

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**RESOLUTION E-3966
February 16, 2006**

R E S O L U T I O N

Resolution E-3966. San Diego Gas & Electric Company requests approval of its proposal to replace Payden and Rygel with NISA Investment Advisors L.L.C. as fixed-income manager for its Non-qualified nuclear decommissioning trust and confirm the NISA investment management agreement by authorizing the Commission's Executive Director or his designate to sign it on behalf of the Commission.

Request approved.

By Advice 1742-E filed on November 14, 2005.

SUMMARY

SDG&E's request is approved.

This Resolution approves the San Diego Gas & Electric [SDG&E] proposal to replace Payden and Rygel [Payden], the fixed-income manager of its Non-qualified trust, with the existing fixed-income manager of its Qualified trust, NISA Investment Advisors, L.L.C. [NISA], and authorizes the Executive Director or his designee to sign the Amendment to the Investment Management Agreement with NISA on behalf of the Commission.

BACKGROUND

Externally managed trust funds to accrue the decommissioning trust funds.

In Order Instituting Investigation No. 86, the Commission conducted an extensive investigation on its own motion into the financing of costs of decommissioning nuclear power plants owned by the California utilities. In Decision [D.] 87-05-062, dated May 29, 1987, the Commission adopted externally managed trust funds as vehicles for accruing resources for the ultimate decommissioning of the nuclear power plants owned by California utilities. In that decision the Commission also established guidelines for trust agreements.

SDG&E's Qualified and Nonqualified Trusts and their Managers.

In response to D.87-05-062, SDG&E established two trust agreements for its nuclear decommissioning costs. One trust agreement was to hold contributions which qualify for an income tax deduction under Section 468A of the Internal Revenue Code [Qualified trust] and another was designed to hold the remaining funds [Nonqualified trust]. By Resolution E-3060, dated November 25, 1987, the Commission approved SDG&E trust agreements.

As of September 30, 2005, SDG&E's total market value of decommissioning trusts was \$628.3 million. Section 3.01 of both trust agreements provides for the establishment of the Nuclear Facilities Decommissioning Master Trust Committee [Committee] consisting of 5 members at least 3 of which cannot be employees, officers, directors, or agents of SDG&E. Subject to Commission approval, the Committee is authorized to appoint investment manager(s) to direct investments of the trusts' assets.

In the past the Commission had approved the appointments of Delaware Investment Advisors, Brown Brothers Harriman & Company, NISA Investment Advisors, Payden and Rygel, and Trust Company of the West [TCW] as *fixed-income* [i.e., bonds and commercial paper] managers. and Fidelity Management Trust Company, State Street Global Advisors, Deutsche Asset Management, and UBS Asset Management as *equity* [i.e., company shares] managers to direct investments of the trusts.

The Commission has set forth its limitations on the nuclear utilities' trust fund investments in a series of decisions. In D.87-05-062, the Commission concluded that *Nonqualified* Trust fund investments in high quality *equity* securities shall not exceed 60% of the trust fund's fair market value. Therefore, the *fixed-income* allocation must at least be 40% for the *Nonqualified* Trust. Most recently, D.95-07-055 authorized that up to 50% of the fair market value of *Qualified* Trust funds may be invested in publicly traded equity securities. Of these, 40% may be invested in non-U.S. equity securities. In authorizing the international equity allocation, the Commission recognized the benefit of diversifying a portfolio through international equities to increase returns and reduce risk.

Payden has Underperformed as the Manager for the Nonqualified Trust's Fixed Income Assets

At the October 3, 2005 meeting, the Committee approved termination of Payden and the hiring of NISA to manage Nonqualified trust's fixed income assets and authorized the execution of an investment management agreement between NISA and the Committee.

Payden has managed a domestic fixed income strategy for SDG&E's Nonqualified trust since August 2000. The portfolio has underperformed its benchmark on the pre-tax and after-tax basis year-to-date, in 2004 and 2003. As of September 30, 2005, Payden's annualized performance since inception on the after-tax basis was 4.8% as compared to 5.1% performance of the benchmark. The primary reason for the underperformance was duration management in the environment of the yield curve flattening, i.e., they invested in shorter maturity bonds - relative to the benchmark, when longer maturity bonds had better returns. The portfolio was defensively positioned relative to the benchmark at the time when the longer maturity securities rallied. Neither security selection nor enhanced yield was able to mitigate the underperformance. The Committee placed Payden on its watch list more than a year ago and finally decided to terminate it.

