.¹¹ In contrast, SDG&E's proposal, if modified as discussed below, would spread this cost over a longer period. Therefore, we adopt this portion of SDG&E's proposal as modified below, in order to avoid the potential for rate shock.¹²

Because SDG&E's proposed "SONGS Equalization Adjustment" is a ratemaking account created to pay off an existing regulatory account in an unusual situation, a more appropriate name for this account is the "AB 265 Regulatory Account," and we therefore change the account's name.

¹¹ \$146 million collected in rates over three years at 5% interest.

¹² We disagree with SDG&E that its proposed adjustment benefits ratepayers by over \$100 million due to SDG&E foregoing its claimed entitlement to 50% of the post-2003 profits from SONGS 2&3. Since the Commission issued D.96-04-059, the Legislature enacted AB1X-6 which requires that SDG&E's generating assets, including SONGS 2&3, remain dedicated to serve SDG&E's ratepayers, and that no public utility may dispose of a generation facility prior to January 1, 2006. Thus, under cost-of-service regulation, SDG&E would not be entitled to 50% of the post-2003 SONGS 2&3 profits. We also find SDG&E's "takings" claim unconvincing because, among other reasons, SDG&E would be fully compensated for SONGS 2&3 post-2003 on a cost-of-service basis.

ORA and the Joint Respondents argue that SDG&E should not earn its full authorized weighted average costs of capital (currently 12.63%) on the unamortized balance of the account. According to ORA and the Joint Respondents, because SDG&E's recovery on the account is relatively risk free, the commercial paper rate is a more appropriate interest rate to apply to the account.

We believe that the appropriate interest rate for the AB 265 Regulatory Account is the cost of debt, not the weighted cost of capital as proposed by SDG&E. The net book value of SONGS 2&3 is zero, and the AB 265 Regulatory Account is a ratemaking account created to address an unusual situation. While a return on the weighted cost of capital may be appropriate for a physical plant, under traditional regulatory techniques, this rate is generally not applied to a relatively risk-free regulatory account.

Our modification of SDG&E's proposal in this respect is consistent with Section 1 of the MOU, which provides that nothing in the MOU is intended to provide the utility with recovery of a cost more than once, and that the Commission can adjust rates to prevent multiple recovery of such cost. To permit SDG&E to recover its cost of capital on the AB 265 Regulatory Account would, in effect, permit SDG&E to recover more than once for the cost of the SONGS 2&3 plant, and we therefore make this appropriate adjustment.¹³

¹³ Applying the cost of debt to the AB 265 Regulatory Account is also consistent with Section 1 of the MOU which states that nothing in the MOU "shall prohibit the [Commission] from employing ratemaking and regulatory techniques, methods, and standards that have been historically used and may be used or implemented in the regulation of public utilities," because under historical ratemaking and regulatory techniques, the cost of capital is generally not applied to a relatively risk-free account.

We also find the cost of debt superior to the commercial paper rate because the account is amortized over nine years, and the commercial paper rate generally applies to shorter term debt. The risk of recovery associated with this account is minimal, if any, and thus also justifies applying the cost of debt, rather than the weighted cost of capital, to this account.

As stated above, the AB 265 Regulatory Account is not a traditional component of cost-of-service regulation. It is a inventive account created to pay off an existing regulatory account in an unusual situation in order to avoid rate shock, and thus is compatible with cost-of-service regulation in this limited situation. Our approval of this account is due to the extraordinary facts associated with the creation of this account, and should not be used as precedent for any other situation.

We acknowledge the equity-related concerns raised by the FEA. However, while large customers did not benefit from the AB 265 rate cap, they did have the benefit of a 6.5 cent/kWh frozen rate that was effective February 7, 2001 pursuant to AB 43X. Furthermore, equity-related concerns must be balanced against reducing the balance in the AB 265 account as soon as possible. At this time, we believe the greater public interest is served by reducing the undercollection to AB 265 customers.

Finally, ORA argues that some of the undercollections in the AB 265 account may be reduced by future refunds ordered by the Federal Energy Regulatory Commission, and that AB 265 requires these refunds to be refunded to ratepayers. We will certainly ensure that all future refunds are applied appropriately.

E. Compliance With Rule 47(d)

Rule 47(d) of the Commission's Rules of Practice and Procedure (Rules) requires an explanation of why the petition for modification was not filed within one year of the issuance of the decision that is requested to be modified. AB1X-6 was enacted in January 2001, the MOU is dated June 18, 2001, and the Commission adopted the decision SDG&E requests be modified in April 1996. Thus, it would have been impossible for SDG&E to have filed this petition within one year of the issuance of D.96-04-059.

V. Comment to the Draft Decision

The draft decision of Commissioner Duque was mailed to the parties in accordance with Pub. Util. Code § 311(g) (1) and Rule 77.7(b).

