STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

December 5, 2002 Agenda ID# 1503
Ratesetting

TO: PARTIES OF RECORD IN R.01-10-024

Enclosed is the alternate draft decision of Commissioner Peevey to the draft decision of ALJ Halligan previously mailed to you. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of them as written, amend or modify them, or set them aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

As set forth in Rule 77.6, parties to the proceeding may file comments on the enclosed alternate order no later than December 12, 2002. An original and four copies of the comments with a certificate of service shall be filed with the Commission's Docket Office and copies shall be served on all parties on the same day of filing. Anyone filing comments shall electronically serve those on the service list who have provided electronic addresses. Parties shall also ensure that they electronically serve their comments on Commissioner Peevey's energy advisor, Kevin Coughlan, at kpc@cpuc.ca.gov and the assigned ALJ Halligan, at jmh@cpuc.ca.gov. For those who have not provided electronic addresses, printed copies of the comments shall be served by first class mail or other expeditious mode of delivery. No reply comments will be accepted.

The Appendices are the same as found in ALJ Halligan's draft decision, and they are not attached to this alternate draft.

/s/ CAROL A. BROWN
Carol Brown, Interim Chief
Administrative Law Judge

kpc:acb

Attachment

Decision **ALTERNATE DRAFT DECISION OF COMMISSIONER PEEVEY**
(Mailed 12/5/02)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Cost Recovery Mechanisms for Generation Procurement and Renewable Resource Development.	Rulemaking 01-10-024 (Filed October 25, 2001))

OPINION ORDERING PACIFIC GAS AND ELECTRIC COMPANY, SAN DIEGO GAS & ELECTRIC COMPANY, AND SOUTHERN CALIFORNIA EDISON COMPANY TO ENTER INTO AND COMPLY WITH THE ATTACHED OPERATING ORDER

(Note: Appendices are not attached. They are the same as found in ALJ Halligan's draft decision previously mailed.)

TABLE OF CONTENTS

Title **Page**

OPINION ORDERING PACIFIC GAS AND ELECTRIC COMPANY, SAN DIEGO GAS & ELECTRIC COMPANY, AND SOUTHERN CALIFORNIA EDISON COMPANY TO ENTER INTO AND COMPLY WITH THE ATTACHED OPERATING ORDER 2

I. Summary 2
II. Procedural Background 2
III. Need for the Operating Order 4
IV. Legal Authority for Operating Order 7
V. The Role of the Commission and DWR 11
VI. The Operating Order 12
A. Modifications to the Operating Order 14
B. Exhibit A — Operating Protocols 18
C. Exhibit B — Fuel Management Protocols 21
D. Exhibit C — Settlement Principles for Remittances and Surplus Revenues 25
E. Exhibit D — ISO Charges 37
F. Exhibit F 37
VII. Proposed Standards for Reasonableness Review 43
VIII. Comments on Alternate Draft Decision 54
IX. Assignment of Proceeding 54
Findings of Fact 54

Conclusions of Law 57

ORDER 58

List of Appendices

Attachment A	Operating Order
Exhibit A	Operating Protocols
Exhibit B	Fuel Management Protocols
Exhibit C	Settlement Principles For Remittances and Surplus Revenues
Exhibit D	ISO Scheduling Coordinator Charges
Exhibit E	Contract Management and Administration Protocols
Exhibit F	DWR Data Requirement from Utility

OPINION ORDERING PACIFIC GAS AND ELECTRIC COMPANY, SAN DIEGO GAS & ELECTRIC COMPANY, AND SOUTHERN CALIFORNIA EDISON COMPANY TO ENTER INTO AND COMPLY WITH THE ATTACHED OPERATING ORDER

I. Summary

This decision adopts the Operating Order under which Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), and Southern California Edison (SCE) will perform the operational, dispatch, and administrative functions for the California Department of Water Resources (DWR) Long-Term Power Purchase Contracts as of January 1, 2003. The Operating Order sets forth the terms and conditions under which the utilities will administer the DWR Contracts and requires the utilities to dispatch all the generating assets within their portfolios on a least-cost basis for the benefit of their ratepayers.

This decision is consistent with Assembly Bill 1 of the First Extraordinary Session (AB X1, Stats. 2001, Ch.4), which authorized the DWR to purchase electricity and sell it to the retail customers of the utilities (with the utilities acting, in effect, as DWR's billing agent) and Section 80260 of the Water Code, under which DWR's authority to make such purchases expires on December 31, 2002.

This decision approves the Operating Order attached to this decision and orders the utilities to comply with the order. The Operating Order is a modified version of the draft Operating Agreement attached to DWR's Memorandum dated November 6, 2002. The reasons for the modifications are discussed below.

II. Procedural Background

On September 19, 2002, the Commission issued Decision (D.) 02-09-053, which ordered PG&E, SDG&E, and SCE, collectively referred to as the "utilities,"

to assume all of the operational, dispatch, and administrative functions for the DWR Contracts. The decision also allocated the DWR Contracts to the resource portfolios of the three utilities to be scheduled and dispatched in a least-cost manner.

D.02-09-053 also directed the utilities and DWR to jointly file proposed Operating Agreements and Proposed Standards for Reasonableness Review by October 1, 2002, and, if there remained specific issues where agreement could not be reached, highlight those differences in a companion comparison exhibit.

On September 25, 2002, PG&E requested an extension of time to file the documents pursuant to Rule 48(b) of the Commission's Rules of Practice and Procedure. By letter dated September 26, 2002, SCE and SDG&E joined PG&E's request. The Commission's Executive Director, in a letter dated September 27, 2002, granted a one-week extension, until October 8, 2002, for filing the documents.

On October 8, 2002, DWR transmitted to the service list a memorandum from Peter Garris of DWR in response to D.02-09-053 along with a proposed initial draft of an Operating Agreement. PG&E, SDG&E, and SCE filed timely comments on the initial draft operating agreement and Proposed Reasonableness Standards for Utility Administration of Allocated DWR Contracts. SDG&E's comments included a draft operating agreement in the form of a red-lined version of DWR's initial draft.

On October 18, 2002, PG&E, SCE, SDG&E, DWR, and Sempra Energy (Sempra) filed comments and proposed revisions to the draft initial Operating Agreements and Reasonableness Review Standards. Aglet Consumer Alliance (Aglet) also filed comments on the proposed reasonableness standards. PG&E, SDG&E, SCE, and DWR filed replies on October 23, 2002.

On November 6, 2002, SDG&E filed a Motion for Leave to file Updated Information regarding the Operating Agreement. SDG&E indicated that it had reached consensus with DWR on additional issues and that it was in the best interest of the Commission to grant its motion. DWR also submitted a revised draft Operating Agreement on November 6, 2002 via a Memorandum transmitted to the service list in the proceeding.

By ruling dated November 6, 2002, the assigned administrative law judge (ALJ) granted SDG&E's motion and invited other interested parties to file updated information if desired. The ruling also provided an opportunity for parties to comment on SDG&E's and DWR's updated information and well as any other updates filed, by November 8, 2002. SDG&E and SCE filed replies on November 8, 2002.

It is clear that the utilities and DWR have been working diligently to reach consensus on an Operating Agreement. We note that significant progress has been made since the initial filings on October 8, 2002. We appreciate the time and effort expended by the parties in an attempt to achieve consensus, and their ability to reach agreement on some issues.

III. Need for the Operating Order

In January 2001, in response to the energy crisis facing California, the Legislature gave the DWR authority to purchase electricity and sell it to, among others, retail customers of the utilities.[1] Utilities' were to provide transmission and distribution for DWR-purchased electricity. The utilities were also to provide billing, collection and related services for both.

[1] Water Code Section 80002.5

Under ABX1-1, DWR's authority to contract for such purchases is not perpetual. Water Code Section 80260 provides that DWR's authority expires on January 1, 2003.[2] Water Code Sections 80000 and 80003 further demonstrate that DWR's authority was an emergency measure designed to stabilize a crisis. Both the Commission and the Legislature have clearly expressed their intent to eliminate the need for DWR to continue procuring power for the utilities after January 1, 2003, consistent with the utilities' statutory obligation to serve their customers.

Consistent with the intent of ABX 1, one of this Commission's fundamental short-term goals is to transition full responsibility for energy market related activities back to the utilities as soon as possible. We should therefore make every effort to relieve DWR from the responsibility to perform any functions that should be performed in the long term by regular market participants. We note that this direction is consistent with the fact that the utility, and not DWR, continues to have a statutory responsibility to serve its customers. The utilities' obligation to serve their customers is mandated by state law and is part and parcel of the entire regulatory scheme under which the utilities received a franchise and under which the Commission regulates utilities under the Public Utilities Act. (See, e.g. Pub. Util. Code §§ 451, 761, 762, 768, and 770.)[3]

---

[2] Water Code Section 80260 provides in pertinent part that "[o]n and after January 1, 2003, the department shall not contract under this division for the purchase of electrical power."

[3] As we explained in D.01-01-046, "a bankruptcy filing or the threat of insolvency has no bearing on this aspect of state law. Even utilities that file for reorganization must serve their customers. The public safety, and the economy's health will be impaired if the utilities avoid their obligation to serve."

In its September 6, 2002 Memorandum in response to the Draft Decision of ALJ Gottstein regarding the allocation of power contracted by DWR under long-term contracts, DWR requested that the Commission direct the utilities to propose appropriate operating protocols in a separate operating agreement, for approval by the Commission. DWR states that operating agreements between DWR and each of the utilities are necessary to define the respective responsibilities of DWR and the utilities if the utilities are to act as agent on behalf of DWR for operational, dispatch, and administrative purposes.

Specifically, DWR notes that, as proposed, the Draft Decision provides that DWR would retain legal and financial responsibilities associated with the Contracts, while the utilities would act as DWR's agent in matters related to the day-to-day operation, including dispatch and scheduling of the Contracts. DWR states that an operating agreement is necessary to fulfill its contractual obligations and provide assurance to the relevant parties that DWR maintains the ability to monitor performance, obtain timely information, and adjust its revenue requirement. D.02-09-053 subsequently directed the utilities to file proposed Operating Agreements for our review and approval.

With DWR no longer in the business of procuring electric power on behalf of the utilities' customers as of January 1, 2003, the utilities will now perform all the day-to-day scheduling, dispatch, and administrative functions for the DWR contracts allocated to their portfolios, just as they will perform those functions for their existing resources and any new procurements. We can now eliminate the duplicative DWR scheduling apparatus that was put in place on a temporary basis under emergency conditions. It is not in the state's interest to allow two entities to continue to perform overlapping functions. Moreover, we should not

continue to allow the utilities to utilize the states' resources, interest-free, to fulfill their obligation to serve.

The utilities will resume procurement by January 1, 2003. As we stated in D.02-09-053, we believe that the best way to coordinate DWR and utility resources as the utilities resume procurement is to put all of these resources under the control of the utilities, to be scheduled and dispatched in a least-cost manner, subject to our oversight.

IV. Legal Authority for Operating Order

Today's decision ordering the utilities to comply with the Operating Order derives from the explicit statutory authority provided in Water Code Sections 80016 and 80106 (b) and from the Commission's general statutory authority under Pub. Util. Code § 701.

Water Code Section 80016 provides in pertinent part that all state agencies "shall and are hereby authorized to, at the request of the department [i.e.,DWR], give the department reasonable assistance or other cooperation in carrying out the purposes of this division." Water Code Section 80106 (b) provides that, at DWR's request, "the commission shall order the related electrical corporation… to transmit or provide for the transmission of, distribute the power and provide billing, collection, and other related services, as agent of the department, on terms and conditions that reasonably compensate the electrical corporation for its services."

The utilities continue to challenge the Commission's authority to order compliance with the Operating Agreement as does Sempra. The arguments advanced by the utilities and Sempra are generally the same as those addressed in D.02-09-053 and are now the subject of applications for rehearing. The Commission will address those arguments in its disposition of the rehearing

applications. We will not revisit today ground that we have already covered in D.02-09-053. We are here today to implement the requirements of that Decision with respect to Operating Agreements, not to reexamine the legal underpinnings of the Decision itself, and we decline to be drawn into a debate more properly reserved for rehearing.

Sempra asserts that the proposed operating agreement and the fact that it contemplates an assignment of DWR's rights and obligations under DWR's long-term contract with SER (the "SER-DWR Contract") violates the terms of that contract. Sempra cites Section 9.01 of the SER-DWR Contract, which states that:

> Except for an assignment made pursuant to Section 9.02 [in connection with financings], neither Party shall assign this agreement or its rights hereunder without the prior written consent of the other Party, which consent may be withheld in the exercise of its sole discretion; provided however . . . . Department shall also have the right to transfer or assign (without relieving itself of liability hereunder) this Agreement to any electrical corporation, as defined in the Act; provided, however, that (A) such assignee is not an Affiliate of Seller; (B) such assignee has credit rating equal to or higher than that of Department and a total capitalization equal to or greater than that of Seller and all of its Affiliates at the time of such assignment; (C) such assignee agrees to provide Seller with such credit assurances as Seller may reasonably require; (D) no such assignment shall be effective until Department shall have provided written notice to Seller of such assignment, which notice shall include the name and address of the assignee; (E) any such assignee shall agree in writing to be bound by the terms and conditions hereof; and (F) Department delivers such tax and enforceability assurance as the Seller may reasonably request. (Emphasis in original.)

As support for its position, Sempra argues that it has long been the rule in California that "if the contract itself provides in terms that it is not transferable, it

certainly cannot be transferred, although it might otherwise be so." *La Rue v. Groezinger*, 84 Cal. 281, 283 (1890); *Murphy v. Luthy Battery Co.*, 74 Cal. App. 68, 74-75 (1925) ("a contract is not to be held assignable where the parties expressly stipulate to the contrary"). "In the absence of a controlling statute the parties may provide that a contract right or duty is nontransferable. [Citations omitted.] Moreover, even when there is no explicit agreement — written or oral — that contractual duties shall be personal, courts will effectuate a presumed intent to that effect if the circumstances indicate that performance by a substituted person would be different from that contracted for." *Masterson v. Sine*, 68 Cal. 2d 222, 230-31 (1968) (citations omitted); *accord Knipe v. Barkdull*, 222 Cal. App. 2d 547, 551 (1966) ("[w]here a contract calls for the skill, credit or other personal quality of the promisor, it is not assignable.") (citation omitted); *see also Kreisher v. Mobil.*

Sempra states that not only is there no controlling statute that would permit the assignment or transfer of rights and obligations as contemplated by the Proposed Operating Agreement, but the law is to the contrary. According to Sempra, Pub. Util. Code § 454.5, requires only that the Commission "specify the allocation of electricity, including the quantity, characteristics, and duration of electricity delivery, that the [DWR] shall provide under its power purchase agreements to the customers of each electrical corporation."[4]

Sempra contends that DWR remains obligated not only to retain title to the power sold under the power purchase agreements but also to administer those agreements pursuant to Water Code Sections 80110 and 80260, as well as in accordance with the terms of its contracts with the energy suppliers. Sempra

[4] Sempra Comments dated October 18, 2002, emphasis added.

argues the law is clear and that DWR cannot do indirectly, by way of the Proposed Operating Agreement, that which it is forbidden to do directly under the terms of its long-term contracts.

The utilities join Sempra in arguing that the Commission cannot force the utilities to sign an operating agreement for two reasons. First, the utilities continue to assert that the Commission may not compel the utilities to accept assignment of DWR's responsibilities under the Contracts because AB1X requires that DWR retain title to the energy it sells to the customers. Second, the utilities claim that under Pub. Util. Code § 454(c) the Commission may not approve a feature or mechanism for an electrical corporation of the feature or mechanism would impair restoration of an electric corporation's creditworthiness.

In response, DWR points out that Sempra fails to note the authority provided to DWR under Water Code Section 80122(b). This Section authorizes DWR to engage in services determined by DWR to be necessary for the purposes of Division 27 of the Water Code. Section 80122(b) specifically provides that DWR may "engage the services of private parties to render professional and technical assistance and advice and other services in carrying out the purposes of this division." Although DWR is correct, we need not rely on that authority in order to accomplish our goal herein. The Commission's plenary authority under Pub. Util. Code § 701, in combination with the authority provided in Water Code Section 80106 (b) form the underpinning of this decision. In addition, as we stated in D.02-09-053, under current practice the utilities can and do accept allocation of DWR contract energy, albeit under a different operational framework, therefore, the requirement that DWR retain title to DWR contract energy in no way serves as a bar to allocation of operational control of the Allocated Contracts.

V. The Role of the Commission and DWR

The parties are sharply divided on the issue of the role DWR will take in determining the reasonableness of the utilities' administration of the contracts. In order to put the various operating agreement and reasonableness standards proposals in context, we must first provide clarification as to the respective roles of the parties.

DWR recovers its costs through a revenue requirement that it submits to the Commission. The Rate Agreement (D.02-02-052) establishes the process whereby DWR recovers its revenue requirements from the customers of the utilities. Generally, DWR is required to submit updated revenue requirements on an annual basis or more frequently if needed, and is required to provide summaries of revenues and costs on a monthly basis. DWR is subject to the reporting requirements of the Rate Agreement, and also to the reporting requirements of the Trust Indenture, as bond issuer.

DWR is entitled to recover in electric rates its bond costs, power procurement costs, and other costs listed in Water Code Section 80134. DWR also has the authority to conduct a reasonableness review under Pub. Util. Code § 451[5] of the costs it seeks to recover in electric rates.

The Commission has the responsibility under Pub. Util. Code § 454.5 to "specify the allocation of DWR power to be included in each utility's procurement plan." As we asserted in D.02-09-053, the Commission also has the exclusive authority to conduct a reasonableness review of the utility's

[5] Water Code Section 80110.

administration of the contracts as part of the utility's portfolio of resources under § 454.5.

In sum, as of January 1, 2003, DWR will: 1) retain legal and financial responsibility for the DWR contracts, 2) remain responsible for calculating the DWR revenue requirement and for submitting revenue requirements to the Commission, and 3) service the bonds as issuer. DWR's responsibilities will not extend to conducting a reasonableness review of the utilities' portfolio dispatch decisions. That responsibility rests with the Commission.

VI. The Operating Order

The Operating Agreement contains a variety of provisions, some of which are in the main body of the agreement and others are located in Exhibits A through F to the agreement. The Operating Agreement describes and defines the duties of the utilities with respect to the operation and administration of the contracts (Section 4.01 and Exhibit A), including the management of gas tolling provisions (Exhibit B) and reporting requirements (Exhibit F). The Operating Agreement also establishes the duties of DWR (Section 5.01). The Operating Agreement includes provisions addressing the consequences of default (Section 7), limitations on liability (Section 10), the confidentiality of information (Section 11), audit rights for DWR and the State of California Bureau of State Audits (Section 12), and dispute resolution (Section 13).

The parties have agreed to many of the provisions in the agreement, but substantial disagreement remains. The Operating Order we approve is based on a modified version of the draft Operating Agreement attached to DWR's November 6, 2002, Memorandum (DWR's Draft). The language of the Operating Order has been changed from that found in DWR's Draft to reflect that the Commission is ordering the utilities to comply with the terms and conditions of

an Operating Order. In addition, we have modified certain language in DWR's Draft to ensure that it properly reflects the direction provided by the Commission in D.02-09-053. The DWR's Draft has also been modified in consideration of the parties' comments. Substantive changes to specific sections of the Operating Order are discussed below.

A. Modifications to the Operating Order

Article II – Allocation of Power Purchase Agreements, Management of the Contracts, DWR Power, Term

Article II, Section 2.01 –

SDG&E objects to the statements in Sections 2.02, 4.01, 7.02, and 12.01 of DWR's draft that would have the utilities' undertaking their duties or functions "on behalf of DWR." SDG&E believes this characterization leaves open the question as to the nature of the capacity in which the utility is undertaking these functions. SDG&E suggests that the relationship should be characterized as one involving the provision of professional services to DWR by a private party in carrying out the purposes of Division 27 of the Water Code.

