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Decision 02-11-027 November 7, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority to Establish Its Authorized rates of return on Common Equity for Electric Utility Operations and Gas Distribution for Test Year 2003. (U 39 M)	Application 02-05-022 (Filed May 8, 2002)
And Related Matters.	Application 02-05-025 (Filed May 8, 2002) Application 02-05-026 (Filed May 8, 2002) Application 02-05-031 (Filed May 8, 2002)

(See Appendix B for appearances.)

INTERIM OPINION ON RATES OF RETURN ON EQUITY FOR TEST YEAR 2003

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INTERIM OPINION ON RATES OF RETURN ON EQUITY FOR TEST YEAR 2003

I. Summary

This interim decision establishes the 2003 ratemaking return on common equity (ROE) for Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), Sierra Pacific Power Company (Sierra), and San Diego Gas & Electric Company (SDG&E). This proceeding remains open for PG&E to true up its test year capital structure and ROE upon its implementation of a financing plan approved by the Bankruptcy Court that enables it to emerge from Chapter 11 of the Bankruptcy Code. The overall ROE and return on rate base is as follows.

Utility		Common Equity	Return on Rate Base
PG&E	- Electric	11.22%	9.24%
	- Gas	11.22%	9.24%
SCE		11.60%	9.75%
Sierra		10.90%	9.04%
SDG&E	- Electric	10.90%	8.77%
	- Gas	10.90%	8.77%

II. Jurisdiction and Background

Applicants are public utilities subject to the jurisdiction of this Commission as defined in Pub. Util. Code § 218.[1] PG&E, a California corporation, provides electric and gas services in northern and central California.

[1] All statutory references are to the Public Utilities Code unless otherwise stated.

SCE, a California corporation and wholly owned subsidiary of Edison International, provides electric service principally in southern California. Sierra, a Nevada Corporation qualified to do business in California and wholly owned subsidiary of Sierra Pacific Resources, provides electric service in the Tahoe Basin of California and electric and gas services in other states.[2] SDG&E, a California corporation wholly owned by Sempra Energy, provides electric service in a portion of Orange County and electric and gas services in San Diego County.

The utilities filed their respective test year 2003 ROE application pursuant to Decision (D.) 89-01-040.[3] PG&E seeks to increase its electric operations ROE to 12.50% from 11.22% and its gas distribution operations ROE to 12.25% from 11.22%, which would result in a $133.5 million increase in its electric revenues and a $22.3 million increase in its gas revenues. SCE seeks to increase its electric operations ROE to 13.00% from 11.60%, which would result in a $128 million increase in its electric revenues. Sierra seeks to increase its California electric operations ROE to 12.50% from 10.80%, which would result in a $362,000 increase in its California electric revenues. SDG&E seeks to increase its electric and gas operations ROE to 12.50% from 10.60%, which would result in a $24.5 million increase in its electric revenues and $6.5 million in its gas revenues.

On June 21, 2002, the applications were consolidated into one proceeding, pursuant to Rule 55 of the Commission's Rules of Practice and Procedure. The consolidation of these applications does not necessarily follow that a uniform

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[2] Sierra's California operations equate to approximately eight percent of its annual electric revenues.

[3] 30 CPUC2d 576 at 610 (1989).

ROE should be applied to each of the four utilities. This is because each of these utilities has unique factors and differences that need to be considered in arriving at a reasonable return. These unique factors and differences encompass three distinct areas: capital structure, long-term debt and preferred stock costs, and return on common equity. The first step in determining a fair ROE is to establish a reasonable capital structure.

III. Capital Structure

Capital structure consists of long-term debt, preferred stock, and common equity.[4] Because the level of financial risk that the utilities face is determined in part by the proportion of their debt to permanent capital, or leverage, we must ensure that the utilities' adopted equity ratios are sufficient to maintain reasonable credit ratings and to attract capital. The Office of Ratepayer Advocates (ORA) has recommended an optimum capital structure for the utilities, which we discuss below. No other interested party opposes the utilities' proposed capital structures.

A. Optimum Structure

ORA conducted a study to determine the optimum capital structure for each of the utilities. ORA defined an optimum capital structure, from the ratepayers' point of view, to be a capital structure in which costs are minimized and both profits and share price are maximized given the constraint of cost minimization. ORA used the average debt weight of a group of 20 to 40 companies similar to each of the utilities in terms of underlying characteristics such as risk, growth, and cash flow patterns. The comparable electric groups

[4] Excludes short-term debt.

were selected so that the average revenue of a firm in the group was approximately equal to the revenue of the holding company of a specific regulated utility. For example, the comparable group for SDG&E consists of firms with average 2001 gross revenues of $8.47 billion compared to gross revenues of $8.03 billion for Sempra Energy, SDG&E's holding company. The comparable gas group consists of 17 companies covered by Value Line in the natural gas distribution industry and three diversified gas companies. ORA's modeling results for PG&E and SDG&E reflect the use of two comparable groups, electric and gas, because these utilities have both electric and gas customers.

ORA's study results show that its optimum capital structure proposal would require PG&E, SCE, and SDG&E to increase their long-term debt ratio with a corresponding decrease in the recommended common equity ratio. Specifically, (1) PG&E would need to increase its long-term debt ratio to 49.00% from 46.20% with a corresponding decrease in its recommended 48.00% common equity ratio; (2) SCE would increase its long-term debt ratio to 49.15% from 47.00% with a corresponding decrease in its recommended 48.00% common equity ratio; and (3) SDG&E would increase its long-term debt ratio to 47.70% from 45.25% with a corresponding decrease in its recommended 49.00% common equity ratio. Also, Sierra would need to decrease its long-term debt ratio to 48.60% from 57.94% with a corresponding increase in its 38.93% common equity ratio.

ORA acknowledges that it cannot affirm that its study results produce an optimum capital structure for the utilities.[5] Even so, ORA recommends that

[5] RT Volume 5 at 671 and 672.

its study result for each of the utilities be adopted, except Sierra. ORA exempts Sierra because it believes that its result for that utility is unrealistic because it would be costly for Sierra and its customers, if implemented. ORA, instead, recommends that Sierra's capital structure should be consistent with Sierra's 42.00% minimum long-term common equity target.

The energy utilities oppose ORA's study and recommendations. The utilities question whether the comparable groups used in ORA's study have optimum capital structures and even if they do, question whether ORA's recommended optimum capital structures are attainable. The utilities also question ORA's establishment of test year 2003 optimum capital structures on the comparable groups' estimated 2005 to 2007 capital structures. The utilities further question ORA's inconsistent treatment of including stranded-cost securitization bonds as a component of the comparable groups' long-term debt while the Commission excludes such bonds in establishing ratemaking capital structures for California utilities.