Findings of Fact

1. The modifications set forth in Section IV.B and C which SDG&E proposes in its petition, as modified in the ordering paragraphs, comply with AB1X-6.
2. We cannot and will not bind the hands of future Commissions to modify the customary categories of operating costs recoverable in rates.
3. The AB 265 Regulatory Account is not necessary to implement cost-of-service ratemaking, but rather, is an accounting mechanism to recover undercollections associated with past SDG&E power purchases.
4. The primary benefit of the AB 265 Regulatory Account is that it avoids rate shock of otherwise paying off a significant portion of the AB 265 Undercollection Balancing Account more quickly.
5. The net book value of SONGS 2&3 is zero, and the AB 265 Regulatory Account is a ratemaking account created to pay off an existing regulatory account in an unusual situation in order to avoid rate shock. While a return of the weighted cost of capital may be appropriate for a physical plant, under

traditional regulatory techniques, this rate is generally not applied to a relatively risk-free regulatory account.

6. The appropriate interest rate for the AB 265 Regulatory Account is the cost of debt, not the weighted cost of capital.

7. AB1X-6 was enacted in January 2001, and the Commission adopted the decision that Edison requests be modified (D.96-04-059) in 1996.

Conclusions of Law

1. Under the recently enacted AB1X-6, the Commission is required to ensure that SDG&E's generating assets, including SONGS 2&3, "remain dedicated to service for the benefit of California ratepayers."

2. The modifications to D.96-04-059 set forth in the ordering paragraphs should be adopted.

3. Our approval of the AB 265 Regulatory Account is due to the extraordinary facts associated with the creation of this account and should not be used as precedent for any other situation.

4. This decision should be effective immediately in order to comply with AB1X-6 with respect to appropriate ratemaking treatment for SDG&E's post-2002 operations as SONGS 2&3 as soon as possible.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company's (SDG&E) July 16, 2001 Petition for Modification of Decision (D.) 96-04-059 is granted to the extent set forth in these ordering paragraphs.

2. Conclusion of Law 20 shall be added to D.96-04-059 as follows:

“20. SDG&E shall have the obligation to serve its CPUC jurisdictional bundled service customers with SONGS 2&3 generation after 2003.”

3. Conclusion of Law 21 shall be added to D.96-04-059 as follows:

“21. We modify the joint proposal with respect to SDG&E to delete Sections 4.5.3 and 4.5.6.”

4. Conclusion of Law 22 shall be added to D.96-04-059 as follows:

“22. We modify Section 4.9.1 (a) of the joint proposal with respect to SDG&E to read as follows: ‘All nuclear decommissioning costs.’”

5. Conclusion of Law 23 shall be added to D.96-04-059 as follows:

“23. We modify Section 4.9.4 of the joint proposal with respect to SDG&E to read as follows: ‘Nothing in this Proposal will preclude SDG&E from requesting that it be permitted to recover at any time (a) any assessments or retrospective premiums under the Nuclear Regulatory Commission (‘NRC’) Secondary Financial Protection Program, or the Master Worker Liability coverage with ANI/MAELU associated with incidents or exposures at any location or relating to SONGS 2&3 nuclear plant decommissioning, or (b) any costs associated with claims by workers and/or third parties including, but not limited to, allegations of exposure to nuclear radiation and/or electric and magnetic fields (‘EMF’) associated with incidents or exposures at any location relating to SONGS 2&3 nuclear plant decommissioning.’”

6. Conclusion of Law 24 shall be added to D.96-04-059 as follows:

“24. From January 1, 2004, until further order of the Commission, SDG&E’s costs associated with its interest in SONGS 2&3 shall include all customary categories of operating costs as determined by the Commission in SDG&E’s general

rate cases or other appropriate proceedings which determine the costs of plant operation. The Commission may consider the following, among other, categories of costs in reaching its determination: fuel costs (fixed and variable), operations and maintenance expenses (including shutdown O&M), costs of emissions credits, direct, joint and common administrative and general (A&G) costs (excluding non-site specific general plant, which may be treated as a capital cost, but which may include operating and maintenance costs and A&G costs charged to SDG&E by the operator of the plant), taxes, scheduling and dispatch costs, congestion costs, ancillary service costs, and other transmission-related costs charged to generators, and decommissioning costs.”

7. Conclusion of Law 25 shall be added to D.96-04-059 as follows:

“25. All reasonable and prudent incremental capital investments for SONGS 2&3 put into service after December 31, 2003, including income taxes and a full return on investment, will be recovered in rates from the time they are placed in service, and such incremental investment will be depreciated over the expected remaining useful life of the plant in question, which will be determined by the remaining term of the applicable license for each plant, granted to SDG&E by the Nuclear Regulatory Commission (NRC), as such licenses may be extended by the NRC.”

8. Conclusions of Law 26 and 27 shall be added to D.96-04-059 as follows:

“26. Effective as of January 1, 2002, an amount equal to \$133,000,000 (such amount is referred to as the AB 265 Regulatory Account) shall be credited as a regulatory account, and depreciated over the period beginning January 1, 2002 and ending December 31, 2010 as a component of rates, and effective on January 1, 2002, the balance in SDG&E’s Energy Rate Ceiling Revenue Shortfall Account (ERC RSA) shall be reduced by the sum of \$146,000,000 on account thereof. The return which SDG&E is entitled to recover in rates on the AB 265 Regulatory Account shall equal SDG&E’s cost of debt.

“27. The Commission shall provide, in the event of a permanent shutdown of SONGS 2&3 prior to the end of the applicable depreciation period, for the treatment of SDG&E’s unamortized incremental capital expenditures for SONGS 2&3 incurred after December 31, 2003, and any other reasonable and prudent costs incurred by SDG&E in connection with the shutdown and decommissioning of the units, in a manner consistent with the Commission’s previously authorized treatment of unamortized nuclear power plant costs (in Decision 92-08-036) in connection with the shutdown of the San Onofre Nuclear Generating Station 1 nuclear power plant prior to the expiration of its useful life.”

9. No later than 20 days after the effective date of this decision, SDG&E shall file with this Commission revised tariff sheets in compliance with General Order 96-A which implement the modifications in this decision. The revised tariff sheets shall apply to service rendered on or after their effective date.

10. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.

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Excerpts from the June 18, 2001 Memorandum of Understanding among California Department of Water Resources, San Diego Gas & Electric Company, and Sempra Energy at pp. 5-6.

“Subject to the further provisions of this MOU respecting recovery of investments, and the ratemaking principles set forth herein, a CPUC Implementing Decision shall provide with respect to Utility’s interest in SONGS 2 and 3 as follows:

- “For SONGS 2 and 3, other than transmission-related costs, operating costs will be recovered through December 31, 2003 through the existing Incremental Cost Incentive Procedure (ICIP);
- “From January 1, 2004 through December 31, 2010, Utility’s costs associated with its interest in SONGS 2 and 3 shall include all customary categories of operating costs (including, but not limited to, fuel costs (fixed and variable), operations and maintenance expenses (including shutdown O&M), costs of emissions credits, direct, joint and common administrative and general (A&G) costs (excluding non-site specific general plant, which shall be treated as a capital cost, but including operating and maintenance costs and A&G costs charged to Utility by the operator of the plant), taxes, scheduling and dispatch costs, congestion costs, ancillary service costs, and other transmission-related costs charged to generators) and decommissioning costs.

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- “Effective as of January 1, 2002, an amount equal to \$133,000,000 (such amount is referred to in this MOU as the “*SONGS equalization adjustment*”) shall be credited as a regulatory asset in respect of Utility’s interest in SONGS 2 and 3, and depreciated over the period beginning on January 1, 2002 and ending December 31, 2010, and effective on January 1, 2002, the balance in ERCRSA shall be reduced by the sum of \$146,000,000 on account thereof. The return which Utility is entitled to recover in rates on that portion of its rate base which is attributable to such regulatory asset shall equal Utility’s authorized weighted average cost of capital. In the CPUC Implementing Decision approving the SONGS 2 and 3 equalization adjustment and the recovery thereof, the CPUC shall provide, in the event of a permanent shutdown of SONGS 2 and 3 prior to the end of the applicable depreciation period, for the treatment of Utility’s unamortized regulatory asset in respect to SONGS 2 and 3, Utility’s unamortized incremental capital expenditures for SONGS 2 and 3 incurred after December 31, 2003, and any other reasonable and prudent costs incurred by Utility in connection with the shutdown and decommissioning of the units, in a manner consistent with the CPUC’s previously authorized treatment of unamortized nuclear power plant costs in connection with the shutdown of the San Onofre Nuclear Generating Station 1 nuclear power plant prior to the expiration of its useful life.
- “Through December 31, 2003, incremental capital expenditures for SONGS 2 and 3 will be recovered through the ICIP mechanism. All reasonable and prudent incremental capital investments for SONGS 2 and 3 put into service after December 31, 2003, including income taxes and a full return on investment, will be recovered in rates from the time they are placed in service, and such incremental

investment will be depreciated over the expected remaining useful life of the plant in question, which will be determined

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- by the remaining term of the applicable license for each plant, granted to Utility by the Nuclear Regulatory Commission (“NRC”), as such licenses may be extended by the NRC.
- “Prior to January 1, 2002, Utility shall not recover or seek to recover any portions of ERCRSA to be credited as the SONGS equalization amount, unless the CPUC shall disapprove the proposed CPUC Implementing Decision for SONGS 2 and 3 described in this Section 3.

“Under current CPUC decisions, net revenues from SONGS 2 and 3 after 2003 are subject to a sharing mechanism whereby profits (as defined) are shared equally between shareholders and customers. The foregoing CPUC Implementing Decision shall provide that such sharing mechanism, and all associated provisions for transfer of post-ICIP cost responsibility to Utility, will be eliminated after December 31, 2003 and through December 31, 2010.”

(END OF APPENDIX A)