This language first appeared in DWR's November 6, 2002 Draft. The memorandum attached to DWR's draft does not explain the reason for the inclusion of the language. Lacking good reason for its inclusion, and considering SDG&E's request for its removal (though without accepting SDG&E's characterization of the utility/DWR relationship), we have deleted this language. Section 3.01 of the Operating Order provides that the utilities will act "as DWR's agent for the limited purposes" of the Order. We believe that this "Limited Agency" definition appropriately reflects the nature of the capacity in which the utilities undertake these functions. We explicate this a bit more in our comments on Section 3.01, below. The phrase "on behalf of DWR" may unnecessarily and inappropriately alter the nature of that limited agency relationship.

Section 2.02 - Standard of Contract Management

The last sentence of Section 2.02 is deleted. Section 2.02, entitled "Standard of Contract Management," would allow DWR, upon request by a utility, to provide a certificate to the utility stating that the utility is in

compliance with the Order in all material respects. Since DWR would be providing such a certification without waiving its own right to review or challenge the utility's performance, the only apparent purpose of obtaining such certification appears to be an attempt to limit the Commission's ability to review the utilities' actions. Since DWR does not have authority for reviewing the utility's administration of the Contracts, we see no logical reason to retain this provision.

Section 2.05 – Term

The utilities take issue with the termination provisions in the November 6, 2002 draft submitted by DWR. Of particular concern to the utilities is the lack of a provision allowing the utilities to terminate the agreement. The draft operating agreement that DWR submitted would allow the utility to terminate the agreement only after an event of default by DWR and DWR's failure to comply with a final, non-appealable adjudication of the matter relating to the event of default by a court of competent jurisdiction. The utilities state that this could require the utility to continue performing under the agreement even if DWR has defaulted under its contracts. In addition, SDG&E and PG&E argue that they should be entitled to terminate the agreement if they incur material financial liabilities in accordance with their performance under the agreement or if the Commission authorizes a termination. SCE also expressed concern regarding the fact that the Commission did have termination rights under the DWR's Draft.

We acknowledge the utilities' concern the DWR's Draft is one-sided in favor of DWR. We address this concern in Section 7.03, which concerns consequences of a DWR Event of Default. We do, however, wish to note here that the Operating Order is not an agreement. It is an order the Commission and

is not subject to termination by the utilities. We will modify the language of Section 7.03 such that the utilities must seek Commission authorization to terminate the Order. This provision will allow the utilities to request Commission authority to terminate the order if they believe circumstances warrant such action.

Article III

Section 3.01 - Limited Agency

Section 3.01 clarifies that the utilities are acting as DWR's agent, for the limited purposes set forth in the Operating Order. The utilities acknowledge that a fundamental underpinning of the Operating Order is that they become, to a limited extent, agents of DWR for purposes of managing DWR generating assets within their portfolio of generating assets. As such, the utilities will act as DWR's agent for limited purposes, such as where purchasing gas associated with the DWR contracts. Utilities disagree with proposed provisions of the Operating Agreement that would create a broader agency relationship.[6] According to SCE, an unlimited agency relationship would create conflicts with the utilities' primary fiduciary obligation to operate in the best interests of its ratepayers and shareholders.

DWR would seem to be equally concerned about a broader agency relationship, albeit for a different reason than that set forth by SCE. DWR's concern is that if given a general agency, the utilities would (inadvertently or otherwise) encumber DWR in undesireable ways. Hence, the language in DWR's initial draft required the utility to operate as DWR's agent for the limited

[6] SCE October 18, 2002 Comments, page 3.

purposes set forth in the agreement. DWR states that the "agency" relationship stems directly from AB 1X. In response to the utilities' concerns, DWR has worked to eliminate any language that might suggest that the utilities were in a general "agency" role, and has consistently referred to the utilities' agency role as that of a "limited agent."

With the understanding that the limited agency role in no way expands the authority of DWR to direct the utilities' activities, we find it reasonable to characterize the utilities as DWR's limited agents. We echo SCE's concern about taking any action that might impede the utilities' satisfaction of this fiduciary responsibility to ratepayers. We believe that, as modified, the OA ensures that the utilities can honor their obligations to their ratepayers.

Article IV

Section 4.01 – Limited Duties of Utility

Consistent with our discussion under Exhibit C, below, we modify Section 4.01 to reflect that, the utilities will be responsible for settlements. A corresponding modification is also made to Section 5.01(c) of Article V.

Article VII

Section 7.03 – Term and Consequences of Default by DWR

As discussed in Section 2.02, above, the utilities expressed concern that Section 7.03 would require the utilities to continue performance under the agreement if DWR has defaulted under its Contracts. They request that Section 7.03 be modified to delete the parenthetical and qualification pertaining to DWR's failure to comply with a final, non-appealable adjudication of the matter relating to such event of default.

As just discussed, we have modified Section 2.02 to reflect that upon a DWR default, utilities may seek Commission termination of the Servicing Order.

With this added provision, there is no need to further modify Section 7.03. In the event of DWR default, and prior to a final, non-appealable adjudication of the matter, if the utilities believe there is good cause to terminate the order they may apply to the Commission for interim relief.

B. Exhibit A — Operating Protocols

Part I.A (Annual and Quarterly Load and Resource Assessment Studies)

SDG&E proposes to offer utilities the option of providing Weekly Load and Resource Assessment Studies, in addition to the required Annual and Quarterly Studies. As the utilities always have the option to provide information beyond that which is required by the agreement, it is not necessary to specifically provide such an option.

Part I.C – Scheduling Protocols

SDG&E also suggests adding a new subsection C.5 to Part I as follows:

> "In order to implement "least-cost dispatch" of resources subject to this Agreement, DWR and Utility shall develop acceptable dispatch protocols and procedures that will enable Utility to dispatch resources on a basis acceptable to DWR and Utility." SDG&E believes it is critical that DWR and the Utilities have a clear understanding of each party's understanding of the meaning of the phrase "least-cost dispatch" before each utility begins scheduling activities. SDG&E argues that failing to undertake this effort will lead to disagreements that are best understood before scheduling activities begin. As discussed in Section V above, DWR is not responsible for reviewing the utilities' dispatch decisions.

Nevertheless, if any of the utilities wish, they may work independently with DWR to develop dispatch protocols that are acceptable to each utility and DWR. We do not adopt this language as a requirement of the Operating Order;

however, because we find that least-cost dispatch is likely to encompass a range of possible options. Furthermore, the utilities should not assume that arranging such dispatch protocols with DWR substitutes for Commission review of utility administration of the Contracts.

Part II – Independent System Operator (ISO) Ancillary Service Market

This section would authorize the utility to develop protocols and procedures for the use of DWR Contracts for Ancillary Services, subject to DWR review.[7] It is not clear if the required review contemplates a one-time review of the protocols, or an ongoing requirement. In PG&E's opinion, the reporting requirements expected by DWR for proving that the contract was used appropriately for Ancillary Services as opposed to energy would render the Ancillary Services option unusable. We agree. We are not opposed to DWR conducting a one-time review of the utilities' proposed protocols for the use of DWR Contracts for Ancillary Services, but we believe that requiring DWR review prior to each transaction would reduce the utilities flexibility in managing their integrated portfolio, potentially jeopardizing our goal of least-cost dispatch. We also note that the utilities should not assume that DWR review of any proposed protocols will substitute for Commission review of its administration of the Contracts.

---

[7] To the extent DWR has already accounted for Ancillary Services in its Revenue Requirement, the utilities and their ratepayers should not have to pay twice for such services. The Draft Decision of ALJ Peter Allen in A.00-11-038, notes that DWR estimates its 2003 cost for providing Ancillary Services at approximately $170 million. Consistent with the Draft Decision of ALJ Allen, we believe that the Revenue Requirement should be adjusted to reflect that the utilities are responsible for the cost of providing Ancillary Services.

Part III.C (Surplus Energy Sales Arrangement)

SDG&E takes issue with the language in subsection C of Part III of the Operating Agreement which states "If Utility sells surplus Power to an entity that requires collateral, the cost and obligation to post such collateral shall be Utility's responsibility." SDG&E states that, in trading surplus energy arising from the Contracts, if DWR is unable to provide the required collateral then the Utility may find that its total portfolio comprised of utility retained generation (URG) resources and DWR allocated contracts cannot be traded into the same markets. Yet the revenue stream from these trades is to be pro-rated in a fashion consistent with the Commission's directive. According to SDG&E, in this event, it may be possible for the utility's customers to be "shorted" revenues as a result solely of DWR's inability or unwillingness to provide and pay for any required collateral.

SDG&E claims that it would be unlawful for the Commission to compel a Utility to provide its own credit facility at its own cost to support any trade of surplus energy from the allocated DWR contracts. SDG&E's argument appears to rely on the assumption that the provision of collateral in connection with surplus sales is a "right" under the contracts that may not be transferred.

SDG&E's argument is flawed. The provision of collateral is not a non-transferrable "right" under the contracts. The collateral requirements at issue in Part III C are not imposed by the DWR Contracts, but rather by exogenous variables (e.g., the ISO Tariff). Collateral may be posted by the utilities without implicating the DWR Contract's provisions. Moreover, we do not find any likelihood of "shorting" of ratepayers by virtue of making the utilities rather than DWR responsible for posting collateral for all surplus sales. As far as we can see, ratepayers are indifferent to whether collateral costs come from DWR's or a

utility's revenue requirement. Consistent with our goal of reducing the utilities' reliance on the states' resources, we adopt DWR's proposed language.

Attachment 5 – Transition Period

The three utilities support adding a provision to Section VII of Attachment 5 to Exhibit A to establish a six-month to one-year transition period, or "learning curve" period during which DWR would "facilitate, assist and cooperate with Utility in the transition from DWR to Utility of the performance of the operational, dispatch, and administrative functions as provided under the agreement."[8] During this "transition period," the utilities would still be subject to reasonableness review of their administration of the DWR Contracts.