If approved by the Commission, NISA would manage the Nonqualified trust's fixed income portfolio by itself. NISA has also been the fixed income manager for the Qualified trust since July 1997. In its triennial report dated October 20, 2005, SDG&E recommends that the Committee hire an additional fixed income manager to diversify management in the qualified trust's fixed income account.

The Amendment to NISA Agreement does not materially change it.

The proposed Agreement between the Committee and NISA is substantially the same as the Agreements previously approved by the Commission. NISA's investment management fee schedules for the Qualified trust, which were previously approved by the Commission as part of the original investment management agreement in July 1997, will also apply to the Nonqualified trust agreement.

D.95-07-055 provides for the Agreements to be approved through the Commission's Advice Letter process. Therefore, SDG&E through AL 1742-E, requests Commission approval of the Agreement with NISA to replace Payden as fixed-income manager of the Nonqualified trust.

NOTICE

Notice of AL 1742-E was made by publication in the Commission's Daily Calendar. SDG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

Advice Letter AL 1742-E was not protested.

DISCUSSION

If the request is approved, NISA would take over from Payden the management of the Nonqualified trust's fixed income account that amounts to about \$30 million as of September 30, 2005.

Payden's Investment Strategy Underperformed

Due to high tax rate of the nonqualified trust, Payden's strategy was to structure a portfolio of municipal bond securities. The investment objective of the portfolio was to maximize after-tax returns on a risk adjusted basis and to exceed the rate of return of the benchmark -- Lehman Brothers 10-year Municipal Index - over three years and for longer periods.

Payden did not meet the performance objectives. Despite the stability of Payden's investment team, its portfolio has underperformed the benchmark because it invested in the bonds with shorter maturity than the bonds in the benchmark, therefore reducing duration of the portfolio. When interest rates fell, bonds with longer maturity produced stronger investment returns. Since Payden's portfolio was invested in bonds with shorter maturity, it was not able to match the performance of the benchmark. Payden did not take appropriate actions in reviewing and adjusting portfolio holdings to improve performance.

NISA's Investment Strategy Has Been Successful.

NISA on the other hand has produced excellent investment results in managing fixed income assets of the Qualified trust. NISA produced an after tax return of 5.95% compared to the benchmark return of 5.77% since inception in August of 1997. Current size of the fixed income holdings in both trusts, however, warrants an additional manager in order to further diversify the trusts' holdings.

NISA, located in St. Louis, MO, has \$4.5 billion in taxable assets under management for 22 taxable *fixed income* clients. In addition to managing core fixed income portfolios, NISA is involved in managing municipal bond portfolios. Its approach to managing Nonqualified trust municipal bond portfolios is to structure broadly diversified, high quality, duration neutral portfolios to outperform chosen benchmarks, after taxes, in up and down markets. NISA believes that the primary benefit of investing in municipal bonds is the tax advantage associated with the sector.

The Energy Division has reviewed SDG&E's AL 1742-E and believes that the proposed Agreement is in compliance with the applicable Commission requirements and the changes will be beneficial to the taxpayers as well as the shareholders of SDG&E. Accordingly, the Energy Division recommends approval of the request by authorizing the Executive Director, or his designee, to sign the Agreement on behalf of the Commission.

COMMENTS

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to PU Code 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

FINDINGS

1. SDG&E filed AL 1742-E on November 14, 2005 requesting approval of its investment management agreement [Agreement] with NISA Investment Advisors, L.L.C. [NISA].
2. In D.87-05-062 the Commission required externally managed trust funds to finance the decommissioning of nuclear power plants.
3. D.95-07-055 requires that all Agreements be approved by the Commission through the advice letter process.
4. At the October 3, 2005 meeting, SDG&E's Nuclear Facilities Decommissioning Master Trust Committee [Committee] approved retaining

NISA to replace Payden and Rygel as the fixed-income manager of its Nonqualified trust.

5. The proposed Agreement between the Committee and NISA is substantially the same as the previous NISA Agreements approved by the Commission, including the fee schedule.
6. The proposed Agreement is in compliance with applicable Commission requirements and should be approved.

THEREFORE IT IS ORDERED THAT:

1. San Diego Gas and Electric Company request in Advice Letter 1742-E is approved.
2. The Commission's Executive Director, or his designee, is authorized to sign the investment management agreement with NISA Investment Advisors, L.L.C.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on February 16, 2006; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners