COM/GFB/ccv

Agenda ID # 3906
Alternate to Agenda ID #3899
Item 26c Ratesetting

Decision **REVISED ALTERNATE PROPOSED DECISION OF COMMISSIONER BROWN (E-Mailed 9/23/04)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs.	Application 00-11-038 (Filed November 16, 2000)
Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E)	Application 00-11-056 (Filed November 22, 2000)
Petition of THE UTILITY REFORM NETWORK for Modification of Resolution E-3527.	Application 00-10-028 (Filed October 17, 2000)

OPINION IMPLEMENTING A PERMANENT ALLOCATION OF THE ANNUAL REVENUE REQUIREMENT DETERMINATION OF THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

I. Summary

This decision adopts a permanent cost allocation methodology that will be applied to the revenue requirement of the California Department of Water Resources (DWR) for its power purchases in 2004 and subsequent years.[1]

The permanent methodology we adopt is a compromise between the proposals litigated by the parties. We do not adopt the proposed settlement agreement between PG&E, SCE and TURN.[2] Our adopted methodology assigns the total costs of the DWR contracts to the utility to which they were physically allocated in D.02-09-053, but adjusts the resulting allocation by separately pooling and allocating the forecast annual "above-market" costs of the DWR contracts to the ratepayers of each IOU as follows: PG&E ratepayers receive 44.8% of the above-market costs, SCE ratepayers receive 45.3%, and SDG&E ratepayers receive 9.9%. These are the same allocation percentages that are used to allocate the annual DWR bond charge revenue requirement, and the same usage should be used to allocate these above-market costs. This will ensure that the above-market burden of the DWR contracts is shared equally by ratepayers in PG&E, SCE and SDG&E territories. Similarly situated customers will pay identical shares of these costs, regardless of location.[3] Consistent with D.04-01-

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[1] For more background on DWR's power purchase program and revenue requirement, and on the relevant statutes, see Decision (D.) 02-02-052, pp. 6-12.

[2] The settlement agreement was generally supported by the Commission's Office of Ratepayer Advocates (ORA), and strongly opposed by San Diego Gas & Electric Company (SDG&E).

[3] In essence, we are adopting SCE's alternative litigation proposal, but improving upon it by using fair allocation percentages that are identified in PG&E's litigation position.

028, this methodology is applied retroactively to January 1, 2004. (D.04-01-028, p. 3.)

II. Background

This Commission has previously established allocations for the DWR revenue requirement for 2001-2002 (see, D.02-02-052), and for 2003 (see, D.02-12-045). For 2004, on an interim basis, we have continued to use the 2003 allocation methodology. (D.04-01-028, as modified by D.04-02-028. This interim allocation was subsequently updated in D.04-08-050.) In this decision, we are adopting an allocation methodology applicable to 2004, but also applicable for the remaining terms of the DWR power purchase contracts.

On September 19, 2003, DWR submitted its original Determination of Revenue Requirements for 2004 to the Commission. Based upon this revenue requirement determination, the parties litigated the methodology to be used for the permanent allocation. Opening testimony was submitted by PG&E, SCE, SDG&E and ORA on December 17, 2003, and those parties and DWR submitted reply testimony on January 9, 2004. Evidentiary hearings were held on January 20 and 21, 2004, and opening and reply briefs were filed by the three utilities on February 10 and 18, 2004, respectively.[4]

Subsequent to the submission of briefs, on April 19, 2004, DWR submitted a supplemental determination, modifying its revenue requirement for 2004 and reducing the amount required from ratepayers by $245 million.[5] Pursuant to an

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[4] ORA submitted only an opening brief, and DWR submitted a memo concurrently with the parties' reply briefs.

[5] The effective submission date of the supplemental determination was April 22, 2004. (See, DWR Letter Memorandum dated May 17, 2004.)

ALJ Ruling, the parties submitted comments addressing the supplemental determination. The calculations in this decision are based upon the 2004 revenue requirement of DWR as modified by the supplemental determination.[6]

On April 22, 2004, the settling parties submitted a motion for leave to submit their proposed settlement agreement. Parties submitted comments and reply comments on the proposed settlement, along with related procedural motions. SDG&E consistently and vociferously opposed the proposed settlement, while ORA generally supported it. The assigned ALJ allowed for submission of the proposed settlement, granted SDG&E's request for evidentiary hearings, and ordered the settling parties to present witnesses for cross-examination. Evidentiary hearings on the proposed settlement were held on June 14 and 15, 2004, with parties submitting opening briefs on the proposed settlement on June 25, 2004, and reply briefs on July 2, 2004.