We understand the concern expressed by the utilities regarding a "cold-turkey" shift. We recognize that DWR has had experience operating these contracts.

We are persuaded that DWR's facilitation, assistance, and cooperation with the utilities' operation and dispatch of the contracts would benefit the utilities and their ratepayers. Mindful of the additional, although minimal cost, associated with DWR continuing to staff a function for which DWR is no longer responsible, we will limit this transition period to the first six months of 2003. If the utilities find this DWR support unnecessary before July 1, 2003, they should terminate the DWR support.

C. Exhibit B — Fuel Management Protocols

Under a number of the DWR Contracts, DWR has the right to provide gas for the generating units. These "gas tolling" provisions allow DWR to use the

[8] Ibid.

physical supply of natural gas to manage the risk of volatility of gas prices reflected in the Contracts. Since gas costs are generally passed-through under the Contracts, the suppliers have few incentives to provide low cost gas. Our evaluation of how DWR and the utilities should manage the contracts with gas tolling provisions relies upon the following principles adopted in D.02-09-053:

> "Moreover, shifting responsibility for administration of gas purchases under gas tolling provisions furthers our goal of extricating DWR from day-to-day procurement activities. In sum, the utility's operational and administrative responsibility for DWR contracts should extend to the implementation of gas tolling provisions (p. 48)."

The portion of the Operating Order addressing the gas tolling provisions is referred to as "Exhibit B", titled "Fuel Management Protocols". The purpose of this exhibit is to describe and define each DWR's and the utilities' specific responsibilities regarding management of those aspects of the Contracts directly related to supplying gas to generators. .

Consistent with our adopted principles, Section I of Exhibit B specifies that DWR will retain legal and financial responsibility for gas and related services whereas the utilities will perform the administrative and operational activities as a limited agent of DWR. Pursuant to Exhibit B, the utilities are responsible for preparing "Gas Supply Plans" including providing recommendations for DWR regarding whether gas tolling options should be exercised; negotiating prices, quantities and delivery periods for gas purchases, arranging for and managing gas transportation and storage, and risk management. This section states that the utilities should have sufficient "flexibility and authority to execute normal day-to-day activities" in administering the fuel provisions of the gas tolling contracts.

In recognition of DWR's continuing legal and financial obligations, we believe it is appropriate for DWR to review the utility's gas supply strategies and plans. However, we find that some elements of Exhibit B extend DWR's area of control outside the acceptable scope and into the rightful domain of the utilities and the Commission. In particular, with respect to gas purchasing, transportation, storage and risk management, we believe DWR should limit its involvement to the review of the utility's general plans in these areas and that, following DWR approval of these plans, the utilities should be free to negotiate and execute agreements without subsequent DWR approval. Specifically, in Sections V through VIII, we decline to require the utilities to submit the agreements to DWR for advance approval prior to execution if DWR has already approved the Gas Supply Plan. In Section XII, we provide that the utility and not DWR will make the final decision related to the use of risk management tools. In Section XVI, the utilities should assume operational and administrative control over the financial hedges operable after the effective date of the Order.

In addition, since the utilities will be responsible for managing the gas tolling provisions of the contracts as of January 1, 2003, including the responsibility for managing gas price risk, they should take action immediately to determine the level of exposure and work with DWR to enter into any necessary forward hedges for the period beginning January 1, 2003. Due to the nature of price risk management tools, this will require entering into arrangements prior to January 1, 2003.

We believe that the utilities should document the decision-making processes they employed related to formulating their recommendations to DWR. To facilitate our reasonableness review process, we will instruct the utilities to maintain any analyses performed to support their recommendation.

SDG&E presented several suggested revisions to Exhibit B of DWR's Draft. First, in reference to Part II (Fuel Activities) , the utility requests that DWR should state what credit requirements should apply for gas procurement from third parties. Second, the utility presents language for inclusion in Part V (Gas Purchasing) which specifies that DWR be responsible for meeting suppliers, credit requirements and to provide all collateral under any gas contract. Additionally, DWR would be required to notify the utility of the availability of DWR collateral for use in fuel planning and proposals. Third, the utility states it has reached agreement with DWR on a revision to Part IX (Managing Gas Delivery/Usage Imbalances altering the utility's duty of care for gas imbalances from prudent gas management practices to commercially reasonable gas management practices, consistent with Good Utility Practices.

In support of its recommendations, SDG&E suggests that DWR may find that it makes economic sense to provide collateral support for gas supply contracts. Therefore, adding this condition would clarify that the utility is not obligated to provide its own credit facility to support any gas purchasing activity.

With the exception of the modification of Part IX, regarding the standard for contract management, we see no need to adopt these provisions. With respect to Part IX, we find that this change is consistent with the standard of contract management described in Section 2.02, above, and should be approved.

Finally, we note a discrepancy between the procedure for paying gas invoices presented in Exhibit B and that described in D.02-09-053 (see page 50 and Conclusion of Law 9). At issue is what party should be responsible for paying suppliers. Exhibit B specifies that the utilities would review the invoices and forward them to DWR for payment whereas the Decision states that DWR

would reimburse the utilities for any payments. We will adopt the payment procedures found mutually acceptable by the parties and specified in Sections X and XIV of Exhibit B.

D. Exhibit C — Settlement Principles for Remittances and Surplus Revenues

D.02-09-053 adopted series of steps associated with the allocation of the DWR contracts to the utilities. Among other things, the decision directs the utilities to integrate the contracts into their respective portfolios, using a least-cost dispatch for the integrated generation portfolio, and, adopts pro rata approach to calculating surplus energy sales and revenues from an integrated utility portfolio by:

> "(1) calculating the amount of surplus sales based on the excess of total utility portfolio resources (including DWR contracts allocated today) relative to loads,
>
> "(2) allocating those sales revenues between DWR and the utilities based on the relative quantities dispatched from utility resources and the DWR contracts, and
>
> "(3) calculating the revenue from retail customers using the difference between dispatched quantities and the surplus sales quantities calculated under (2)."

Surplus Sales Quantity Determinations

Exhibit C, titled Settlement Principles for Remittances and Surplus Revenues, describes the methodology used to calculate revenues associated with surplus sales from the utility's integrated portfolio and retail customer deliveries – utility remittances to DWR for DWR energy provided to retail customers. Formulas contained in each utility's and DWR's drafts follow a pro rata calculation, but each approach is different.

The most contentious set of issues revolves around the definition of surplus sales – determining what types of sales count as attributable to the utility's allocation of DWR contracts versus the rest of the utility's portfolio, and whether transaction costs and any penalties, adjustments and other costs associated with energy sold into the ISO market are net of the sale.

PG&E approaches the problem by first defining its total load obligations: retail load, existing energy exchange transactions, Western Area Power Administration (WAPA) load obligations, pumping load (such as Helms), and transmission and distribution losses. Surplus energy is defined as the difference of these obligations from the integrated portfolio of PG&E URG and its allocated DWR contracts. PG&E identifies the remainder as surplus energy for (A) wholesale bilateral sales not embedded in its current obligations, (B) energy sold to the ISO as instructed energy[9], and (C) energy sold to the ISO as uninstructed energy.[10] DWR's surplus energy share would be this remainder multiplied by the percentage of DWR energy delivered to retail customers, hourly. PG&E's share would be the complement. Payments of surplus energy revenues would be made monthly, while remittances for retail customer deliveries would be made daily, as they are now made.

SDG&E's approach is similar to DWR's initial version of Exhibit C, but refines the definitions of what sales types are included or excluded from the pro rata calculations. SDG&E states that since it has no wholesale obligations, it

---

[9] ISO Instructed Energy occurs in real time to balance grid supply and load imbalances, where certain resources having spare capacity are able to sell energy to the ISO.

[10] Uninstructed Energy occurs when delivered energy and real-time demand are unequal.

defines Surplus Energy Quantity by subtracting its total retail customer load requirement from the sum of dispatched Utility Supply and dispatched DWR Supply. In general, the remainder forms the denominator for Surplus Sales.

However, due to anticipation of some restricted transmission and/or recognition of economic and operational efficiencies, where a resource-specific sale might avoid a high congestion charge, SDG&E identifies some exceptions under the category of resource-specific sales. These latter transactions would be excluded from the pro rata sharing formulas, and would be wholly attributed to either the utility or to DWR, depending on the resource.

SCE submits a proposal to add a new Attachment J to its existing servicing agreement with DWR, moving other parts of Exhibit C into Exhibit A. SCE submits that surplus energy sales emanate from the utility's integrated portfolio. SCE determines the quantity of deliveries to retail customers at the meter. To SCE, all surplus sales are wholesale sales (exchanges, forward sales, ancillary services[11] and instructed deviations) and are excluded from the pro rata calculation. The only type of surplus sale that SCE would deem a "portfolio" surplus sale to be apportioned pro rata is a positive uninstructed deviation[12]. . SCE would base its calculations of sales using ISO Settlements data.

SCE would identify surplus sales after 1-1-03 as tied to a specific resource. Resource-specific sales quantities and revenues would be separated, and the revenues net of transaction costs would be directed to either SCE or DWR,

---

[11] Ancillary Services are ISO transactions where capacity from certain resources is used to provide grid reliability rather than energy to be sold in the market.

[12] Positive Uninstructed Deviations occur when scheduled energy exceeds demand. The energy is sold to the ISO market. Negative Uninstructed Deviations occur when demand exceeds scheduled supply.

respectively, depending on the resource. For SCE, resource specific sales could occur due to restricted transmission and/or a condition where it is more economic to sell power from an out-of-area resource than to import the power. Sales of Ancillary Services Capacity bid to the ISO would be classified as a resource-specific sale. However, existing exchanges on or prior to 9-19-02 would constitute a utility URG-only sale and any new exchanges would be made from the utility's URG.

SCE disagrees that any forward sale of surplus energy should be approved by DWR, and instead would incorporate a plan for surplus sales in its Procurement Plans submitted to the Commission for approval. SCE would provide DWR with any executed sales transactions at the time such submittals are required. As such, SCE requires DWR to provide collateral supporting any forward portfolio sale where the purchaser of the forward sale requires such collateral.

The utilities agree that revenues from any surplus sales made would be net of the transaction costs. This would include brokerage fees, transportation fees and losses. The utilities also net out any adjustments and penalties and other costs for energy sold into the ISO.

In response to the Parties, DWR's Exhibit C (dated 11-6-02) evolved into a more complex description based on dispatched quantities of URG and the allocated contracts. DWR's position is to isolate transactions related to retail load. DWR adjusts both the total URG and the DWR allocated contract dispatched quantities to exclude ISO Instructed Energy, Ancillary Service sales and transmission losses. In addition, the URG quantity would exclude any exchanges, and any existing, non-retail obligations in effect before the effective date of the Operating Agreement. DWR would also exclude from the URG

quantity any forward sale delivery obligation based on a URG resource. But a sale from a DWR allocated contract for a period in excess of 30 days, requires DWR's express approval. DWR would permit a resource-specific sale of a DWR allocated contract's surplus energy under conditions of unavailable transmission or uneconomic congestion charges, subject to DWR approval.

The resulting quantity, including positive ISO Uninstructed load deviations,[13] less retail load, represents the total surplus energy quantity.

Resource-Specific Sales

SDG&E identifies certain energy and capacity transactions as resource-specific, tying sales of some surplus energy and the resulting revenues to the resource providing the additional energy. SDG&E would exclude a resource-specific sale from the portfolio, if it is excluded from the ISO schedule for serving retail load. Otherwise, such a sale would be included in the portfolio and would be treated as a forward sale. PG&E prefers to add all sales transactions, including forward sales and resource-specific sales but excluding Direct Access, into the pro rata calculation. SCE's position is that surplus sales and revenues are resource-specific, and the associated quantities, revenues and transaction costs should be tied to the resource. DWR's position is that resource-specific sales can be included in surplus calculations as a pro rata sale where transmission is unavailable or if it is more economic to sell due to high congestion charges. However, DWR insists that it must approve such a sale if it exceeds 30 days, similar to a forward sale, if a DWR contract is involved.

[13] This condition exists when scheduled supply exceeds metered demand.

Variants of a resource-specific sale are Ancillary Services and ISO Instructed energy. Ancillary services are transactions where capacity from certain resources is sold to the ISO for ancillary services rather than being used as energy to serve retail load. Similarly, ISO instructed energy is a transaction where certain resources are able to sell energy from unused capacity into the ISO in the real time market to balance supply and load imbalances on the grid. Resources from both the utility portfolio and DWR Contracts may qualify for use as Ancillary services and/or ISO instructed energy. These "sales" are resource-specific, and most parties agree that they should be excluded from the pro rata calculation. Should revenues or quantities accrue due to Ancillary Services and ISO Instructed energy, they should be tied to and returned to the resource. Only PG&E would include them.

Exchanges

Exchanges of energy are defined by SDG&E as "transactions where energy is delivered to a third party in one period and a similar, but not necessarily equal, amount of energy is returned by the third party in a different period." DWR would not allow exchanges of DWR Allocated Contracts, and would instead consider this to be a URG transaction. PG&E would include an exchange as a URG purchase for incoming and as a part of its total energy obligations as outgoing. SCE recommends that exchanges be treated as utility supply due to the complexity of tracking energy inbound and outbound. SDG&E considers exchanges as portfolio transactions to be shared pro rata, where outbound energy is treated as a forward sale, with the supply receipt shared pro rata based on the relative supplies originally sent.

Forward Sales

Forward Sales can occur shortly before a schedule is submitted to the ISO or for a longer period of time such as 30 days into the future. DWR proposes to include forward sales in the calculation of surplus sales if the sale emanates from an Allocated Contract, but requires the ability to approve any forward sale from an Allocated Contract extending longer than 30 days. DWR would allow the utility to sell URG without any approval, but the forward sale would be excluded from the pro rata surplus calculation.

Negative Surplus Sales

Negative Surplus Sales Amounts occur when the sales of surplus energy results in a cost. PG&E and DWR agree that any negative surplus sales amounts (negative price) are attributed to the integrated portfolio, and define these amounts as overgeneration conditions. SCE also envisions overgeneration as a "portfolio" sale, but defines the term further as paying the buyer to take energy. Negative price amounts occur when the sales of surplus energy results in a cost, and these quantities and sales would be calculated pro rata.

Discussion

We have reviewed the parties' positions and that of DWR, and appreciate the detail and efforts all have shown in this negotiation process. Although PG&E's position is the most straightforward, and SCE's proposal for resource-specific sales has some merit, we believe that SDG&E's approach submitted October 23, 2002 best serves to equitably integrate and adjust the surplus sales quantities between the utilities' portfolios and the DWR Allocated Contracts.

Under D.02-09-053, we have directed the utilities to integrate the DWR Allocated Contracts into their respective generation portfolios and to resume the scheduling and operation of electricity transmission through the ISO. The hourly

scheduling will be done on a least-cost dispatch of the integrated portfolio. The utility's scheduling also entails consideration of time and supply sensitive energy, available capacity and transmission constraints. All scheduling is made in recognition of forecast demand. The objective is to economically manage a portfolio of resources dedicated to meeting loads following a least-cost dispatch, while efficiently balancing the schedules to ensure grid reliability. We recognize that hourly operational decisions must be made in advance and in real time. Also, at times, more energy might be available than is either scheduled or demanded, causing conditions of surplus sales or overgeneration.

In consideration of the circumstances leading to periods of surplus energy, we will define surplus energy as a condition where dispatched supply from the utility's integrated portfolio occurs in excess of loads. Loads include retail load and existing utility non-retail loads and obligations.

We find that some resource-specific sales, exchanges, forward sales and negative surplus sales should be recognized under our definition of what constitutes a surplus sale. While these sales types are exceptions to the more usual type of surplus sales, all surplus sales should be made net of transaction costs, including transmission and brokerage costs, losses, and other related costs and penalties. We decline to adopt SCE's recommendation for a broad exclusion for all resource-specific sales because it represents a significant departure from the pro rata sharing policy adopted in D.02-09-053. This policy was adopted, in part, to counterbalance the utilities' incentive to dispatch utility resources first, leaving DWR resources to be sold as surplus. Therefore, although we recognize that it is indeed possible to identify which specific resources have been dispatched at any point in time and to designate the last resources dispatched as

surplus, we find that the proposal conflicts with the policy goals delineated in D.02-09-053 and we reject it.

We will approve an exception with respect to Ancillary Services or ISO Instructed Energy, however, because there is less utility discretion involved in which resources are scheduled and, as a result, less potential for gaming. Where a resource provides Ancillary Services or ISO Instructed Energy, the quantities and net revenues should be tied to the resource and excluded from pro rata sharing.

Exchanges allow available supplies to be optimized under the utility's integrated portfolio. As identified by SDG&E, exchanges are portfolio transactions, but are not necessarily equal quantities sent and received. We agree with SCE that due to the complexity of tracking utility and DWR power that is outbound and inbound on an hourly basis, the source of generation for exchanges should be counted as URG in the pro rata calculation.

We agree with DWR that forward sales should be included in the pro rata calculation if the sales emanate from a DWR Allocated Contract. However, we disagree that the utilities should consult with DWR before executing the forward sale of a DWR allocated contract quantity made in excess of 30 days. We see no reason for DWR to approve any forward sale. All forward sales should be included in the pro rata calculation.

Negative surplus sales are a distinct possibility under today's demand conditions. We recognize that these sales will produce a negative price and therefore, will be distributed pro rata.

We allow the exceptions of certain resource-specific sales, exchanges, and forward sales to occur in order to allow the utilities to optimize their portfolio resources. However, we require a paper trail of these transactions to review for

reasonableness. The utilities shall report instances of these identified exceptions in the Procurement Plans filed pursuant to D.02-10-062, with an explanation of the circumstances surrounding the surplus sale.

We have adapted SDG&E's rewritten version of Exhibit C dated October 23, 2002, but have inserted PG&E's initial methodology of defining its total load obligations, in order to capture all load that is met by the utilities' portfolios, including WAPA,[14] and to make the operating agreements more responsive to PG&E and SCE's concerns. As identified below and later under Exhibit F, we also modify Exhibit C to comply with D.02-09-063 for the utility's role of performing the settlement function.

Settlements

D.02-09-053 defines the role of the utilities with regard to performing the settlement functions, where "…DWR will be financially responsible for paying all contract-related bills. However, as DWR points out, this does not require that DWR staff and consultants continue to perform the billing and collection "settlement" function for those contracts. Rather, we expect the utilities to assume these activities for the DWR contracts as they resume the same settlement functions for new procurements." (D.02-09-053, *mimeo,* p. 47.) Also, "… the utilities should perform all of the day-to-day scheduling and dispatch functions for the DWR contracts allocated to their portfolios, just as they will perform these functions for their existing resources and new procurements. This includes performing the billing and collection "settlement" functions for DWR contracts, and verifying all invoices." (D.02-09-053, FoF 30, *mimeo.,* p. 67.)

Exhibit C (DWR Version 11/6/02) outlines bilateral settlement functions to be maintained by DWR, but not the utilities. However, Exhibit C would require the utilities to do the scheduling, but forward all of the hourly ISO scheduling statements to DWR to validate the payment of generator invoices, among other processes.

