Decision **PROPOSED DECISION OF ALJ SULLIVAN** **(Mailed 9/24/2002)**

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

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| Application of Southern California Edison Company (U 338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs. | Application 00-11-038<br>(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<br>(Filed November 22, 2000) |
| Petition of THE UTILITY REFORM NETWORK for Modification of Resolution E-3527. | Application 00-10-028<br>(Filed October 17, 2000<br><br>Bond Charge Phase |

**(For a list of appearances, see Attachment A)**

# DECISION ADOPTING METHODOLOGYFOR SETTING SURCHARGES TO RECOVER BOND-RELATED COSTS INCURRED BY THE DEPARTMENT OF WATER RESOURCES

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## Decision Adopting Methodology For Setting Charges To Recover Bond-Related Costs Incurred By The Department of Water Resources

### 1. Summary

During the months following the Governor's Proclamation of January 17, 2001, declaring a crisis because exorbitant electricity prices affected the solvency of California's utilities, the Department of Water Resources (DWR) purchased electricity on behalf of the customers in the service territories of Pacific Gas and Electric Company (PG&E), San Diego Gas and Electric Company (SDG&E) and Southern California Edison Company (SCE). DWR incurred over $10 billion in debt in making these purchases

Shortly, DWR will issue between $11 and $12 billion dollars in bonds to refinance an interim loan taken out to cover electricity costs, to repay advances from the State's General Fund and to create financial reserves for the repayment of these loans. Sections 80110 and 80134 of the Water Code entitle DWR to recover the revenues needed to repay bond-related costs and require that this Commission impose charges on electric customers to effectuate cost recovery. We call this charge the bond charge.

This decision anticipates that DWR will shortly advise the Commission of the revenues it needs to repay bond-related costs and adopts a methodology for establishing a charge to repay these bonds. We adopt a simple methodology that applies a per kilowatt-hour (kWh) charge on all consumption that is not specifically excluded from this surcharge. The bond charge is set by dividing the annual revenue requirement for bond-related costs by an estimate of the annual consumption not excluded from this charge.

We adopt a policy that excludes a major block of bundled[1] residential consumption from the bond charge. In particular, based on a consideration of applicable law, past Commission precedent and legislative intent, we exclude residential sales up to 130% of baseline, medical baseline, and California Alternate Rates for Energy (CARE) eligible customer usage from the bond charges.

On the basis of the evidentiary record in this proceeding, we estimate that this policy will result in a per kWh surcharge between 0.6371 and 1.07323 cents in 2003, and between 0.5932 and 0.9141 in 2004, depending on the level of the bond placement and terms of repayment.[2] For 2003, until a decision in Rulemaking (R.) 02-01-011 becomes final and unappealable, the most probable initial bond charge imposed on the non-excluded consumption of bundled electric service from the local utility will range between 0.7927 and 1.0732 cents per kWh.

Consistent with the terms of the "Rate Agreement By and Between State of California Department of Water Resources and State of California Public Utilities Commission" (Rate Agreement), we establish an advice letter process that, following DWR's determination of a final 2003 revenue requirement[3] and a compliance filing by PG&E, SCE and SDG&E, sets a bond charge that applies a per kilowatt hour (kWh) surcharge to the non-excluded consumption of all

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[1] Bundled electric service consists of electric power, transmission, distribution, and billing services sold together to residential, commercial and industrial customers.

[2] *See* Table 1, below, for the details of how the charge varies with different borrowing and repayment scenarios.

[3] A "final 2003 revenue requirement" means the notification to the Commission by DWR of the revenue requirement that will be needed to pay bond costs.

customers receiving bundled electric service from these utilities.[4] To implement our policies, we order PG&E, SDG&E, and SCE to initiate changes in their billing systems to enable them to set and collect bond charges within five days of DWR's submission of its final 2003 revenue requirement for bond-related costs to the Commission (pursuant to Water Code § 80110) or by November 15, 2002, whichever is later. Consistent with past decisions, PG&E, SDG&E and SCE shall add a line to the electric bill specifying bond charges. We grant, however, PG&E's request to defer the implementation of a line item until February 2003.

In addition, we establish balancing accounts to track over and under payments of bond-charges, with subaccounts to track the payments and obligations of specific customer groups as may be subsequently specified in a decision issued in R.02-01-011. That decision may establish subaccounts, as necessary, applying to unbundled (*i.e.*, direct access) customers, where we can track the payments and responsibilities of specific customer classes for bond-related charges.[5] When a decision on the applicability of a bond charge to direct access (DA) customers becomes final and unappealable, we will amortize under and over payments in each subaccount, as necessary. If we determine to impose

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[4] We also note that pending further determinations under consideration in R.02-01-011, bond charges may be imposed on direct access (DA) customers receiving service from Electric Service Providers (ESP). Also, pending further determination in R.02-01-011, the Commission may also impose bond charges on departing load (DL) customers. This decision should not be interpreted as resolving or prejudging any of the issues in this rulemaking.

[5] We note that the establishment of this accounting mechanisms does not prejudge determinations that the Commission may make in R.02-01-011.

the bond charge on DA customers, the surcharge on bundled customers will decrease.[6]

Finally, we note that it is possible for the customers of PG&E and SCE to pay the bond charge within current rate levels, i.e. with no rate increase. For the customers of SDG&E, the record in this proceeding is unclear whether current rates will cover these bond charges. We therefore order SDG&E to track bond payments in a balancing account and provide information on whether and how rates should change to accommodate the bond charge in the DWR Revenue Requirement Phase of this proceeding.

## 2. Background

On January 17, 2001, Governor Gray Davis proclaimed a state of emergency when "unanticipated and dramatic increases in the price of electricity [ ] threatened the solvency of California's major public utilities, preventing them from continuing to acquire and provide electricity sufficient to meet California's energy needs..." thereby imperiling the "... safety of person and property within the state."[7] In response to the crisis, Governor Davis ordered the DWR to procure electricity to mitigate the effects of the emergency. The State's General Fund loaned more than $6 billion to DWR, and DWR obtained an Interim Loan in the amount of $4.3 billion to purchase power during the electricity crisis.[8]

On January 19, 2001 Governor Davis signed Senate Bill (SB) 7X, which authorized DWR to purchase electric power for California consumers. On

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[6] This may also include a bond charge imposed on DL customers as may be subsequently determined in a decision, separate from the one involving DA customers.

[7] D.02-02-051 (2002 Cal. PUC LEXIS 170), Appendix B, Proclamation Issued by the Governor of the State of California on January 17, 2001.

February 1, 2001, Governor Davis signed Assembly Bill (AB) 1X. AB1X, as amended by Senate Bill (SB) 31X (the Act),[9] requires that the Commission impose specific charges on electric customers sufficient to compensate DWR for its costs under the Act, including procuring and delivering power and issuing and paying bond principal and interest. (*See*, Water Code §§ 80110, 80134.)

In Decision (D.) 02-02-051, the Commission adopted the Rate Agreement. The Rate Agreement facilitates DWR's issuance of the bonds authorized by Water Code § 80130, and establishes a framework for discharging DWR's and the Commission's statutory obligations set forth in the Act. According to the terms of the Rate Agreement (and pursuant to the statutory scheme), the Commission will impose charges sufficient to provide for the payment of all bond-related costs incurred by DWR.

To meet these obligations, on June 6, 2002, the Assigned Commissioner's Ruling (June 6th ACR) initiated a new phase (Bond Charge Phase) in this proceeding for the purpose of setting a bond charge to recover the bond-related costs incurred by DWR. The June 6th ACR further noted that D.02-02-051 did not decide whether a bond charge should be levied on customers to the extent they purchase power from an ESP, namely, DA customers, but directed that the Commission consider this issue in a future decision after providing an opportunity for parties to present all legal and policy considerations relevant to reaching that decision. The June 6th ACR stated that these policy issues would

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[8] *Id.*, Findings of Fact 3-5.

[9] AB 1X (Chapter 4, Statutes of 2001 First Extraordinary Session), as amended by SB 31 (Chapter 9, Statutes of 2001-2002 First Extraordinary Session).

be addressed in R.02-01-011. Finally, the June 6th ACR noted that there would be coordination between the Bond Charge Phase and R.02-01-011.

On July 23, 2002, a Prehearing Conference (PHC) was held at the Commission in San Francisco, at which time the Administrative Law Judge (ALJ) and parties discussed and resolved procedural issues identified in a Joint Case Management Statement.

On July 26, 2002, the ALJ issued a ruling that clarified the scope of this proceeding, including its relationship with R.02-01-011. In particular, expanding upon the ACR, this ruling stated:

> "R.02-01-011 will make the policy determination concerning <u>whether</u> and <u>how</u> DA and departing load (DL) customers bear responsibility for the costs of financing these bonds. This proceeding, in contrast, will determine the bond charge rates and recovery mechanisms for raising the revenues needed to finance the bonds."[10]

The ruling ordered that a workshop should be held on the first date scheduled for hearings in order to allow the parties the chance to resolve some of the outstanding issues and discovery disputes. Finally, in response to discussions during the PHC, the ruling addressed the novel situation pertaining to discovery. The ruling explained that Section 80110 of the California Water Code sets forth, along with other duties, DWR responsibility for conducting any review of the reasonableness of the revenues required to finance the bonds. The ruling also noted that the Commission and parties to the proceeding require information to ensure that any bond charge adopted by this Commission is supported by facts. Finally, the ruling noted that in the Rate Agreement, DWR

[10] ALJ Ruling, July 26, 2002, p. 3.

agreed to participate and provide “any other materials necessary to facilitate the Commission’s completion of its proceedings, taken in connection with the establishment of Power Charges or Bond Charges by the Commission.”[11]

On July 29, 2002, the parties participated in the workshop, discussing the testimony provided by DWR. In addition, the parties discussed how, in light of the clarification of the scope of the proceeding, they could withdraw testimony that pertained to the policies under examination in R.02-01-011. Finally, parties agreed on a series of scenarios that could be used to estimate the charges that would result from alternative policies and methodologies for setting the bond charge.