III. Permanence of the Allocation

All parties agree that the allocation methodology that is adopted here should be permanent. (See, e.g., SCE Opening Brief, p. 43, PG&E Opening Brief, p. 4, SDG&E Opening Brief, pp. 2-3.) We concur. Annual litigation of the allocation methodology is not an efficient use of the parties' or the Commission's time and resources. Prior to today, the relatively uncertain and unstable nature of the electricity market, and the newness of the DWR contracts themselves, made us reluctant to adopt a permanent allocation methodology. The

[6] One difference between the two is that they are based on different modeling runs. The original revenue requirement determination was based on Prosym Run 43, while the supplemental determination is based on Prosym Run 45. The allocation adopted today is based on Prosym Run 45.

Commission and the parties have now gained enough experience, particularly with the DWR contracts, that it is appropriate to make our allocation methodology for the DWR revenue requirement permanent, and eliminate the annual litigation process we have used to date.

IV. Proposed Settlement Agreement

Given the broad-based support among the parties for the proposed settlement agreement, we must give it serious consideration. At the same time, we acknowledge SDG&E's questioning the legitimacy of a settlement entered into by two parties (who already largely agreed with each other) in which those two parties agree to shift costs to a third, non-settling party. (SDG&E Comments re Proposed Settlement, p. 27.)

The proposed settlement divides DWR's revenue requirement into three categories, referred to as: (1) as DWR's contract costs; (2) DWR's other power costs; and (3) planned changes in power charge accounts. (Motion of Settling Parties, p. 4.) Each category receives its own allocation approach.

The proposed settlement would start by allocating DWR's contract costs on the same basis that the contracts were allocated for operational purposes in D.02-09-053. This method is generally referred to as the "cost-follows-contracts" or "CFC" methodology, and was also generally advocated in the litigation positions of PG&E and SCE.

This initial CFC-based allocation would then be adjusted by "Fixed Annual Adjustment Amounts." (Brief of Settling Parties, pp. 8, 14.) According to the Settling Parties, using these fixed annual adjustment amounts results in the projected "above market costs" of DWR's long-term contracts being allocated to the customers of PG&E, SCE and SDG&E based on utility allocation percentages of 43.6%, 42.6%, and 13.8%, respectively.[7] These percentages "[A]re designed primarily to constitute a reasonable reflection of the relative net-short positions of the three utilities that DWR initially sought to serve when it entered into its contracts, and the other equity "yardsticks" advanced by the parties to this proceeding." (*Id.*, p. 8.)

The same utility allocation percentages would be applied to DWR's other power costs, which include all of DWR's administrative, general, and extraordinary item expenses, and any new cost categories specified by DWR not directly related to a specific contract. (*Id.*, p. 7.)

For the third category, planned changes in power charge accounts, which reflects the planned annual changes in the operating reserves maintained by DWR, different percentages would be applied, of 44.4% for PG&E, 45% for SCE, and 10.6% for SDG&E. These percentages represent the currently adopted allocation percentages for DWR's bond charge revenue requirement. (*Id.*, p. 7.)

The proposed settlement agreement is in fact an odd hybrid. It starts from a CFC approach, which in its pure form has the advantages of simplicity, ease of administration, and not requiring the use of confidential information. A pure CFC approach does, however, have one serious problem – it is simply not equitable, as even its advocates will admit. (SCE Opening Brief, p. 29.)

The benefits and flaws of a CFC approach are well summarized by SCE's witness:

> As Edison's testimony states, CFC allocation methodology provides certain operational and administrative benefits that

[7] These annual adjustments are reduced to zero for the years 2012 and 2013.

> none of the other allocation methodologies provide, but we were also very clear in our testimony that it is not cost-based, but neither are the other allocation proposals; it is not equitable, and neither are most of the other allocation proposals; but that in -- in large, when you look at all the factors considered, it's a reasonable way to allocate these costs for what is a very difficult decision the Commission has to make. (SCE witness Cushnie, Transcript p. 7237.)

The allocation of fixed costs resulting from a CFC approach is somewhat arbitrary, as we noted in D.02-12-045:

> Since DWR signed contracts for a statewide need, allocating the fixed costs of contracts to utility service territories based upon geographic location does not match how or why those contracts were obtained. It would be arbitrary and unfair for one or more service territories to end up with a disproportionate number of high-priced contracts when DWR was not trying to balance costs among service territories. (*Id.*, p. 11.)

In order to remedy this problem with the CFC approach, the proposed settlement adjusts the CFC allocation through the fixed annual adjustment amounts. The logic behind this approach is explained:

> The customers of the utilities must take power from DWR, and must bear the costs of that power. To the extent that the costs are equal to the market costs for the power, there is no burden associated with the requirement that customers take DWR's power. It is only to the extent that the costs of the power exceed its market value that a burden is imposed on customers. Therefore, in allocating the DWR Annual PCRR, the Settlement Agreement focuses on achieving a result that fairly allocates the above-market component of the DWR contract costs to the customers of the three utilities. Under the Settlement Agreement, a CFC allocation is adjusted, through the use of Fixed Annual Adjustment Amounts, so that each utility's customers are expected to bear a market price for the power

> they receive from DWR, plus a fair share of the above-market component of DWR's costs. (Brief of Settling Parties, p. 15.)

While the underlying logic – attempting to fairly allocate the above-market costs of the DWR contracts – is sound, the percentages that the proposed settlement uses to allocate above-market costs do not yield a fair result. This is because they do not spread the costs equally among the ratepayers who will be paying these costs, so the impact on similarly situated ratepayers will vary, depending on that ratepayer's location. As described below, our adopted allocation methodology avoids this flawed result.

Another problem with the proposed settlement is its fundamental reliance upon forecasts of the relative net-short positions of the three utilities. The "Utility Allocation Percentages" that form the basic yardstick for the proposed settlement "[A]re designed to constitute a reasonable reflection of the relative net-short positions of the IOUs that DWR initially sought to serve when it entered into its contracts." (Motion of Settling Parties, p. 6.)[8]

The propriety of allocating future revenue requirements on the basis of forecasts of the utilities' net-short positions was actively litigated. (See, e.g., PG&E Opening Brief, pp. 14-19, re 2001-2002 net-short.) The basic idea behind the use of the net-short forecasts is that DWR was procuring power to fill the net-short positions of the utilities, creating a causal link between the net-short

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[8] The Motion of the Settling Parties states that it used "three principle net short allocation percentages presented in the proceeding:" SCE's proposed net short percentages based on D.02-02-052, PG&E's percentages based on DWR's Prosym Run 19g, and percentage shares derived from the Nichol Declaration. (*Id.*, p. 14.) The first source addresses the 2001-2002 net short, while the other two contain forecasts for both 2001-2002 and for future years.

positions and the size and cost of the contracts themselves. The net-short forecasts are in essence treated as a proxy for the state of mind of DWR at the time it entered into the contracts that are at issue here.

The main problem with use of the individual net-short forecasts for allocating the costs of the contracts is the fact that DWR's purchases and contracts were made to cover the *aggregate* net short position of all three utilities, not the *individual* net short of each utility. (See, e.g., D.02-12-045, p. 12.) Contracts were signed to meet statewide needs, not the needs of individual utilities. (*Id.*, p. 11.) We must find an allocation approach that reflects this fact. Second, a forecast of the net-short for only 2001 and 2002 does not actually reflect what DWR may have expected each utility's needs (and other sources of electricity, such as hydro) to be over the life of the contracts. (See, D.02-09-053, p. 30; SDG&E Reply Comments, pp. 5-6.) Third, the longer-term forecasts presented in this proceeding as reflecting the information available to DWR back when it was signing the contracts (the Nichols Declaration and Prosym Run 19g) are of uncertain value. (See, e.g. PG&E Opening Brief, pp. 16-19, SDG&E Reply Brief, pp. 11-12.) Also, as we noted in D.02-12-045, the amount of energy actually delivered to each utility's customers by the remaining DWR contracts does not necessarily match each utility's net short. (D.02-12-045, pp. 11-12.) While superficially appealing, the net short forecasts do not presently provide a principled basis for allocating the costs of the DWR contracts.

Accordingly, because of the flaws described above, we do not approve the proposed settlement agreement.

V. Litigation Positions

Since we have rejected the proposed settlement agreement, we next consider the litigation proposals of the parties. Unfortunately, we also find each litigation proposal, as submitted, to be unsuitable for permanently allocating the costs of the DWR contracts.

The primary litigation proposals of PG&E and SCE, while not identical, are based upon the inequitable Cost-Follows-Contracts methodology and invite significant re-litigation. For the reasons discussed above, we reject a pure CFC approach. The proposals of ORA and SDG&E are based upon the allocation methodology adopted for 2003 in D.02-12-045. However, the ORA proposal is somewhat incomplete, and SDG&E incorporates additional self-serving resource assumptions in its proposal. Neither provides a solid foundation for a permanent methodology.

Having rejected the settlement proposal, as well as each party's primary litigation proposal, we turn, finally, to SCE's "alternative" litigation proposal. We believe that this proposal, with the adjustments we describe below, can serve as the foundation for an equitable method to permanently allocate the costs of the DWR contracts.

As we have observed previously, the DWR contracts at issue were signed at a time of crisis, confusion, and uncertainty, rendering our traditional notions of cost causation inappropriate. In large part we are "spreading the pain" of a unique occurrence, for which our standard methods are ill-suited. Accordingly, we must find another way to reach a fair allocation. We believe that Edison's "alternative" litigation proposal, as described in its Opening Brief, provides the best starting point of all the proposals before us:

> As an alternative proposal, SCE proposes an AMC cost allocation methodology whereby all avoidable DWR contract costs and wholesale energy revenues continue to be allocated on a CFC basis, as required by Decision No. 02-09-053. Annually, however, the Commission would allocate the forecast AMC costs associated with the contracts allocated to all of the

> IOUs (SCE footnote: An annual determination of the AMC costs on a forecast basis is necessary as a ten-year projection of such costs will be unreliable in the later years).
>
> The AMC costs, including gains and losses on hedge transactions that the IOUs enter into as DWR's limited agent, would then be allocated to the IOUs based on their fixed percentage share of the net-short obligations that DWR sought to serve when it entered into its long-term contracts in early 2001. (SCE Opening Brief, p. 6-7.)

Edison's proposal is sound in theory, but its choice of allocation percentages is flawed. Based on the record in this case, we are convinced that a fair outcome is one that allocates the above-market cost burden of the DWR contracts equally to all IOU customers. The cost allocation percentages we adopt must accomplish this, and those percentages that do not accomplish this will be rejected. We believe that the allocation percentages that are adopted should yield a result that impacts similarly situated customers equally, regardless of their location in the state. The customers themselves will perceive such an outcome as fair.

As a guide to evaluating the various allocation methodologies, several parties recommended the use of a "fairness yardstick" or "fairness metric," against which allocation proposals could be measured. Not surprisingly, there was some divergence among the parties among what should be considered fair. More fundamentally, the cost allocations that resulted from various methods varied dramatically.

To achieve a fair result, we will allocate the burden of the DWR contracts, their "above-market costs", to the customers of the IOUs based on the forecast usage of the customers who will be billed for these costs. This is the usage that is not exempted, under Assembly Bill (AB)1X (Chapter 4 of the Statutes of 2001-02 First Extraordinary Session), from paying DWR power costs: all usage except residential usage up to 130% of baseline, CARE, and medical baseline. The table below provides that "non-exempt" bundled usage for each IOU. The allocation percentages shown in this table are permanently adopted.

FORECAST NON-EXEMPT BUNDLED LOAD, 2004

Line No.	Utility	Responsible load, MWh	Allocation Percentages
1	PG&E	49,407,356	44.8 percent
2	SCE	49,921,476	45.3 percent
3	SDG&E	10,912,716	9.9 percent
4	Total	110,241,549	100.0 percent

We turn next to the above-market costs themselves. SCE submitted a projection of above-market DWR contract costs in its December, 2003 testimony (Exhibit 04-28). SDG&E criticized SCE's estimates, but did not submit its own estimates of these costs. Parties have expressed a strong preference that the allocation we adopt today be permanent, and SCE's explanation of its methodology is credible. Accordingly, we adopt the only estimate of above-market costs that is in the record in this proceeding, SCE's Exhibit 04-28. Appendix A shows how SCE's annual forecast of above-market costs shall be pooled and re-allocated between PG&E, SCE and SDG&E each year from 2005 through 2013, using the adopted percentages.

Implementation of this approach will be straightforward. Every year when DWR submits its annual revenue requirement request to the Commission, it will be allocated between the customers of PG&E, SCE and SDG&E by starting with DWR's forecast of total contract costs in each IOU territory, and then making the adjustments to that are shown in Appendix A. This annual adjustment achieves an equal distribution of the above-market costs to ratepayers in the three IOU service territories. DWR's non-contract costs shall be allocated as described in the next section of this Decision. To illustrate this approach, Appendix B provides an illustrative calculation of the expected DWR contract allocations based on this method, for 2004 through 2013.[9] Appendix C shows the calculation of the IOU power charges under this methodology for 2004.

Finally, as is the case today, each annual revenue requirement allocation shall also reflect a "true-up" of DWR's total costs between the three IOU service territories that reflects actual costs incurred for the most recent year for which complete data is available (e.g., the 2005 DWR revenue requirement allocation will be adjusted for the true-up prepared using 2003 actual data, and so on for future years). The above-market cost calculations, and resulting annual adjustments, that are calculated in Appendix A are permanent, and will not be trued up. However, we will allow adjustments to the above-market calculations adopted in this order if any DWR contracts are renegotiated from 2004 onward. The Settling Parties, in their comments to the Proposed Alternate Decision of Commissioner Brown, request that Section 8 of the settlement, the provisions relating to DWR contract renegotiations, be adopted. This is not necessary under

[9] These estimates are provided for illustrative purposes only. They are based on energy modeling that DWR provided in support of its 2004-only revenue requirement, which was also used to prepare Exhibit 04-Comp, the Comparison Exhibit in this proceeding. In practice, DWR will update its annual forecast of expected contract costs as part of its annual revenue requirement requests to the Commission.

the approach we adopt today. Rather, whenever any DWR contract is renegotiated, the IOUs shall work together to estimate the resulting annual benefits of the renegotiation. These benefits shall be allocated to each IOU using the equal-cents-per kWh allocators we adopt today, and used to adjust the Annual Adjustments shown in Appendix A of this decision. This process, when necessary, can occur as part of the annual DWR revenue requirement proceedings before the Commission.

VI. Allocation of Non-Contract DWR Costs

DWR's revenue requirement includes other costs and revenues, in addition to its estimate of the annual costs of its contracts. These costs are shown below:

Administrative & General Expenses	$59,000,000
Extraordinary Costs	$37,054,868
Net Operating Revenues	($320,372,326)
Interest Earnings on Fund Balance	($32,212,129)
Other Revenues (Contract Settlements, Extraordinary Receipts)	($51,896,968)

In D.04-01-028 and D.04-08-050, we allocated these costs on a pro-rata basis, using the pre-direct access sales percentages from the methodology adopted in D.02-12-045. We continue that approach here, and make it permanent. In contrast to our allocation approach regarding the above-market costs, these costs and reductions to DWR accounts are directly related to DWR's ongoing year-to-year activities, so we see no reason to change our past approach. The allocation percentages adopted in D.04-08-050 for DWR's non-contract costs are permanently fixed as follows: PG&E 40.69%, SCE 45.40%, and SDG&E 13.91%.

VII. Surplus Sales

All three utilities propose that the sharing of revenue from surplus sales on a pro-rata basis between DWR and the utilities, as established by D.02-09-053, be eliminated. (See, e.g., SDG&E's Opening Brief, pp. 33-37.) DWR does not oppose the elimination of sharing revenues from surplus sales, but notes that as a result of eliminating the sharing of revenues of surplus sales, all DWR sales would be deemed delivered to retail end use customers. DWR states its willingness to work with the utilities and the Commission to amend the Operating and Servicing Agreements to accommodate a Power Charge calculation that reflects that all DWR power is delivered to retail end use customers.

In spite of the agreement between DWR and the utilities on this matter, we cannot change the Operating and Servicing Agreements in this decision, in advance of the necessary filings by DWR and the utilities. The current surplus sales methodology will remain in place for 2004, but we encourage the utilities and DWR to work together to bring the proposed changes before the Commission in the appropriate forum, so that we can implement any agreed-upon changes concurrently with our allocation of DWR's 2005 revenue requirement.

VIII. Utility Specific Balancing Accounts

The utilities recommend the establishment of utility specific balancing accounts that would track the revenues received by DWR from the customers of each utility against DWR's costs (or revenue requirement) for those same customers. (See, e.g., SDG&E Opening Brief, pp. 37-38, SCE Opening Brief, pp. 46-47.) DWR has indicated that it is willing to create and maintain these accounts. We direct the three utilities to work with DWR to work out the details of implementing utility specific balancing accounts, consistent across all three utilities, and in compliance with all applicable statutes. The three utilities and DWR should coordinate with Energy Division staff in developing the details of the utility specific balancing accounts. The utilities shall submit advice letters within 75 days of this decision, describing the utility specific balancing accounts and how they work.

IX. Rehearing and Judicial Review

This decision construes, applies, implements, and interprets the provisions of Assembly Bill (AB)1X (Chapter 4 of the Statutes of 2001-02 First Extraordinary Session). Therefore, Pub. Util. Code § 1731(c) (applications for rehearing are due within 10 days after the date of issuance of the order or decision) and Pub. Util. Code § 1768 (procedures applicable to judicial review) are applicable.

X. Assignment of Proceedings

Loretta M. Lynch and Geoffrey F. Brown are the assigned Commissioners and Peter V. Allen is the assigned Administrative Law Judge in these proceedings.

XI. Comments on Alternate Decision

The alternate decision of Commissioner Brown was mailed to the parties in accordance with Rule 77.6 of the Commission's Rules of Practice and Procedure. Comments were received on September 16, 2004 from The Settling Parties, SDG&E, ORA, California Large Energy Consumers Association, and DWR. Reply comments were received on September 20 from the Settling Parties and SDG&E. Changes have been made in the text of this decision in response to these comments from parties.

On September 30, in response to the revised alternate decision issued by Commissioner Brown, SDG&E sent a letter to all Commissioners requesting an opportunity to submit direct testimony and evidence regarding the alternate decision's methodology for allocating the above-market cost component of the DWR contracts. SDG&E has made numerous requests to submit such testimony. (See, e.g., Motion for Reconsideration, filed June 4, 2004.) These requests have been denied by the ALJ. On July 1, 2004, SDG&E filed a "Motion of San Diego Gas & Electric Company for Commission Decision Allowing SDG&E to Present Direct Testimony and Evidence on the Contested Issues Raised by the Proposed Settlement in Accordance with Rule 51.6."[10]

We find no basis for granting SDG&E's Motion. First, the ALJ had set evidentiary hearings regarding the proposed settlement agreement, including the above-cost allocation methodology. Thus, SDG&E has been provided an opportunity to cross-examine witnesses and submit detailed comments regarding the methodology. Second, SDG&E seeks to submit direct testimony and evidence to demonstrate the alleged adverse impacts of this allocation methodology on its ratepayers. However, the rate impacts about which SDG&E wants to submit testimony are in fact in the record in some detail.[11] (See, May 24, 2004 Opening Comments of SDG&E, pp. 1-2, 5-9.) Moreover, SDG&E fails to explain what additional evidence it seeks to introduce through direct testimony that it cannot present through the filing of comments. Accordingly, SDG&E's Motion is denied.

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[10] In its November 24, 2004 Comments in response to a November 18, 2004 Assigned Commissioners' Ruling, SDG&E again requests hearings on the above-market cost allocation methodology.

[11] In fact, there is even more rate and bill impact information now in the record as a result of the comparison exhibit (Exhibit 04-COMP BILL) and SDG&E's November 24 Comments.

Findings of Fact

1. Annual re-litigation of an allocation methodology to be applied to DWR's revenue requirement is neither efficient nor necessary.
2. DWR's supplemental revenue requirement determination was based on Prosym Run 45.
3. The Proposed Settlement's use of historical forecasts of the net short positions of the three utilities as a basis for future cost allocation is too uncertain to be found equitable.
4. The underlying logic of the Proposed Settlement--attempting to fairly allocate the above-market costs of the DWR contracts--is sound.
5. Edison's "alternative" litigation position can serve as the basis for an equitable allocation methodology.
6. (AB)1X (Chapter 4 of the Statutes of 2001-02 First Extraordinary Session) exempted residential usage up to 130% from paying DWR power costs.
7. The above-market burden of DWR's contract costs should be spread equally among the non-exempt ratepayers in PG&E, SCE and SDG&E territories.
8. SCE's explanation of its projection of above-market DWR contract costs is credible.
9. DWR contract renegotiations may lend to lower above-market costs.
10. DWR's non-contract costs should be allocated each year using the same allocation percentages adopted for this purpose in D.04-08-050.
11. The utilities proposed, and DWR agreed to, the implementation of utility specific balancing accounts.

Conclusions of Law

1. A permanent allocation methodology for DWR's revenue requirement should be adopted.

2. The Proposed Settlement is inconsistent with D.02-12-045.

3. The Proposed Settlement is not equitable, and should not be approved.

4. Southern California Edison's proposal to allocate the above-market portion of DWR contract costs provides a reasonable starting point for a permanent allocation.

5. SCE's projection of above-market DWR contract costs is credible, and should serve as the basis for a permanent allocation of these costs.

6. (AB)1X (Chapter 4 of the Statutes of 2001-02 First Extraordinary Session) exempted residential usage up to 130% from paying DWR power costs.

7. It is equitable to allocate the above-market costs of DWR's contracts equally to non-exempt PG&E, SCE and SDG&E ratepayers.

8. The allocation percentages that were adopted in D.04-08-050 for DWR's non-contract costs should be made permanent, except that changes related to DWR contract renegotiations should be allocated as discussed herein so that all ratepayers benefit from reduced above-market costs.

9. DWR should establish utility specific balancing accounts.

10. This decision construes, applies, implements, and interprets the provisions of Assembly Bill (AB) 1X (Chapter 4 of the Statutes of 2001-02 First Extraordinary Session).

O R D E R

IT IS ORDERED that:

1. The allocation methodology adopted today for Department of Water Resources' (DWR) revenue requirement is permanent, except that changes related to DWR contract renegotiations shall be allocated as discussed herein.

2. The Proposed Settlement is not adopted.

3. The annual above-market costs of DWR's contracts shall be pooled and re-allocated to the ratepayers in PG&E, SCE and SDG&E territories. The adopted annual adjustments are shown in Appendix A.

4. The allocation percentages adopted in D.04-08-050 for DWR's non-contract costs are permanently fixed as follows: PG&E 40.69%, SCE 45.40%, and SDG&E 13.91%.

5. Pursuant to D.04-01-028, the allocation methodology is applied retroactively to January 1, 2004.The details of the allocation methodology we adopt are set forth in Appendices A, B, and C..

6. The utilities shall provide updated estimates of direct access customer responsibility surcharge revenues in their implementation advice letters.

7. The 2004 power charges shown in Appendix C, after final adjustments by the utilities as described above for DA CRS, shall go into effect immediately, and will remain in effect until further order of the Commission.

8. Within 14 days of the issuance of today's decision, Southern California Edison Company (SCE), Pacific Gas and Electric Company (PG&E), and San Diego Gas & Electric Company shall file advice letters with revised tariffs that reflect the power charges, as adjusted for DA CRS. These new tariffs shall be effective as of the date of today's decision, subject to review by the Commission's Energy Division.

9. The utilities are directed to work with DWR to implement utility specific balancing accounts, as described above.

10. Pub. Util. Code § 1731(c) (applications for rehearing are due within 10 days after the date of issuance of the order or decision) and Pub. Util. Code § 1768 (procedures applicable to judicial review) are applicable to this decision.

11. This order is effective immediately.

This order is effective today.

Dated ____________________________, at San Francisco, California.

APPENDIX A

Permanent Annual Adjustments To IOU Allocations to Achieve Equal Sharing of Above-Market DWR Contract Costs

	SCE Estimate of Above-Market Costs of DWR Contracts Assigned to Each IOU (source: SCE Exhibit 04-28)				Re-allocation of Annual Total Above-Market Costs Based on Equal-Cents-per-kWh Allocator				Resulting Annual Adjustments to IOU Allocations			
Year	PG&E	SCE	SDG&E	Total	PG&E	SCE	SDG&E	Total	PG&E	SCE	SDG&E	Total
					44.8%	45.3%	9.9%	100%				
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)
					= .448 x (d)	= .453 x (d)	= .099 x (d)		=(e) – (a)	=(f) – (b)	=(g) – (c)	
2004	$616,740	$899,740	$341,898	$1,858,378	$832,876	$841,543	$183,959	$1,858,378	$216,136	($58,197)	($157,939)	$0
2005	$576,780	$418,800	$300,096	$1,295,676	$580,688	$586,730	$128,258	$1,295,676	$3,908	$167,930	($171,838)	$0
2006	$448,740	$378,240	$258,162	$1,085,142	$486,332	$491,393	$107,417	$1,085,142	$37,592	$113,153	($150,745)	$0
2007	$374,030	$367,690	$242,054	$983,774	$440,902	$445,490	$97,383	$983,774	$66,872	$77,800	($144,671)	$0
2008	$345,700	$363,270	$164,706	$873,676	$391,559	$395,633	$86,484	$873,676	$45,859	$32,363	($78,222)	$0
2009	$276,760	$234,390	$75,822	$586,972	$263,066	$265,803	$58,104	$586,972	($13,694)	$31,413	($17,718)	($0)
2010	$127,290	$207,080	$60,066	$394,436	$176,776	$178,615	$39,045	$394,436	$49,486	($28,465)	($21,021)	$0
2011	$104,290	$159,340	$24,458	$288,088	$129,114	$130,457	$28,518	$288,088	$24,824	($28,883)	$4,059	$0
2012	$20,260	$0	($2,693)	$17,567	$7,873	$7,955	$1,739	$17,567	($12,387)	$7,955	$4,432	$0
2013	$0	$0	($334)	($334)	($150)	($151)	($33)	($334)	($150)	($151)	$301	$0
Total	$2,890,590	$3,028,550	$1,464,236	$7,383,376	$3,309,034	$3,343,467	$730,874	$7,383,376	$418,444	$314,917	($733,362)	($0)

(END OF APPENDIX A)

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APPENDIX B

Illustrative Calculation of Expected DWR Contract Allocations Reflecting Equal Sharing of Above-Market Costs

	Forecast Costs of DWR Contracts Assigned to Each IOU by D.02-09-053 ($000)				Annual Adjustment to Equalize Above Market Costs of DWR Contracts (see Appendix A) ($000)				Adjusted Allocation of DWR contracts ($000)			
Year	PG&E	SCE	SDG&E	Total	PG&E	SCE	SDG&E	Total	PG&E	SCE	SDG&E	Total
2004	$1,534,288	$2,002,488	$541,967	$4,078,743	$216,136	($58,197)	($157,939)	$0	$1,750,424	$1,944,291	$384,029	$4,078,743
2005	$1,666,016	$1,473,246	$574,602	$3,713,864	$3,908	$167,930	($171,838)	$0	$1,669,924	$1,641,176	$402,764	$3,713,864
2006	$1,643,867	$1,492,965	$556,558	$3,693,389	$37,592	$113,153	($150,745)	$0	$1,681,459	$1,606,117	$405,813	$3,693,389
2007	$1,570,042	$1,455,451	$524,566	$3,550,060	$66,872	$77,800	($144,671)	$0	$1,636,914	$1,533,251	$379,895	$3,550,060
2008	$1,557,697	$1,434,590	$337,537	$3,329,824	$45,859	$32,363	($78,222)	($0)	$1,603,556	$1,466,953	$259,315	$3,329,824
2009	$1,556,910	$1,427,688	$308,214	$3,292,812	($13,694)	$31,413	($17,718)	($0)	$1,543,216	$1,459,101	$290,496	$3,292,812
2010	$499,289	$1,362,356	$291,206	$2,152,852	$49,486	($28,465)	($21,021)	($0)	$548,775	$1,333,892	$270,185	$2,152,852
2011	$372,488	$1,185,811	$96,567	$1,654,866	$24,824	($28,883)	$4,059	($0)	$397,312	$1,156,928	$100,627	$1,654,866
2012	$57,369	($53,448)	$39,136	$43,057	($12,387)	$7,955	$4,432	$0	$44,983	($45,493)	$43,568	$43,057
2013	$5,746	($21,698)	$7,705	($8,247)	($150)	($151)	$301	$0	$5,596	($21,850)	$8,006	($8,247)
Total	$10,463,713	$11,759,448	$3,278,059	$25,501,220	$418,444	$314,917	($733,362)	($0)	$10,882,158	$12,074,365	$2,544,697	$25,501,220

(END OF APPENDIX B)

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APPENDIX C
2004 IOU Cost Allocation Summary

1	Total DWR Contract Costs				$4,859,626,196
2	Administrative & General Expenses				$59,000,000
3	Extraordinary Costs				$37,054,868
4	Net Operating Revenues				($320,372,326)
5	Interest Earnings on Fund Balance				($32,212,129)
6	Other Revenues (Contract Settlements, Extraordinary Receipts)				($51,896,968)
7	**Net Total of Variable Contract Costs, other Fixed Costs, and Net Revenues**				**$4,551,199,641**
8					
9	**Allocation of Contract Costs**	**PG&E**	**SCE**	**SDG&E**	**Total**
10	Sales Allocator (MWh)	49,407,356	49,921,476	10,912,716	110,241,549
11	Percentages	44.8%	45.3%	9.9%	100.0%
12					
13	Start with: Cost-Follows-Contracts Allocation	$1,743,564,626	$2,271,115,361	$843,710,473	$4,858,390,460
14	Subtract: SCE Estimate of IOU-specific Above-Market Costs	($616,740,000)	($899,740,000)	($341,897,836)	($1,858,377,836)
15	Result: CFC Net of IOU-specific AMC	$1,126,824,626	$1,371,375,361	$501,812,637	$3,000,012,624
16	Add back: pooled and re-allocated AMC	$832,875,961	$841,542,646	$183,959,229	$1,858,377,836
17	Final Allocation of DWR contract Costs	$1,959,700,587	$2,212,918,007	$685,771,866	$4,858,390,460
18					
19	**Adopted Allocator of Non-Contract Costs and Revenues**	40.69%	45.40%	13.91%	100.0%
20	Allocated Non-Contract Costs and Revenues	($125,498,765)	($140,025,656)	($42,902,134)	($308,426,555)
21	DWR Reconciliation to SCO	($2,707,202)	($3,020,570)	($925,465)	($6,653,237)
22	Less: Off-system Sales				
23	**Subtotal: Allocated DWR Costs**	($18,078,332)	($215,013,323)	($39,486,934)	($272,578,590)
24	2001/2002 True-up (D.04-01-028)	($100,590,687)	$41,308,258	$59,282,429	$0
25	**Sub-Total--Revenue Requirement before Direct Access Revenues**	**$1,712,825,601**	**$1,896,166,716**	**$661,739,762**	**$4,270,732,079**
26	Less: Direct Access CRS Revenues	($104,312,750)	($104,663,900)	($32,119,330)	($241,095,980)
27	**Total Revenue Requirement**	**$1,608,512,851**	**$1,791,502,816**	**$629,620,432**	**$4,029,636,099**
28					
29	**Calculate IOU Power Charges**	**PG&E**	**SCE**	**SDG&E**	**Total**
30	2004 DWR Delivered Energy (MWh)	21,145,876	21,910,180	7,998,786	51,054,842
31	**Partial IOU Power Charge**	**$0.07607**	**$0.08177**	**$0.07871**	**$0.07893**
32	Adjustment to Match DWR Operating Account Balance	**($0.00090)**	**($0.00090)**	**($0.00090)**	**($0.00090)**
33	**Adopted IOU Power Charges**	**$0.07517**	**$0.08087**	**$0.07782**	**$0.07803**

(END OF APPENDIX C)