This is not a new issue. In Decision (D.) 89-11-068, the Commission reasoned that the utilities should be given some discretion to manage their capitalization with a view towards a balance between shareholders' interests, regulatory requirements, and ratepayers' interests.[6] The Commission also concluded that the energy utilities' capital structures should continue to be evaluated on a case-by-case basis in proceedings such as this.

While it may be a desired goal, we are not prepared to adopt a specific optimum capital structure, let alone an optimum range, without some assurance that the adopted capital structure is reasonably attainable by the utilities and in

[6] 33 CPUC2d 495 at 541 to 545 (1989).

the public interest, neither of which has been substantiated in this proceeding. Thus, we conclude that the utilities should be given some discretion to manage their capital structures.

B. PG&E

PG&E seeks a capital structure consisting of 46.20% long-term debt, 5.80% preferred stock, and 48.00% common equity. This is the capital structure that is currently authorized, with the same proportion of debt and equity used to finance assets in rate base over most of the last decade, and the basis for managing its finances and obtaining a Standard and Poor's (S&P) investment grade Single-A credit rating.[7] At the same time, PG&E expresses its intent to seek additional rate relief to reflect any financial distress it continues to incur if its investment grade credit rating and financial health are not restored at the beginning of 2003, the test year for its next General Rate Case (GRC).

On April 6, 2001, PG&E filed a voluntary petition for relief under 1.c. Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court of the Northern District of California (Bankruptcy Court). Subsequently, PG&E filed a September 20, 2001 Plan of Reorganization (Plan) with the Bankruptcy Court, as amended on April 19, 2002, that provides for, among other matters, $5.4 billion in new debt, $2.7 billion in debt to certain creditors in satisfaction of their allowed claims, and $345 million of refinanced debt to be issued to certain creditors.

In response to PG&E's plan, the Commission filed an April 15, 2002 alternative plan (Commission's initial plan) with the Bankruptcy Court

[7] All bond ratings are to S&P's ratings unless otherwise stated.

providing for, among other matters, PG&E to issue approximately $3.86 billion in new debt securities and $1.75 billion in common stock.

PG&E expects to emerge from bankruptcy at the beginning of its test year. Whether under PG&E's Plan or the Commission's initial plan, PG&E expects that its capital structure would be nearly the same as that being requested in this application.[8] PG&E assumes that it will not issue any new debt, make any distribution of capital, and make no debt service payments except those permitted by the Bankruptcy Court. In addition, the Commission's initial plan provided for a 48.13% equity ratio, which approximates the 48% equity structure being proposed in this proceeding.

Subsequently, on August 30, 2002, the Commission and the Official Committee of Unsecured Creditors jointly filed an amended Commission plan that replaces the common stock component of the Commission's plan with preferred stock. Under the amended Commission's plan, PG&E's common equity ratio would decrease to 37.00% from 48.13% and its preferred stock ratio would increase to 13.88% from 2.74%. It also provides for the Commission to establish retail electric rates for PG&E's customers sufficient to pay interest and dividends, fund required reserves for, and allow PG&E to meet its obligations with respect to scheduled amortization and redemption of the securities to be issued under the amended plan. It further provides for PG&E to recover prudently incurred costs and for the Commission to facilitate PG&E's achievement and maintenance of investment grade credit ratings.

Although PG&E believes that its proposed plan will enable it to obtain an investment grade credit rating, it may seek additional rate relief in the GRC.

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[8] RT Volume 2 at p. 254.

PG&E does not believe that either of the Commission's plans will enable it to achieve an investment grade credit rating.

Should the Commission's initial plan be implemented, PG&E foresees a need to increase its ROE in the area of 30%. PG&E attributes that substantial ROE change as being necessary to compensate its shareholders for additional risks due to the issuance of speculative grade debt requiring a 10% to 17% interest rate resulting in a minimum of 100 basis points increase in its long-term debt costs. Should the Commission's amended plan be implemented, PG&E contends that its risk would further increase because the substitution of preferred stock in place of common stock would substantially impact its preferred stock costs and capital structure, and require its new debt to carry an even higher interest rate under the Commission's initial plan.

ORA acknowledges that the Commission's plans would impact PG&E through higher debt costs and, if the Commission's alternative plan were adopted, higher preferred stock costs. However, it sees no effect on PG&E's ROE because PG&E's ROE is "estimated from market models using a group of comparable companies."[9] ORA concludes that even if the Commission's plan were to enable PG&E to achieve an investment grade credit rating there would be no impact on PG&E's ROE. ORA contends that the credit quality of a particular firm is a firm-specific risk that can be diversified away by investors.

We find that any adjustment to PG&E's capital structure at this time is purely speculative. With PG&E expecting to emerge from Chapter 11 at the beginning of its test year, the capital structure being adopted by this decision may become obsolete in a very short time. Absent an adjustment to its capital

[9] See ORA's September 18, 2002 filing in response to an ALJ Ruling at p. 5.

structure and associated costs, PG&E may not have a sufficient margin of safety for payment of interest, preferred dividends, reasonable common dividends, or ability to keep some money in the business as retained earnings to fulfill its public utility service obligation. Therefore, irrespective of which plan the Bankruptcy Court adopts, at the very least, an adjustment to PG&E's capital structure and costs would be necessary to assist PG&E in maintaining investment-grade creditworthiness.

It is appropriate and necessary to retain PG&E's currently authorized capital structure and to keep its application open to true up that capital structure and associated costs with changes resulting from it implementing the financing contemplated by the Chapter 11 plan approved by the Bankruptcy Court.

C. SCE

SCE also seeks the same capital structure that it is currently authorized. That target capital structure is 47.00% long-term debt, 5.00% preferred stock, and 48.00% common equity. SCE recommends no change and maintains that its capital structure will enable SCE to restore its financial strength and return it to an investment grade Triple-B rating from its speculative grade Double-B credit rating.

D. Sierra

Sierra seeks a capital structure consisting of 54.87% long-term debt, 3.13% preferred stock, and 42.00% common equity. This is a change from its 57.94% long-term debt, 3.13% preferred stock, and 38.93% common equity request set forth in its application

Sierra explains that the capital structure in its application was its best estimate at that time. However, based on recent financial projections supporting its ability to attain at least a minimum 42.00% common equity ratio, Sierra has

modified its request. Sierra believes this revised capital structure is necessary to move its credit rating from speculative grade Double-B to investment grade Single-A. The revised capital structure is consistent with ORA's recommendation.

E. SDG&E

SDG&E, the only utility in this proceeding with an investment grade credit rating (Single-A), also seeks no change in its authorized capital structure. SDG&E contends that its current capital structure is attainable under its current business plan. That capital structure is 45.25% long-term debt, 5.75% preferred stock, and 49.00% common equity.