DWR states that existence of a "strong and well-defined settlements methodology, which is consistent with both AB1X and the Contract Allocation decision, allows DWR to have much less involvement in operational aspects of managing the contracts (e. g., forecasting, scheduling, surplus sales)."[15]

SCE described the current process as follows: "SCE will perform the settlement function for DWR contracts to permit DWR to determine the amount of payment to be paid under the DWR contracts allocated to SCE. DWR will then completely duplicate that settlement process. This "shadow" settlement process will be the settlement process that DWR relies upon for purposes of payment. To accomplish the shadow settlement function, DWR is requesting under Exhibit F of the Operating Agreement that the utility provide it with essentially all of the information that the utility employees collect to complete the settlement process. "[16]

We have already acknowledged that, as financial obligor under the contracts, DWR will continue to be responsible for payment of contract-related bills. However, we believe that it is most efficient to shift responsibility for

---

[14] PG&E retail load obligations per CPUC May 2002 Service Order (D.02-05-048) includes WAPA load, although this is not retail load.

[15] DWR Memorandum dated October 8, 2002.

[16] November 8, 2002 Comments of SCE on Supplemental Filing of DWR.

settlements to the utilities as they resume procurement. As stated above, our goal is to return to the utilities the responsibility for all the duties and functions associated with serving their customers. As such, we should not permit the utilities to continue to rely on the support of the State to perform duties that, in the long-term, should be their responsibility.

Exhibit F below directs the utilities to provide the information necessary to validate such invoices. Given that DWR will continue to have access to information sufficient to validate payments, we see no benefit in delaying the transfer of this responsibility.

We note however, that DWR's assertion of the need for duplicate settlement data is not required for purposes of payment of fuel and fuel transportation obligations or for ISO settlements. The procedure for fuel-related and ISO settlements permits the utilities to provide a settlement statement to DWR and advise DWR of its accuracy, which DWR will rely upon for purposes of payment. That procedure should be followed for energy sales as well. The settlement function is part and parcel of administering an integrated portfolio. Allowing the utilities to shift the responsibility for settlements to DWR would hinder our goal of extricating DWR from the day-to-day portfolio management activities. It would also be duplicative. As SCE points out: "DWR wants a utility to perform the settlement process and then send DWR the data so that they can duplicate the settlement process. Ratepayers will presumably be required to pay twice for such duplicative services by means of DWR's revenue requirement.[17]

[17] Reply Comments of SCE on DWR Agreements, dated October 23, 2002.

In sum, the utility's operational and administrative responsibilities should extend to include the settlements function.

E. Exhibit D — ISO Charges

DWR believes that the transition of responsibility for the residual net short to the utilities, the utility responsibility to make operating decisions as to the utilization of the contracts as DWR's agent, and a goal of simplicity, all dictate that responsibility for the ISO charges should revert to the utilities. In DWR's view, responsibility for ISO charges goes hand in hand with the responsibility for scheduling the power. DWR also notes that this view is also consistent with the fact that the existing arrangements for ISO costs expire at the end of December 2002.

We agree that the responsibility for ISO Charges should revert back to the utilities as of January 1, 2003. Although certain ISO charges may be resource-specific there is no reason why the utilities should not be held responsible for them. Presumably, the ISO charges would not occur were the utility not scheduling power to meet its obligation to serve its customers. DWR entered into the Contracts for the benefit of the utilities. Responsibility for all ISO Charges associated with serving the utilities customers belongs with the utilities, consistent with their obligation to serve those customers.

F. Exhibit F

DWR filed an Exhibit F on October 23, and later modified it to reflect the changes resulting from its review of the utilities written filing and its discussions with the utilities. DWR's filing requires extensive data to be provided to DWR by the utilities, the frequency for which the utilities should provide such information to DWR, and the effective date for when the utilities shall provide such information to DWR. DWR requires information on several categories

including, contracts/trade, schedule, ISO settlements, fuel costs, revenue remittance, and resource information.

To provide further information to the Commission and the Utilities, DWR submitted an attachment with the mapping of its data requirements to Exhibit F, outlining the functions (for example, revenue requirements, validation of revenue remittances, rate agreement reporting, bond management, and fiscal management reporting) where DWR would require the requested information.

SDG&E also filed an Exhibit F on October 23 and submitted further revisions for the Commission to consider through its November 6 motion. PG&E filed an Exhibit F on October 23, but did not file a revised version on November 6. Edison filed revisions to its Servicing Order on October 23, 2002. Section 8 of SCE's proposal refers to audit rights and records, but does not specifically address data requirement.

Discussion

In reviewing Exhibit F, we rely on three principles. First, the purpose of Exhibit F should be to establish the requirement for DWR to obtain certain data it needs to fulfill its legal and financial obligation under the long-term contracts and as consistent with D.02-09-053. Information that DWR might need to fulfill its other obligations, for example, under the bond indenture, should be provided for as directed by the Servicing Arrangements.

Second, as described in Section V above, the CPUC, not DWR, is responsible for reviewing the utilities' dispatch decisions; therefore, access to any information that could also be used for validation of least-cost dispatch by DWR is limited to validation of revenue remittances.

SCE, in its reply comments filed on November 8, states its concern about the role of DWR with respect to least-cost dispatch vis-à-vis the date DWR is

collecting.[18] SCE states that it has articulated its concern to DWR that SCE could comply with "least-cost dispatch" under the Commission guidelines, but could find itself in noncompliance under DWR's process. We agree with SCE, and the resolution is to reaffirm that the Commission has jurisdiction over just and reasonable actions of the utilities.

The Utilities are subject to our reviews with rules that are established to help evaluate the utility administration and management of the allocated contracts. An independent review of the Utilities' least-cost dispatch by DWR would be duplicative and in cases where DWR's analysis may differ from the CPUC's, would create confusion for the Utilities. DWR has the option to participate in our proceeding if it believes the Commission will benefit from its input in determining the reasonableness of the Utilities least-cost dispatch.

Finally, the reporting requirement should be efficient and to the extent possible, eliminate creating new reports or procedures. It should be narrowly permitted to implement the procedures adopted in this decision. In particular, we want to avoid duplicating any unnecessary reporting requirements that already exist as a result of the Rate Agreement (D.02-02-052), the Bond Indenture, or the Servicing Arrangements.

In addition, it would be a waste of the state's resources if DWR duplicates the Commission's efforts and engages in reviewing the day-to-day operational, dispatch, and administrative activities of the utilities with respect to the DWR Contracts. DWR's role should be to establish and validate the process by which

---

[18] We recognize that some necessary information may have to be duplicated for both DWR and CPUC.

the Utilities provide data to DWR. DWR's data requirements should be consistent with its role.

Review of Components of Exhibit F:

Schedule: As stated in D.02-09-053, DWR will remain financially obligated for the contracts and will continue to pay suppliers under the terms of the allocated contracts. This requires that DWR obtain standard, reliable, and timely information from the utility to fulfill its obligation.

In DWR's November 6 filing, DWR states that the information from the utilities "will be used to support bilateral contract settlements, validation of ISO settlements, allocation, validation and payment of fuel procurement provided by Utility, revenue requirement management and various on going reporting." We realize that DWR has agreed to and has obtained PG&E's and SDG&E's agreements to perform all settlement related functions for the allocated contracts. However, as we discussed under Exhibit C above, we require the utilities to perform the settlements.

Therefore, any information in Exhibit F is intended to allow the Department to perform this function is unnecessary, and should be deleted. Now that we have determined that the Utilities will perform the settlement, we need to identify what portions of the DWR's requested data that is necessary for performing the settlement process can be deleted from Exhibit F. Unfortunately, DWR's mapping does not identify which information is required to perform the settlement function. DWR's mapping chart is nothing more than a list of what DWR believes is needed, with no justification as to how specific information is used in establishing a specific report. Therefore, we cannot easily identify from DWR's filing what information will need to be eliminated if the Utilities perform settlements.

Other parties have inconsistent positions with respect to the type of information needed by DWR. SDG&E agrees with most of DWR's Exhibit F, including DWR's continuation of performing settlement functions, while PG&E, even though is supportive of DWR performing the settlement functions, does not agree with the entire reporting requirement requested by DWR. In Exhibit C of its filing, PG&E states that:

> "DWR requires sufficient information to support payment request so that it can meet the accountability requirements of the State's Controller's office and the State Auditor, and simultaneously comply with the applicable statutes concerning disbursement of public monies. For these reasons, DWR shall retain the ability and responsibility to calculate bilateral settlements with Contract counter parties and make the associated payments to suppliers, and Utility will provide the data as required in Exhibit F to allow it to perform these duties in a timely manner as set forth herein."

But in Exhibit F, PG&E offers to only provide DWR with load and resource information that is required to submit to the CPUC as part of the Procurement proceeding and certain scheduling information that it submits in its day-to-day interactions with the CAISO. Therefore, based on what the parties have provided us, we conclude that the detailed daily information requested by DWR and outlined under the category of "Schedule " in Exhibit F, are the types of information necessary for settlement-related functions, which can be eliminated if DWR does not perform those functions. Since DWR has not justified how this hourly information from the Utilities is needed to perform other DWR financial and legal duties under the contracts, we reject DWR's request to obtain the information under the "Schedule."

ISO Settlements: Similarly, we reject DWR's request to obtain data related to "ISO Settlement." We cannot determine why DWR would need

Utilities' preliminary and final settlement statements and supporting files to support its financial and legal obligations. It appears that DWR would need this information to duplicate the Utilities' determination of the amount to be paid under the contracts. In other words, DWR would want to verify the invoices submitted by the Utilities for payment and "provide each utility with a certificate that the utility is in compliance with the Operating Agreement in "all material respect."[19] We agree with SCE that DWR is not in the position of certifying Utilities performance under the contracts. Furthermore, it is not clear why DWR is not using a parallel treatment for gas cost. Under DWR's proposed procedure for payment of gas costs, DWR would rely on the Utilities to verify and provide a settlement statement. It is not clear why DWR would rely on the Utilities to review and approve invoices for payments of gas costs,[20] but not extend the same treatment to the Utilities with respect to the electric costs incurred under the contracts. The same procedure should be followed for both gas and electric costs. We deny DWR's request and instead require that the Utilities provide an invoice with a summary data attached for each contract. This information should be sufficient for DWR to verify the amount it needs to pay for each contract.