F. Conclusion

We reject ORA's optimum capital structure study. As ORA admits, it is not clear that the study produces an optimum capital structure that is attainable for each utility. On the other hand, the capital structures being proposed by the utilities are balanced, attainable, intended to either return their credit ratings to investment grade from a speculative grade or to maintain an investment grade rating. The utilities' proposed structures are also designed to attract capital. For these reasons, we find that the utilities' proposed capital structures are fair. The following capital structures for the utilities are consistent with the law, in the public interest, and should be adopted for test year 2003. As stated previously, we intend to update PG&E's capital structure when we are certain of the outcome in Bankruptcy Court.

	PG&E	SCE	SIERRA	SDG&E
Long-Term Debt	46.20%	47.00%	54.87%	45.25%
Preferred Stock	5.80%	5.00%	3.13%	5.75%
Common Equity	48.00%	48.00%	42.00%	49.00%

The next step in determining a fair ROE is to establish reasonable long-term debt and preferred stock costs.

IV. Long-Term Debt and Preferred Stock Costs

Long-term debt and preferred stock costs are based on actual, or embedded, costs. Future interest rates must be anticipated to reflect projected changes in a utility's cost caused by the issuance and retirement of long-term debt and preferred stock during the year. This is because the ROE is established on a forecast basis each year.

In D.90-11-057, we recognized that actual interest rates do vary and that our task is to determine "reasonable" debt cost rather than actual cost based on an arbitrary selection of a past figure.[10] In that regard, we concluded that the latest available Data Resources, Inc. (DRI) forecast should be used to determine embedded debt cost in ROE proceedings. Consistent with this conclusion, the assigned Commissioners' Scoping Memo and Ruling allowed the utilities to update their long-term debt and preferred stock costs to reflect September 2002 interest rate forecasts. That update was submitted on September 18, 2002.

A. Investigation

Although ORA recommends that the utilities proposed costs be adopted for this proceeding, it "questions the range of debt and preferred costs filed by the utilities and recommends that the Commission order that these costs be audited in a separate proceeding."[11] ORA wants the Commission to open an investigation into the reasonableness of these costs. The purpose of that

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[10] 38 CPUC2d 233 at 242 and 243 (1990).

[11] Exhibit 42 at 1-13.

investigation is to require the utilities to file updated long-term debt and preferred stock costs so that ORA and interested parties could review such costs for reasonableness through discovery on exactly how the estimates were made, verification that there are no arithmetic errors, and confirmation that the estimates are consistent with past agreements.[12]

Prior to the establishment of the utility rate case plan in 1989, ROE and rate design issues were addressed as part of GRC proceedings taking up to two years, and in some instances longer, for a decision. Recognizing the need to streamline GRCs and to ease the burden of issuing end of year decisions, a rate case plan was established. That plan bifurcated the ROE and rate design components of a GRC into distinctly separate proceedings.

ROE applications then became a generic ROE proceeding for addressing issues strictly related to ROE. Those issues involve the reasonableness of capital structure, long-term debt and preferred stock costs, and ROE. Long-term debt and preferred stock costs are an integral component of the ROE proceeding and, as such, are properly reviewed in an ROE proceeding. To the extent that ORA or an interested party question the reasonableness of any of these costs, that party has the ability to flesh out errors, differences, and reasonableness through audits, field investigations, data requests, meetings, and examination of witnesses within the established ROE regulatory process. We reject ORA's request to open a separate investigation into the reasonableness of such costs.

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[12] RT volume 5 at 694-695.

B. PG&E

PG&E estimates its long-term debt cost by starting with its March 31, 2002 recorded cost, which reflects the contractual interest rates that PG&E is obligated to pay once the Bankruptcy Court authorizes payment of the accrued interest. Added to this base are anticipated changes in interest rates for variable rate bonds, factors in bond maturities, and changes due to amortization of redemption premiums, to arrive at a 2002 and 2003 year-end estimated cost of long-term debt. With no new issuances of debt forecasted in 2002 or 2003, PG&E derives a 7.63% average long-term debt cost for its test year. It uses the same method to calculate its 6.05% preferred stock cost.

PG&E updated its long-term debt and preferred stock costs to reflect the September 2002 DRI interest forecast for test year 2003. That update resulted in its long-term debt cost being reduced to 7.57% from 7.63%. The result of this update did not change PG&E's preferred stock cost.

C. SCE

SCE projects its long-term debt cost to be 8.19% based on a simple average of its year end 2002 long-term debt and year end test year 2003 long-term debt. It uses the same method to calculate its 6.51% preferred stock cost. Its updated costs exhibit using the most recent DRI forecast shows no change in its test year long-term debt and preferred stock costs.

D. Sierra

Sierra estimates its long-term debt cost by weighting its average long-term debt cost assigned to its electric department. That long-term debt cost is 7.67%. Sierra does not expect to issue any new electric department debt in the test year. As with long-term debt, its preferred stock cost is determined by

calculating its embedded cost. With no plan on issuing preferred stock in the test year, Sierra's 7.91% preferred stock cost reflects embedded cost.

E. SDG&E

SDG&E estimates its long-term debt cost by starting with its December 31, 2001 embedded cost. Adjusted from that cost are 2002 and 2003 amortizations of issue discounts and premiums, issuance expenses, debt reacquisition costs and the retirement of its first mortgage bond series MM. In keeping with its 1998 ROE testimony, SDG&E excludes rate reduction bonds from its cost calculation because such bonds don't support utility ratebase.[13]

With no new issuances of debt during the test year, its average long-term debt cost for the test year 2003 is 6.67%. SDG&E is not planning on issuing any preferred stock in the test year, and uses the same method to calculate its 7.51% preferred stock cost.

Subsequent to the filing of its testimony, SDG&E called its Bond Series LL on July 1, 2002, thereby impacting its long-term debt cost. That change reduced its average long-term debt cost to 6.64% from 6.67%, as reflected in its update cost exhibit. That update exhibit did not change SDG&E's preferred stock cost.

F. Conclusion

No party disputes the long-term debt or preferred stock costs being proposed by the utilities. We have reviewed the costs, which are consistent with the September 2002 DRI interest forecast. The following long-term debt and

[13] 75 CPUC2d 494 (1997).

preferred stock costs for the utilities are consistent with the law, in the public interest and should be adopted.

	PG&E	SCE	SIERRA	SDG&E
Long-Term Debt	7.57%	8.19%	7.67%	6.64%
Preferred Stock Cost	6.05%	6.51%	7.91%	7.51%

Having determined the appropriate long-term debt and preferred stock costs we now address the appropriate ROE.

V. Return on Common Equity

The legal standard for setting the fair rate of return has been established by the United States Supreme Court in the Bluefield and Hope cases.[14] The Bluefield decision states that a public utility is entitled to earn a return upon the value of its property employed for the convenience of the public and sets forth parameters to assess a reasonable return. Such return should be equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings attended by corresponding risks and uncertainties. That return should also be reasonably sufficient to assure confidence in the financial soundness of the utility, and adequate, under efficient management, to maintain and support its credit and to enable it to raise the money necessary for the proper discharge of its public duties.

The Hope decision reinforces the Bluefield decision and emphasizes that such returns should be sufficient to cover operating expenses and capital costs of

[14] The Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944) and Bluefield Water Works & Improvement Company v. Public Service Commission of the State of Virginia, 262 U.S. 679 (1923).

the business. The capital cost of business includes debt service and stock dividends. The return should also be commensurate with returns available on alternative investments of comparable risks. However, in applying these parameters, we must not lose sight of our duty to utility ratepayers to protect them from unreasonable risks including risks of imprudent management.

We attempt to set the ROE at a level of return commensurate with market returns on investments having corresponding risks, and adequate to enable a utility to attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility service obligation. To accomplish this objective we have consistently evaluated analytical financial models and risk factors prior to exercising informed judgment to arrive at a fair ROE.

A. Financial Models

Historically, quantitative financial models are used as a starting point to estimate a fair ROE. The models commonly used in ROE proceedings are the Capital Asset Pricing Model, Discounted Cash Flow Analysis, and Market Risk Premium. Detailed descriptions of each financial model are contained in the record and are not repeated here.

Although the parties agree that the models are objective, the results are dependent on subjective inputs. For example each party uses different proxy groups, risk-free rates, beta, market risk premiums, growth rates, calculations of market returns, and time periods within their respective financial models. It is the application of these subjective inputs that result in a wide range of ROEs being recommended by the parties.

The overall ROE range for PG&E's electric operations is from 9.05% to 15.80%, PG&E's gas operations is 9.35% to 13.88%, SCE is 8.99% to 13.88%, Sierra is 8.89% to 13.85%, SDG&E's electric operations is 8.97% to 14.85%, and SDG&E's

gas operations is 9.35% to 14.85%. PG&E has both the largest and smallest overall ROE range, with its electric operations having a 675 basis points spread and its gas operations 453 basis points.[15] A tabulation summarizing the broad ROE range results derived from the various financial models used by the utilities, Aglet Consumer Alliance (Aglet), Federal Executive Agencies (FEA), and ORA is set forth in Appendix A.

From these broad ROE ranges the parties advance arguments in support for their respective analyses and in criticism of the input assumptions used by other parties. These arguments will not be addressed extensively in this opinion, since they do not materially alter model results. The financial models are used only to establish a range from which the parties apply their individual judgment to determine a fair ROE.

B. Risk Factors

Risk factors consist of financial, business, and regulatory risk. Financial risk is tied to the utility's capital structure. The proportion of its debt to permanent capital determines the level of financial risk that a utility faces. As a utility's debt ratio increases, a higher return on equity may be needed to compensate for that increased risk.

None of the utilities propose a major change in their capital structure for the test year. We have adopted a moderate change for Sierra, which increases its long-term debt to 54.87% from 47.56%, resulting in Sierra's shareholders taking on additional risk. Absent a shift in the other utilities' capital structure

[15] One basis point equals 0.01%.

there is no additional financial risk associated with their debt/equity ratios to consider.[16]

Business risk pertains to uncertainties resulting from competition and the economy. That is, a utility that has the most variability in operating results has the most business risk. An increase in business risk can be caused by a variety of events that include deregulation, poor management, a failed marketing campaign, and greater fixed costs in relationship to sales volume.

Regulatory risk pertains to new risks that investors may face from future regulatory actions that we, and other regulatory agencies, might take. Examples include the potential disallowance of operating expenses and rate base additions.

C. Discussion

We must set the ROE at the lowest level that meets the test of reasonableness.[17] At the same time our adopted ROE should be sufficient to provide a margin of safety for payment of interest and preferred dividends, to pay a reasonable common dividend, and to allow for some money to be kept in the business as retained earnings.

In the final analysis, it is the application of informed judgment, not the precision of financial models, which is the key to selecting a specific ROE estimate. We affirmed this view in D.89-10-031, which established ROEs for GTE

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[16] As discussed previously, this proceeding will remain open to allow PG&E to update its capital structure, long-term debt and preferred stock costs, and return on common equity, as a result of the bankruptcy proceedings.

[17] 46 CPUC2d at 369 (1992), 78 CPUC at 723 (1975).

California, Inc. and Pacific Bell, noting that we continue to view the financial models with considerable skepticism.

We consistently consider the current estimate and anomalous behavior of interest rates when making a final decision on authorizing a fair ROE. In PG&E's 1997 cost of capital proceeding we stated "Our consistent practice has been to moderate changes in ROE relative to changes in interest rates in order to increase the stability of ROE over time."[18] That consistent practice has also resulted in the practice of only adjusting rate of return by one half to two thirds of the change in the benchmark interest rate.[19]

In past Commission decisions, 30-year treasury bonds and AA utility bond interest rates were referenced as benchmarks for evaluating cost of common equity for electric utilities. In the 1999 cost of capital order, the Commission discussed evidence on the historic spread between authorized ROE and 30-year Treasury bond rates from test years 1990 to 1998, before deciding that AA utility bonds provide a better benchmark for setting the ROE.[20] In the recent ROE application of SDG&E and other major energy utilities, we continued to rely on AA utility bonds during a period of time that the DRI forecast for 30-year Treasury bonds dropped during a tremendous turmoil in the foreign market.[21] At that time investors were fleeing to the safety of U.S. Government backed securities, resulting in Treasury rates falling to unusual low rates in comparison to AA utility bonds.

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[18] 77 CPUC2d 556 at 563 (1996).

[19] 57 CPUC2d 533 at 549 (1994).

[20] 196 P.U.R. 4th, 438.

[21] D.99-06-057, mimeo, p. 49 (1999).

Consistent with our practice to moderate changes in ROE relative to changes in interest rates we compare the most recent trend of DRI interest rate forecasts between the date that testimony was prepared in April to the date this matter was submitted in September, 2002. The interest rate trend is going in a downward direction. The September 2002 AA utility bond interest rate forecast for test year 2003 is 7.16%, a 46 basis point decline in interest rate from the April 2002 forecast of 7.62%.

We also compare the most recent DRI interest rate forecast to the DRI forecast used in the utilities prior ROE proceedings. Except for SDG&E, interest rates have changed materially downward when the test year 2003 forecast for the utilities is compared to the test year forecast used in their prior rate proceeding. For example, the forecast AA utility bond interest rate used to moderate PG&E's test year 2000 ROE was 7.72%,[22] SCE's test year 1997 ROE was 7.92%; and, Sierra's test year 2001 was 7.48%.[23] The AA utility bond interest rate used to moderate SDG&E's test year 1999 ROE was 5.87%, 129 basis points lower than the forecast AA utility bond interest rate for test year 2003.[24] This downward trend in interest rates, except for SDG&E, warrants a downward adjustment in the financial model results being used to derive a fair ROE for the utilities.