Revenue Remittance: DWR is requesting a number of reports related to customer bills under this category. PG&E, in its comments, has identified certain information, which is not available to PG&E or is not currently included in its

---

[19] SCE's November 8, 2002 reply comments

[20] DWR's 11-6-02 proposal. Section XIV of Exhibit B. For natural gas, pipeline transportation and storage services provided under DWR contracts and administered by Utility on behalf of DWR, DWR shall pay invoices from suppliers after they have been reviewed and approved for payment by Utility.

customers' bills. In addition, DWR itself has identified several data that it does not currently have access to, but expects to receive from the Utilities in the future. It is not clear why DWR needs this additional information for revenue remittances. We deny DWR's request as outlined in our Exhibit F.

Resource Information: Under this category, DWR is requesting a series of information related to load and resources including unit capacity, variable cost unit, and derate by unit. DWR is requesting this information for "planning purposes," but fails to identify what the planning refers to. From the utilization matrix provided for Exhibit F, it appears that most of the information in this category is used for revenue remittance verification, and a few are used for revenue requirement. Still, it is not clear how or for what planning purposes the requested information will be used. We cannot grant DWR's request without understanding the need for the submittal of this category of information.

VII. Proposed Standards for Reasonableness Review

Part of our mandate in this decision is to adopt reasonableness standards for utility administration of DWR contracts. In D.02-09-053, we stated that "The reasonableness of the utilities' administration of the DWR contracts we allocate today, including how they elect to dispatch the contract power quantities relative to other resources in their portfolio, should be at issue over the life of the contracts". We also stated that the forum for this reasonableness review should be the annual procurement proceedings, where the utility procurement process as a whole is reviewed.[21] Subsequent to D.02-09-053, we approved D.02-10-062, which adopts standards for utility behavior with respect to utility procurement.

[21] D.02-09-053, mimeo. p. 7.

To the extent possible, our reasonableness review standards should be consistent with those adopted in D.02-10-062.

PG&E, SDG&E, SCE and Aglet each filed proposed standards. We have reviewed the various proposals in light of the policy direction provided in D.02-09-053, D.02-10-062, and the language in AB 57, Section 1, (d) that directs the Commission to "assure that each electrical corporation optimizes the value of its overall supply portfolio, including Department of Water Resources contracts and procurement pursuant to Section 454.5 of the Public Utilities Code, for the benefit of its bundled service customers," and finally in light of the language of § 454.5(d)(2).

The utilities' proposed standards generally seek to limit the Commission's review of utility activities related to the DWR Contracts. The utilities' proposals range from limiting the periods for which the utilities would be subject to review to limiting the areas of review. For example, the utilities recommend that the Commission adopt a one-year "learning curve" period during which time utilities contract administration would not be subject to disallowances. PG&E's rationale, which is consistent with that of the other utilities, is as follows:

> "Given 1) the complexity of the DWR contracts, 2) the lack of consistency in interpretation of the allocated DWR contracts, 3) the ongoing disputes between DWR and contract counterparties, and 4) the utilities' lack of familiarity with the DWR contracts from an operational, settlements and administrative perspective, it is reasonable to establish a one year transition that ensures continued reliability and provides for a "learning curve" period. During this transition, the utilities will develop a full understanding of the contracts and operate and administer the contracts in parallel with DWR to ensure consistency in approach. During this transition, the utilities' administration, operation, scheduling and dispatch of DWR contracts will not be subject to reasonableness review or disallowances of any kind by the Commission, except in the event of gross incompetence, fraud, willful violation of contract terms or similar grounds." (PG&E 10-8, p. 13.)

We believe this recommendation is flawed in for several reasons. From a policy perspective, it is inappropriate to allow the utilities to "practice" with ratepayer funds. From a legal perspective, the Commission is already bound by the requirements of AB 57 with respect to ensuring that utilities optimize the resources in their portfolio for the benefit of ratepayers, and as such, we cannot excuse the utilities from review. In addition, as discussed in Exhibit C, above, the utilities have had ample notice of the nature and timing of this responsibility. They should be reasonably well versed in the asserted "complexity" of the DWR contracts by the time they commence administration of those contracts. In addition, as discussed in more detail below, the asserted "familiarity" that DWR brings to bear is not so substantial as the foregoing excerpt suggests.

The utilities also seek to limit the Commission's review by arguing that an after-the-fact reasonableness review of the utilities' administration, operating, scheduling, and dispatch decisions is prohibited by AB 57 and SB 1976. Despite the clear language in D.02-09-053, the utilities continue to argue that the scope of

reasonableness review of contract administration permitted under AB 57 is very narrow and involves only a review of whether utility actions were conducted in accordance with the terms of the contract. Specifically, they utilities interpret Pub. Util. Code § 454.5(d)(2) to state that after-the-fact reasonableness reviews of a utility's actions are prohibited with one exception: "the Commission may establish a regulatory process to verify and assure that each contract was administered in accordance with the terms of the contract, and contract disputes which may arise are reasonably resolved."

Under this interpretation, the utilities contend that as long as the utility does not violate the terms of the DWR Contracts in the exercise of their contract administration duties, AB 57 does not authorize the Commission to disallow costs. As support for this position, PG&E states that the Commission recognized this requirement in D.02-09-053:[22]

> The Commission cannot determine that some portion of DWR's Revenue Requirement is not just and reasonable and must be borne by shareholders, without running afoul of Water Code Section 80110. In fulfilling our legislative mandate to review the reasonableness of the utilities' administration of the DWR contracts (including the gas tolling provisions thereof), we are constrained by the fact that this Commission cannot deny DWR recovery of its reasonable costs. (D.02-09-053, p. 54.)

What PG&E neglects to acknowledge, however, is that D.02-09-053 goes on to state that the review contemplated [by D.02-09-053] would not impact DWR's revenue requirement (*mimeo.* at p. 55). Although AB1X limits the Commission's role with respect to determining the justness and reasonableness of DWR's

[22] PG&E 10-8.

revenue requirement, it does not limit the Commission's ability to regulate the utilities. The decision further states that "the PU Code Section process established by this Decision will be devoted to allocating costs between ratepayers and shareholders, without impacting DWR revenues." In this decision, we reaffirm that; consistent with AB1X and our direction in D.02-09-053, the reasonableness of the contracts themselves will not be at issue in this proceeding. To the extent there is any confusion, we clarify that it is only the utility's administration of the Contracts that will be subject to our review.

Their position on the legality of reasonableness reviews notwithstanding, SDG&E takes the position that the primary standard by which the Commission should evaluate the utilities' administration of the Contracts should come from the approved Operating Agreement. SDG&E proposes a standard whereby utility actions taken in conformity with the terms of the operating agreement would be deemed reasonable.

Similarly, PG&E proposes that the Commission find that to the extent the utility is directed by DWR to administer, operate, schedule or dispatch a DWR Contract, such utility performance shall be deemed reasonable and that any and all costs incurred by DWR directly or indirectly under the allocated DWR contracts will be exempt from reasonableness review. SDG&E and PG&E believe that the Commission has already acknowledged the logic of these approaches in D.02-09-053, by stating that it would be "hard pressed to imagine a scenario in which DWR orders a utility to take some actions, only to have this Commission find that the utility acted unreasonably"[23]. They recommend that, to the extent

[23] SDG&E October 23, 2002 Comments page 12.

that DWR under the Operating Agreement or otherwise directs the utilities to administer the allocated DWR contracts in a specific way or has otherwise approved the utilities' actions, such utility actions should be per se reasonable and exempt from Commission reasonableness review. In their view, the Commission's separate review of utility contract administration is potentially redundant and, may prove to be in conflict with DWR standards.

SCE takes an opposing position and requests that the Commission affirm that DWR does not have any reasonableness review authority over the utilities' actions and that any obligations SCE may have to DWR with respect to administration of the contracts will be enforced by the Commission. SCE takes issue with the provision in the DWR's Draft would allow DWR to review and participate in the utility's decision-making for its system. SCE acknowledges its obligations to ratepayers, as well as the Commission's, and maintains that those obligations should not be compromised by conflicting oversight and control.

We agree with SCE that the ultimate arbiter of whether the utilities have complied with the terms and conditions of the Operating Order is the Commission, not DWR. PG&E's and SDG&E's requests ignore the explicit purpose of this Operating Order. It is precisely because DWR does not have authority to review or direct the utilities' actions that the Operating Order is required. Consistent with the discussion regarding the role of DWR, above, we note that DWR does not have authority to review the reasonableness of the utility's actions. As such, DWR will not be in a position to direct the utilities to administer a contract in a specific way other than to request compliance with the Operating Order, if necessary. The purpose of the Operating Order is to provide assurance to DWR and other relevant parties that DWR maintains the ability to

monitor performance, obtain timely information, and adjust its revenue requirement. We will not adopt SDG&E and PG&E's proposed standards.

Without exception, the utilities propose a standard that would limit the scope of disallowance risk associated with the utilities' administration of the allocated DWR Contracts to a portion of the incremental costs of administering the DWR Contracts. The utilities provide two primary arguments in support of this principle. First, they repeat the argument that the Commission is legally constrained from disallowing costs incurred under the DWR contracts. The Commission cannot indirectly disallow costs incurred under the DWR contracts by reclassifying such action as a disallowance related to utility administration of those same DWR contracts. The scope of risk, therefore, must be limited to disallowance exposure be limited to a portion of the incremental costs of administering the DWR contracts that are authorized for recovery by the Commission.

Second, the utilities claim that reasonable limits on liability are essential to support utility creditworthiness. They argue that if the risk of disallowance associated with the contract administration function is unlimited, the rating agencies may withhold investment grade ratings unless and until a track record is developed that establishes an acceptable diminished scope of disallowance risk. They assert that, under the AB 57 framework, the Commission is required to evaluate the impact of its procurement decisions on the restoration of the utilities' investment grade credit rating. In order to address the financial community's concerns about the limitless nature of the disallowance risk, the utilities recommend that the Commission "cap" the potential disallowance at no more than a maximum 100% of the utilities' costs of administering the allocated DWR contracts that they seek to recover in their own rates. Under the utilities' proposals, utility risk would be limited to the disallowance of costs associated with the DWR contract administration function that the utilities seek to recover

in rates. The utilities believe that this proposal would provide an incentive to do the job well without transferring the blame for bad contracts from DWR to the utilities.