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[22] See D.00-06-040, mimeo, p. 16 (2000). Although this decision involves a settlement not constituting approval of, or precedent regarding, any principle or issue of the settlement in that proceeding or in any future proceeding, that decision adopted, independent of any settlement, a range of ROE reflective of interest rate trends to assess the reasonableness of the settlement.

[23] See 69 CPUC2d 327 at 339 (1996) and, D.00-12-062, mimeo, p. 20 (2000).

[24] D.99-06-057 mimeo, p. 49 (1999).

The utilities perceive the existence of increased diversifiable and non-diversifiable business and regulatory risks.[25] These risks include the financing of large under-collections, municipalization, Performance-Based Ratemaking mechanisms, cogeneration, direct access, distributed generation, substations, photovoltaic systems,[26] diesel fuel, propane, power procurement, and legislation pending in Sacramento regarding generation, procurement, and purchase of high cost renewable energy.

The utilities contend that these perceived risks require higher ROEs so their shareholders can be fairly compensated and the utilities may continue to attract capital. To accomplish this result, each utility applied above average risk factors in their financial models. Sierra and SDG&E, apparently perceiving even higher risks, further adjusted their financial model results upward; Sierra by 75 basis points and SDG&E by 100 basis points.

While FEA also reflects above average risks for the California utilities in its financial models, Aglet and ORA do not. Aglet and ORA contend that no upward ROE adjustment is necessary because the risks perceived by the utilities are diversifiable, requiring no adjustment. They cite D.94-11-076 as support for excluding a diversifiable risk adjustment.

In that decision, the Commission concluded that little or no weight should be given to diversifiable risk and that general economic factors such as interest rates and financial market trends carry more weight than risks associated

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[25] Diversifiable risk, or unique risk, is the firm-specific risk that can be eliminated by assembly of a balanced portfolio of investments.

[26] Photovoltaic systems produce electricity for a specific facility eliminating the need for a customer to purchase energy from a utility.

with individual utilities or utility industries.[27] By that same decision we found that distinctions between diversifiable and non-diversifiable risks are not clear-cut.[28]

We could analyze each of the risks identified by the utilities to determine which are diversifiable, which are not, and which may be a hybrid. However, such an exercise is not productive at this time.[29] This is because, irrespective of the final result of any such exercise, in the eyes of the public and investors the electric utility industry is highly unstable at this time. The utilities are being increasingly driven by regulatory and business factors that include energy availability, ability to attract capital to raise money for the proper discharge of their public utility duties and to maintain investment-grade creditworthiness, important components of the Hope and Bluefield decisions.

Therefore, we find that there is a net increase in utility risks that warrants the ROEs being adopted in this proceeding to be set at approximately the mid to upward end of an ROE range found just and reasonable for each utility.

Having discussed the generic factors used in setting a fair ROE we next address a fair and reasonable ROE for each utility.

D. Fair and Reasonable ROEs

The utilities, interested parties, and ORA used their individual financial model results, risk assessments, and informed judgment to recommend

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[27] 57 CPUC2d 533 at 550 (1994).

[28] *Id.* at 549.

[29] Although we are not conducting a diversifiable risk exercise in this proceeding, we are not reversing our stated position of excluding diversifiable risk.

an appropriate ROE for the utilities. The following tabulation summarizes these recommendations.

		UTILITY	AGLET	FEA	ORA
PG&E	- Electric	12.50%	10.60%	11.25%	10.50%
	- Gas	12.25%	10.70%	11.25%	10.50%
SCE		13.00%	10.60%	11.25%	10.50%
Sierra		12.50%	10.60%	-[30]	10.50%
SDG&E	- Electric	12.50%	10.60%	11.25%	10.50%
	- Gas	12.50%	10.70%	11.25%	10.50%

Both PG&E and Aglet recommend a ROE differential between PG&E's electric and gas operations. While PG&E seeks a 25 basis points differential between its electric and gas operations, with its electric operations being assigned the higher ROE, Aglet recommends a 10 basis points differential, with PG&E's gas operations being assigned the higher ROE.

PG&E bases its electric recommendation on the results of four financial models, each of which are further divided into four separate levels of risk. Two of the initial financial models are variations of the Empirical Capital Asset Pricing method (ECAPM) rejected in D.99-06-057 because it artificially raises the ROE requirement.[31] Half of these models are based on financial data from eight electric utilities in states not active in energy restructuring and the other half are based on 12 electric utilities with 65% or more of their revenue coming from regulated electric operations. Its gas recommendation is based on the results of

[30] FEA makes no ROE recommendation for Sierra.

[31] *Id.* pp. 45-46.

three financial models that use information from 12 of 19 selected local natural gas distribution companies.[32]

Aglet's ROE differential is based on its Discounted Cash Flow model result that shows local natural gas distribution companies in its model have ROEs 12 basis points higher than electric and combination utility ROEs in its study. Aglet also places reliance on evidence in other proceedings demonstrating that gas operations have higher sales volatility.

This opposing view on whether PG&E's electric or gas operations should have a higher ROE demonstrates subjectivity in the financial models and explains why we view the financial model results with skepticism. Upon review of the financial models pertaining to PG&E's electric and gas operations we concur with PG&E that a differential in ROE between its electric and gas operations may be warranted because of differences in electric and gas financial model results, with its electric operations requiring a higher ROE. However, with changes to be made in PG&E's capital structure, long-term debt and preferred stock costs, and risks from its implementation of a financial plan approved by the Bankruptcy Court, the establishment of a differential between electric and gas operations is premature at this time. We defer consideration of an ROE differential between PG&E's electric and gas operations to the true-up phase of this proceeding.

Aglet recommends a 10 basis points ROE differential between SDG&E's electric and gas operations, with the higher ROE going to the gas

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[32] PG&E excluded seven local natural gas distribution companies from its financial models because those companies have not paid dividends in the past five years, have fewer than three analysts forecasts or have announced a merger.

operations. Aglet's recommendation is based on its Discounted Cash Flow model result showing that gas utility ROEs are 12 basis points higher than electric and combination utility ROEs and reliance on evidence in other proceedings demonstrating that gas operations have higher sales volatility. This is insufficient evidence for us to conclude that SDG&E's gas operations warrant an ROE different from its electric operations. Even if we were satisfied that sufficient evidence exists, this differential, when combined with changes in interest rates and risks factors, would not warrant a 10 basis points differential between SDG&E's electric and gas operations. We reject Aglet's ROE differential for SDG&E's gas operations.

After considering the evidence on the market conditions, trends, creditworthiness, interest rate forecasts, quantitative financial models based on subjective inputs, risk factors, and interest coverage presented by the parties and applying our informed judgment, we conclude that the following subjective range of ROE for the utilities are fair and reasonable.

		ROE RANGE
PG&E	- Electric	10.80%-11.80%
	- Gas	10.80%-11.80%
SCE		10.80%-11.80%
Sierra		10.60%-11.60%
SDG&E	- Electric	10.50%-11.50%
	- Gas	10.50%-11.50%

More specifically, the ROE ranges reflect judgmental tempering of the financial model results, business and regulatory risks, and a downward trend in the test year AA utility bond interest rate forecast. For PG&E, its range also reflects the impact of no change in its capital structure, suspension of dividend payments, and a speculative grade credit rating. For SCE, the range also reflects the impact of no change in its capital structure, suspension of dividend

payments, embedded debt cost higher than the most recent test year AA utility bond interest rate forecast, and a speculative grade credit rating. For Sierra, its range also reflects the impact of a change in its capital structure and a speculative grade credit rating. For SDG&E, its range also reflects the impact of no change in its capital structure, embedded long-term debt cost lower than the most recent test year AA utility bond interest rate forecast benefiting shareholders and ratepayers, and an investment grade credit rating.

Given the business and regulatory risks, downward trend in the test year AA utility bond interest rate forecast, embedded long-term debt cost in relation to test year AA utility bond interest rate forecast, ability to pay dividends of the individual utilities, and keeping this proceeding open to true up PG&E's test year ROE upon PG&E's implementation of a financial plan approved by the Bankruptcy Court, we adopt the following ROEs as being fair and reasonable for the 2003 test year.

		AUTHORIZED ROE
PG&E	- Electric	11.22%
	- Gas	11.22%
SCE		11.60%
Sierra		10.90%
SDG&E	- Electric	10.90%
	- Gas	10.90%

VI. Implementation

PG&E shall file an advice letter to change its electric rate components effective January 1, 2003 to incorporate changes in its electric revenue requirement related to this proceeding. PG&E shall reflect the gas revenue requirement authorized by this decision in its January 2003 gas rates, in conjunction with the implementation of its annual true-up of Balancing Accounts

rate changes. PG&E shall update its ROE upon implementing the financing contemplated by the reorganization plan approved by the Bankruptcy Court.

SCE's Performance Based Ratemaking Mechanism continues to govern its ROE, except for its ROE applicable to utility retained generation assets (URG) until a final decision is issued in its Application (A.) 02-05-004 GRC. Hence, SCE's ROE and return on rate base being authorized by this decision applicable to non-URG operations shall become effective and implemented on the same date as the final decision in its general rate case proceeding.[33] The test year revenue requirement applicable to such operations shall be prorated as of the effective date of the cost of capital decision. The revenue requirement for SCE's URG operations shall become effective January 1, 2002 and shall be recorded in its "Native Load Balancing Account" subject to refund or true up in its pending GRC.

Sierra and SDG&E shall implement the revenue requirement change being authorized by this order through advice letter filings to become effective January 1, 2003.

VII. Pending Motion

Subsequent to the filing of reply briefs, Aglet filed an objection to SCE including Appendices A and B with all references to those appendices in SCE's reply brief on the basis that parties have not had an opportunity to cross-exam any witnesses on it. Aglet seeks a ruling that excludes the above information from the record, or in the alternative, a similar result by this decision.

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[33] See D.96-09-092, 68 CPCU2d 274 (1996), as modified by D.01-06-038 and D.02-04-055.

Responses to Aglet's motion were filed by ORA, PG&E, and SCE. ORA concurs with Aglet's motion on the basis that SCE is using its reply brief to introduce new evidence.

PG&E and SCE oppose Aglet's motion. PG&E, not taking a position on the merits of the disputed information, believes that the questionable information should be admitted to show the positions that Mr. Weil and ORA took in that proceeding. SCE explains that its attachments were included in its reply brief to demonstrate how the Commission considered procurement risk and that ORA introduced and addressed the issue of levered and unlevered betas in the 1999 cost of capital proceeding.

Appendix A consists of excerpts from "TURN/UCAN/Weil Testimony In 1999 Cost of Capital Proceeding A.98-05-019 et al." wherein Aglet's witness states his opinion on regulated distribution utility risk and Appendix B contains excerpts from ORA's "Testimony By Dr. Bradford Cornell In 1999 Cost of Capital Proceeding, A.98-05-019 et al." on betas.

There should be no dispute that both procurement risk and levered/unlevered betas were addressed in this proceeding.[34] SCE included the questionable appendices in its reply brief to show how these issues were considered in the 1999 cost of capital proceeding. The appendices do not represent new evidence. Rather, they demonstrate that Weil and ORA addressed these same issues in the 1999 cost of capital proceeding. Such positions are dated and not necessarily their current position on these issues, as such, the appendices should be allowed to show only that Weil and ORA addressed these issues in the

[34] See for example, Exhibit 9, 42 and 52, and RT Volume 5 at 654-656.

1999 cost of capital proceeding. Aglet's motion to exclude these appendices should be denied.

VIII. Assignment of Proceeding and Procedural Matters

Geoffrey Brown and Michael Peevey are the Assigned Commissioners and Michael Galvin is the assigned Administrative Law Judge (ALJ) in this proceeding.

The utilities requested that their respective ROE application be classified as a ratesetting proceeding within the meaning of Rule 5(c). By Resolution ALJ 176-3088, dated May 16, 2002, the Commission preliminary determined that the applications of PG&E, SCE, and Sierra were ratesetting proceedings and that hearings were expected. ALJ Resolution 176-3089, dated June 6, 2002, made a similar finding on SDG&E's application. This ratesetting classification was subsequently affirmed in the Assigned Commissioners Brown and Peevey's July 20, 2002 Scoping Memo and Ruling.

That Scoping Memo and Ruling, among other matters, designated ALJ Galvin as the principal hearing officer, established an evidentiary hearing schedule and determined the issues of this proceeding. Those issues encompassed all estimates upon which the utilities proposed capital structure and rate of return for the test year 2003 were based on. However, issues, such as flotation cost, addressed and resolved in prior Commission proceedings are not to be re-litigated unless new information is asserted.[35]

An evidentiary hearing was held on August 12, 2002 and continued through August 16, 2002. Each of the utilities, Aglet, FEA, and ORA submitted

[35] Flotation cost consists of direct and indirect costs associated with the issuance of new stock.

testimony and evidence. The proceeding was submitted upon the receipt of September 6, 2002 reply briefs subject to receipt of a late-filed exhibit updating long-term debt and preferred stock costs. By a September 11, 2002 ALJ ruling, the submission of this proceeding was set aside to receive additional information on the Commission's August 30, 2002 revised plan of reorganization for PG&E and to receive objections to an Aglet motion to strike certain information included in the reply brief of SCE. This matter was resubmitted on September 18, 2002.

The principal hearing officer's proposed decision on this matter was filed and served pursuant to § 311(d) and Rule 77.1 of the Commission's Rules of Practice and Procedure.

Rule 77.3 requires comments to focus on factual, legal, or technical errors in the proposed decision and in citing such errors shall make specific references to the record. Comments that merely reargue positions taken in briefs are accorded no weight and are not to be filed. Rule 77.4 requires comments proposing specific changes to the proposed decision to include supporting findings of fact and conclusions of law.

Comments to the proposed decision were timely filed by PG&E, SCE, Sierra, SDG&E, FEA, Aglet, and ORA. Reply comments were timely filed by PG&E, SCE, SDG&E, and ORA. To the extent such comments required discussion or changes to the proposed decision, the discussion or changes have been incorporated into the body of this order.

Findings of Fact

1. Applicants are public utilities subject to the jurisdiction of this Commission.

2. Other than ORA recommending an optimum capital structure for each of the utilities, no party took issue with the utilities proposed capital structures.

3. ORA cannot affirm that its recommended optimum capital structure for he utilities actually produces an optimum capital structure.

4. The use of an optimum capital structure was considered and rejected by D.89-11-068.

5. Long-term debt and preferred stock costs are an integral component of the ROE proceeding and, as such, are properly reviewed in an ROE proceeding.

6. Prior to the establishment of the utility rate case plan in 1989, ROE and rate design issues were addressed as part of GRC proceedings taking up to two years, and in some instances longer, for a decision.

7. Parties have the ability to investigate errors, study differences, and determine the reasonableness of a utility's long-term debt and preferred stock costs through audits, field investigations, data requests, meetings and examination of witnesses within the established ROE regulatory process.

8. We reject ORA's request to open a separate investigation into the reasonableness of a utility's long-term debt and preferred stock costs.

9. D.90-11-057 recognizes that actual interest rates do vary and that our task is to determine reasonable debt costs.

10. Prior decisions utilized AA utility bond interest rates as benchmarks for evaluating cost of common equity for electric utilities.

11. There is no objection to the long-term debt and preferred stock costs being proposed by the utilities in their application.

12. The legal standard for setting the fair ROE has been established by the United States Supreme Court in the Bluefield and Hope cases.

13. An ROE is set at a level of return commensurate with market returns on investments having corresponding risks, and adequate to enable a utility to

attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility obligation.

14. Quantitative financial models are commonly used as a starting point to estimate a fair ROE.

15. D.94-11-076 found that distinctions between diversifiable and non-diversifiable risks are not clear-cut.

16. Although the quantitative financial models are objective, the results are dependent on subjective inputs.

17. It is the application of informed judgment, not the precision of quantitative financial models, which is the key to selecting a specific ROE.

18. The individual parties' use of quantitative financial modes resulted in a broad ROE range from 9.05% to 15.80% for PG&E, 8.99% to 13.81% for SCE, 8.89% to 13.85% for Sierra, and 8.97% to 14.85% for SDG&E.

19. Two important components of the Hope and Bluefield decisions are that the utilities have the ability to attract capital to raise money for the proper discharge of their public utility duties and to maintain creditworthiness.

20. Our consistent practice has been to moderate changes in ROE relative to changes in interest rates in order to increase the stability of ROE over time.

21. The September 2002 AA utility bond interest rate forecast for test year 2003 is 7.16%, a 46 basis points drop in interest rate from the April 2002 forecast of 7.62%.

22. D.99-06-057 rejected the ECAPM financial model because it artificially raises the ROE requirement.

23. At this time, PG&E has a speculative grade D credit rating.

24. At this time, SCE and Sierra have a speculative grade Double-B credit rating.

25. SDG&E has an investment grade Single-A credit rating.

26. Alternative plans to bring PG&E out of bankruptcy are before the Bankruptcy Court.

27. PG&E expects to emerge from Chapter 11 at the beginning of its ROE test year.

28. SCE's Performance Based ratemaking mechanism governs its ROE until a final decision is issued in its pending GRC, A.02-05-004.

29. Procurement risk and levered/unlevered betas addressed in this proceeding were also addressed in the 1999 cost of capital proceeding.

Conclusions of Law

1. Optimum capital structures should not be adopted for the utilities in this proceeding.

2. The utilities' test year capital structures are reasonable and should be adopted.

3. The long-term debt and preferred stock costs being proposed by the utilities are consistent with the law, in the public interest, and should be adopted.

4. This ROE proceeding should be used to flesh out errors, differences, and reasonableness of long-term debt and preferred stock costs.

5. Risks being experienced by the utilities warrant the ROEs being adopted in this proceeding at approximately the mid to upward end of an ROE range found just and reasonable.

6. The most recent trend of DRI interest rate forecasts between the date that testimony was prepared in April to the date this matter was submitted should be considered to moderate changes in ROE relative to changes in interest rates.

7. A downward trend in interest rates, except for SDG&E, warrants a downward adjustment in ROE.

8. A test year ROE range from 10.80% to 11.80% is just and reasonable for PG&E based on financial model results, increase business and regulatory risks, no change in capital structure, a downward trend in AA utility bond interest rate forecast, and a speculative grade credit rating.

9. A test year ROE range from 10.80% to 11.80% is just and reasonable for SCE, based on financial model results increased business and regulatory risks, no change in capital structure, a downward trend in AA utility bond interest rate forecast, and a speculative grade credit rating.

10. A test year ROE range from 10.60% to 11.60% is just and reasonable for Sierra based on financial model results, increased business and regulatory risks, change in capital structure, downward trend in AA utility bond interest rate forecast, and a speculative grade credit rating.

11. A test year ROE range from 10.50% to 11.50% is just and reasonable for SDG&E based on financial model results, increased business and regulatory risks, no change in capital structure, downward trend in AA utility bond interest rate forecast, embedded debt cost lower than the most recent forecast AA utility bond interest rate forecast, and an investment grade credit rating.

12. A test year 11.22% ROE, which results in an overall 9.24% return on electric and gas rate base should be adopted as just and reasonable for PG&E, based upon all of the evidence considered in this proceeding.

13. A test year 11.60% ROE, which results in an overall 9.75% return on rate base, should be adopted as just and reasonable for SCE, based upon all of the evidence considered in this proceeding.

14. A test year 10.90% ROE, which results in an overall 9.04% return on rate base, should be adopted as just and reasonable for Sierra, based upon all of the evidence considered in this proceeding.

15. A test year 10.90% electric and gas ROE, which results in an overall 8.77% return on electric and gas rate base, should be adopted as just and reasonable for SDG&E, based upon all of the evidence considered in this proceeding.

16. PG&E, Sierra, and SDG&E should file advice letters to implement changes in electric and gas revenue requirements being authorized by this order effective January 1, 2003.