Aglet argues that there is no sound reason to rule out utility liability for consequential damages and that the utilities must be held fully responsible for management decisions that involve high levels of ratepayer costs. In development of such standards, it is important that the scope of any disallowance be tailored to the imprudent action.

We recognize the utilities' concerns that reasonableness review risk could negatively affect their credit ratings. We must, however, balance these concerns with ratepayer interests. The potential risk associated with unreasonable contract administration to the ratepayers is considerable. DWR's revenue requirement request for calendar year 2003 alone exceeds 5 billion dollars.[24] If the utilities were to administer the contracts in such a way to as to enhance revenues from the URG (and thereby decrease revenues associated with the DWR Contracts), the ratepayers will be harmed as DWR charges may have to increase to ensure recovery of DWR's revenue requirement. We believe that the utilities' level of exposure to cost disallowances should reflect the level of ratepayer risk. In addition, we want to avoid creating a framework under which the utilities, if tempted to perform some unreasonable action, could easily compare the penalty with the potential gains. We will not adopt the utilities proposal for a cap on potential disallowances. We think it is worthwhile to note, however, that the record leading up to D.02-10-062 demonstrates that there were

[24] DWR request 8-16-02.

only a limited number of disallowance decisions made by the Commission during the seventeen year period from 1980 to 1996 for the three utilities and that the majority of these decisions and dollar adjustments involved affiliate transactions.

SCE proposes that the Commission adopt a lower standard than the "reasonable manager" standard used by the Commission in past Energy Cost Adjustment Clause proceedings. Under SCE's proposed "lower" standard the utilities administration of the contracts would be deemed reasonable absent evidence of gross negligence, of involved intentional misconduct, fraud, or a knowing violation of the law. Aglet strongly opposes any lowering of the "reasonable manager" standard and suggests that, Commission standards should reflect that the overall level of generation and procurement costs is higher than ever.

SCE also proposes to define "least-cost" dispatch as a dispatch decision that either results in the lowest cost to the ratepayers on a forecast basis, or is required for reliability reasons (e.g., dispatching units out of economic order due to transmission constraints or overgeneration). SCE requests recognition that least-cost dispatch is not a precise exercise, and that dispatch practices should be deemed reasonable under the standard describe above. We concur and our decision reflects that that policy.

We find SCE's proposed standard is a reasoned middle ground that recognizes the unique characteristics of the utilities assuming operation responsibility for the DWR contracts while at the same time recognizing AB 57's requirement that the utilities administer the DWR contracts in a competent manner that benefits ratepayers. We adopt SCE's proposals with the explicit inclusion of a "least-cost dispatch" requirement. Prohibited utility conduct

under this standard includes any action that results in preference to URG resources or the utility's own negotiated contracts.

As stated above, the forum in which we will apply the reasonableness review standards will be the annual procurement proceedings, where the utility procurement process as a whole is reviewed. Among other things, the Commission will review the reasonableness of URG expenses, contract administration, and least-cost dispatch operations as part of those proceedings.

Future Revisions

In its reply comments of November 8, 2002, SDG&E states that it "fully anticipates that over time, the informational requirements presently contemplated by Exhibit F will change or become unnecessary. In this event, it is sensible to allow the parties periodically to revisit what requirements should change or be deleted. To this end SDG&E suggests the following language be inserted at the end of the last paragraph at page A-6: "This Appendix will be revisited annually to ensure that data reporting remains relevant and useful."

This provision seems reasonable given the breadth and the amount of information that is to be exchanged between the Utilities and DWR, however, we believe that this relook should apply to the Operating Order and the other exhibits as well. At a minimum, we expect the reporting process to be streamlined as the Utilities and DWR become familiar with the exchange of information. This review should occur as part of the annual review of the utilities' procurement plans.

In addition, in order to be in a position to quickly identify and address potential issues, we should require the utilities and DWR to provide a report to the Commission after they have had several months' experience operating under

this order. We will schedule a full panel hearing before the Commission on or soon after March 31, 2003.

VIII. Comments on Alternate Draft Decision

The alternate draft decision of Commissioner Peevey was mailed to the parties in accordance with Rule 77.6 of the Rules of Practice and Procedure. Comments were filed on _____ .

IX. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Julie M. Halligan is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. On September 6, 2002 DWR submitted its Memorandum in response to the Draft Decision in R.01-10-024 (the Draft Contract Allocation Decision) requesting that the Commission direct the utilities to propose and negotiate operating agreements, for approval by the Commission.

2. DWR and the utilities have been unable to agree on a mutually acceptable operating agreement.

3. The Commission has exclusive authority to review the utilities' contract administration. It is reasonable to require the utilities to act as a "limited agent" of DWR for the purposes of complying with the operating order.

4. We find that the "limited agency" definition appropriately reflects the nature of the capacity in which the utilities will be operating under this agreement. The phrase "on behalf of DWR" is unnecessary and should be deleted.

5. There is no reason for DWR to provide a "certificate" to the utilities stating that they are in compliance with the Order.

6. It is not necessary for DWR to approve the utilities' protocols and procedures for the use of DWR Contracts for Ancillary Services.

7. The provision of collateral is not a "right" under the contracts and therefore, can be performed by the utilities.

8. The operation and dispatch of the Contracts under three separate portfolios will be significantly different from operation of those same contracts on a state wide basis, therefore it is not reasonable to adopt a one-year "transition period".

9. Following DWR's approval of a master fuel plan, the utilities should not need to obtain DWR approval for agreements entered into consistent with the plan.

10. Since the utilities will be responsible for managing the gas tolling provisions of the contracts as of January 1, 2003, including the responsibility for managing gas price risk, they should take action to determine the level of exposure and work with DWR to enter into any necessary forward hedges immediately.

11. Although the proposed procedure for payment of fuel-related obligations differs from the procedure adopted in D.02-09-053, the mutually agreed-upon procedure specified in Sections X and XIV of Exhibit B is reasonable and we adopt it.

12. In consideration of the circumstances leading to periods of surplus energy, we define surplus energy as a condition where dispatched supply from the utility's integrated portfolio occurs in excess of loads. Loads include retail load and existing utility non-retail loads and obligations.

13. SDG&E's approach for calculating surplus sales best serves to equitably integrate and adjust the surplus sales quantities between the utilities portfolios and the DWR Contracts.

14. Where a resource provides Ancillary Services or ISO Instructed Energy, the energy and or revenues should be tied to the resource and excluded from pro rata sharing.

15. The source of generation for exchanges should be counted as utility retained generation in the pro rata calculation.

16. Forward sales should be included in the pro rata calculation.

17. Negative surplus sales should be distributed pro rata.

18. The utilities' operational and administrative functions should include performing settlements.

19. Responsibility for ISO charges goes hand in hand with the responsibility for scheduling the power.

20. Responsibility for all ISO charges associated with serving the utilities' customers belongs with the utilities, consistent with their obligation to serve those customers.

21. The reporting requirements should be narrowly tailored to implement the requirements of this order. In particular, we should avoid duplicating unnecessarily any reporting requirements that already exist as a result of the Rate Agreement, the Servicing Arrangements, or the Bond Indenture.

22. It is reasonable to establish a six-month "learning curve" during which utility administration, operation, scheduling and dispatch of DWR contracts will still be subject to reasonableness review or disallowances of any kind.

23. We agree with SCE that the ultimate arbiter of whether the utilities have complied with the terms and conditions of the Operating Order is the Commission, not DWR.

24. There is no evidence to support the claim that the Operating Order will impair the utilities' credit rating.

25. To the extent that any of the requirements of this decision conflict with the Rate Agreement or the Servicing Agreement, those orders govern.

26. The standard of review for utility administration of DWR contracts should be that the contracts are dispatched under the "least-cost" definition proposed by SCE and that the contracts are administered in a competent manner and without intentional misconduct, gross negligence, fraud, or a knowing violation of the law.

Conclusions of Law

1. The Commission's action ordering the utilities to comply with the Operating Order is consistent with the statutory authority in Water Code Section 80106.

2. The Operating Order is not an agreement between the utilities and DWR, but rather it is a Commission order directing the utilities to comply with the terms and conditions set forth in the Operating Order and the related attachments.

3. Pursuant to Water Code 80106(b), DWR may request that the Commission to order the utility to provide certain services.

4. Water Code Section 80134 does not authorize DWR reasonableness review of utility activities.

5. We should review contract administration on a timely and regular basis in concert with the review of the procurement plans contemplated in D.02-10-062.

6. The Operating Order and all of the related attachments should be approved, and the utilities should be ordered to comply with the Operating Order and attachments.

O R D E R

IT IS ORDERED that:

1. The Operating Order is approved and adopted as part of this decision.
2. The effective date of the Operating Order shall be today.
3. The utilities shall take all necessary actions to prepare to perform under this order in a timely and efficient manner.
4. Pursuant to Water Code Section 80106 (utility) shall be ordered to comply with all terms and conditions of the Operating Order as set forth in Appendix A of this decision.

This order is effective today.

Dated _____, at San Francisco, California.

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Commissioner Peevey's Alternate Draft Decision, on all parties of record in this proceeding or their attorneys of record.

Dated December 5, 2002, at San Francisco, California.

/s/ Sally Cuaresma
Sally Cuaresma

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 to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

* *

The Commission's policy is to schedule hearings (meetings, workshops, etc.) in locations that are accessible to people with disabilities. To verify that a particular location is accessible, call: Calendar Clerk (415) 703-1203.

If specialized accommodations for the disabled are needed, e.g., sign language interpreters, those making the arrangements must call the Public Advisor at (415) 703-2074, TTY **1-866-836-7825 or (415) 703-5282 at least** three working days in advance of the event.