17. SCE should file an advice letter to implement changes in its URG revenue requirements being authorized by this order effective January 1, 2003. Its revenue requirement being authorized by this order should be prorated and implemented as of the effective date of its GRC decision.

18. Appendices A and B to SCE's reply brief reflect positions taken in the 1999 cost of capital proceeding and do not necessarily reflect the current position on those issues. Aglet's motion to exclude these appendices should be denied.

19. This proceeding should remain open to address the impact of PG&E's ROE due to its implementation of the financing contemplated by the Chapter 11 plan approved by the Bankruptcy Court to enable PG&E emerge from Chapter 11.

20. Aglet motion to exclude from SCE's reply brief certain appendices and reference to those appendices should be denied.

21. The utilities ROE applications should be granted to the extent provided for in the following order.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company's (PG&E) cost of capital for its test year 2003 electric and gas operations is as follows:

	Capital Ratio	Cost Factor	Weighted Cost

Long-Term Debt	46.20%	7.57%	3.50%
Preferred Stock	5.80	6.05	0.35
Common Stock	48.00	11.22	5.39
Total	100.00%		9.24%

2. PG&E shall file an advice letter to change its electric rate components effective January 1, 2003 to incorporate the change in its electric revenue requirement as authorized by this decision. PG&E shall reflect the gas revenue requirement authorized by this decision in its January 2003 gas rates, in conjunction with the implementation of its annual true-up of Balancing Accounts rate changes. If the Energy Division Director suspends any tariffs, such tariffs shall become effective upon the date the Energy Division Director confirms that the tariffs are in compliance.

3. Southern California Edison Company's (SCE) cost of capital for its test year 2003 is as follows:

	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	47.00%	8.19%	3.85%
Preferred Stock	5.00	6.51	0.33
Common Stock	48.00	11.60	5.57
Total	100.00%		9.75%

4. SCE shall record, effective January 1, 2003, the actual revenue requirement applicable to its utility retained generation (URG) operation in its "Native Load Balancing Account." The revenue requirement applicable to SCE's non-URG operations shall become effective and implemented on the same date as the final decision is issued in its general rate case (GRC) proceeding (Application (A.) 02-05-004). The test year revenue requirement applicable to non-URG operations shall be prorated as of the effective date of its GRC decision.

5. Sierra Pacific Power Company's (Sierra) cost of capital for its test year 2003 is as follows.

	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	54.87%	7.67%	4.21%
Preferred Stock	3.13	7.91	0.25
Common Stock	42.00	10.90	4.58
Total	100.00%		9.04%

6. Sierra shall implement the revenue requirement change being authorized by this order through an advice letter filing to become effective January 1, 2003. If the Energy Division Director suspends any tariffs, such tariffs shall become effective upon the date the Energy Division Director confirms that the tariffs are in compliance.

7. San Diego Gas & Electric Company's (SDG&E) cost of capital for its test year 2003 electric and gas operations is as follows.

Component	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	45.25%	6.64%	3.00%
Preferred Stock	5.75	7.51	0.43
Common Stock	49.00	10.90	5.34
Total	100.00%		8.77%

8. SDG&E shall file an advice letter to revise its respective tariffs to incorporate the tariff changes authorized herein effective January 1, 2003. SDG&E shall spread the revenue requirement changes being proposed by this decision on a uniform percentage basis to its electric and gas rates pursuant to the electric and gas rate design in effect, as explained in its application. If the Energy Division Director suspends any tariffs, such tariffs shall become effective

upon the date the Energy Division Director confirms that the tariffs are in compliance.

9. A.02-05-025, A.02-05-026, and A.02-05-031 are closed.

10. PG&E's A.02-05-022 remains open to true up its test year 2003 ROE with changes in its capital structure, long-term debt and preferred stock costs, and risk that results from it implementing the financing contemplated by a Chapter 11 plan approved by the Bankruptcy Court that enables PG&E to emerge from Chapter 11. Within 30 days after completing any such financing, PG&E shall file a request in this proceeding for authority to true up its test year 2003 capital structure and ROE. That request shall include testimony on its revised capital structure, long-term debt and preferred stock cost, risks, and ROE.

11. SCE's Appendices A and B to its reply brief shall be included in the record only for the purpose of showing that Weil and ORA addressed procurement risk and levered/unlevered betas in the proceeding that resulted in Decision 99-06-057.

This order is effective today.

Dated November 7, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

APPENDIX A
RESULTS OF FINANCIAL MODELS

PG&E - ELECTRIC		PG&E - GAS	
PG&E	11.60% - 15.80%	PG&E	11.80% - 12.90%
Aglet	10.42% - 11.25%	Aglet[1]	10.87%
FEA	9.35% - 13.88%	FEA	9.35% - 13.88%
ORA	9.05% - 11.47%	ORA	9.47% - 12.27%

SCE		SIERRA	
SCE	13.15% - 13.81%	Sierra[2]	11.15% - 13.85%
Aglet	10.13% - 11.25%	Aglet	10.13% - 11.25%
FEA	9.35% - 13.88%	ORA	8.89% - 11.15%
ORA	8.99% - 11.51%		

SDG&E – ELECTRIC		SDG&E - GAS	
SDG&E[3]	11.15% - 14.85%	SDG&E[4]	11.15% - 14.85%
Aglet	10.13% - 11.25%	Aglet[5]	10.87%
FEA	9.35% - 13.88%	FEA	9.35% - 13.88%
ORA	8.97% - 11.42%	ORA	9.47% - 12.27%

(END OF APPENDIX A)

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[1] Aglet used only the DCF model to quantify its gas operations recommendation.

[2] The utility's quantitative financial model results, except for the allowed risk premium, were reduced by 25 basis points to exclude the impact of flotation cost not an issue in this proceeding. RT Vol. 4, pages 468 and 469.

[3] *Id.*

[4] *Id.*

[5] Aglet used only the DCF model to quantify its gas operations recommendation.

APPENDIX B
APPEARANCES

Applicants: Christopher J. Warner, Andrew Niven, and Shirley Woo, Attorneys at Law, for Pacific Gas and Electric Company; Robert B. Keeler and Frank H. Cooley, Attorneys at Law, Paul T. Hunt and Paula Arriola, for Southern California Edison Company; David Norris, Attorney at Law, for Sierra Pacific Power Company; and, Sempra Energy, by Lisa Urich, Attorney at Law, and Mark W. Ward, for San Diego Gas & Electric Company.

Interested Parties: James Weil, for Aglet Consumer Alliance; Department of the Navy, by John M. Cummins, Attorney at Law, and John B. Legler, for Federal Executive Agencies; and, Marcel Hawiger, Attorney at Law, for The Utility Reform Network.

Office of Ratepayer Advocates: Robert C. Cagen and Paul Angelopulo, Attorneys at Law.

(END OF APPENDIX B)