Three days of hearings were held on July 30, 31 and August 1, 2002. Parties filed opening briefs on August 9, 2002 and reply briefs on August 16, 2002.[12]

In addition, on August 5, 2002, PG&E filed a “Motion to Compel Responses to Data Requests and Production of Documents by DWR” (Motion to Compel). On August 9, 2002, DWR responded to the Motion to Compel with a Memorandum served on all parties to this proceeding. On August 13, the ALJ presided over a telephonic Law and Motion Hearing. On August 16, an ALJ

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11 Rate Agreement, Section 7.2.

12 Parties filing opening or reply briefs include: Alliance for Retail Energy Markets (AReM); California Large Energy Consumers Association (CLECA); Energy Producers and Users Coalition, Kimberly Clark Corporation, and Goodrich Aerostructures Group (EPUC); Modesto Irrigation District (Modesto); Merced Irrigation District (Merced); the Office of Ratepayer Advocates (ORA); PG&E; SDG&E; SCE; and The Utility Reform Network (TURN).

Ruling memorialized the resolution of the various discovery issues and accepted into evidence late-filed Exhibits 2, 3 and 101.

On August 12, the Commission authorized its General Counsel to issue a certificate that financing documents consistent with an "Amended and Restated Addendum of Material Terms of Financing Documents" comply with Section 7.10 of the Rate Agreement.[13] This addendum permits DWR to increase the amount of net bond proceeds to $11.95 billion.

On August 13, DWR submitted a transmittal note and "Supplemental Testimony of Douglas Montague on behalf of the California Department of Water Resources" (Supplemental Testimony). The transmittal note states that this is "significant additional material relied upon in proposed determination of a revenue requirement." The cover sheet of the Supplemental Testimony notes that DWR is "voluntarily submitting Prepared Testimony in this proceeding."

On August 14, SCE submitted a copy of comments (dated August 14, 2002) submitted to DWR in its administrative proceedings on DWR's 2003 revenue requirement. SCE noted that it served these comments on participants in this proceeding.

## 3. Details of DWR's Proposed Bond Sale

DWR, the State Treasurer's Office, and their combined financing team of underwriters, financial and legal advisors began in early 2001 the process of structuring a power supply revenue bond credit that would comply with the provisions of AB1X and also receive investment-grade ratings. This group faced a formidable task. The proposed sale of bonds at close to $12 billion will be "the

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[13] *See* http://www.cpuc.ca.gov/word_pdf/REPORT/17898.doc

largest municipal bond sale in history."[14] In addition, there are several aspects of this financing, as well as of AB 1X and DWR's power supply program, that make this bond deal complex and unusual:

- DWR entered into certain contracts for power (called priority contracts) that have a higher priority for payment than bond costs.
- As several contracts include terms that pass through the costs of natural gas, fluctuations in gas prices will lead to fluctuations in the price paid by DWR for power.
- Unlike a typical municipal bond offering, where the borrowing entity has the power to provide a dedicated stream of revenues, in this particular situation, the Commission must impose bond and power charges on IOU customers.

These characteristics serve to complicate the credit structure of DWR's indenture. DWR, working with rating agencies, has developed an elaborate credit structure that is described in Exhibit 1, pp. 6-13. We will not describe the detailed features of the credit structure or the elaborate flow of funds between the multiple reserve accounts, but will focus on the key features of the financing that drive the costs of the funds.

The most unusual element of the credit structure is the large number of reserve accounts that are funded at a total of more than \$3.6 billion.[15] Because the projected borrowing is \$11.95 billion, the balances deposited in accounts will

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[14] Exhibit 1, p. 5.

[15] Supplemental Testimony. The \$3.6 billion reserve figure is the sum of deposits to accounts listed in the table on page 8. This sum includes deposits to Debt Service Reserve Account, Bond Charge Collection Account, Priority Contract Account, Operating Account, and Operating Reserve Account.

total 30% or more of total borrowing. The purposes of these reserves, however, are readily described:

- The reserves provide bondholders with additional security in covering the contingency that the revenues designated for repayment of bonds are needed to pay "priority contracts;"
- The reserves help maintain a quality investment-grade credit rating for DWR's bonds, as required by the Act;
- As a result of the additional security and higher credit rating the reserves produce, the reserves can help to lower overall costs of the bonds.

The exact annual revenue requirement needed to support the bonds will not be known until the bond placement is complete. To support this Commission's development of a bond charge methodology, DWR's Exhibit 1 does provide the best estimates of the credit structure and costs as of July 9, 2002. At that date, DWR estimated that a bond issuance of $11.1 billion (with reserve accounts funded at more than $3.0 billion[16]) would, after adding in miscellaneous bonding costs, lead to a 2003 revenue requirement of $841,965,794, which will rise to $971,256,477 and remain at that level through the repayment period.

In Exhibit 1, DWR's estimate anticipates an "A-level" rating, which will then lead to an "all-in average" interest rate of 5.24% for the 20 year bonds.[17]

DWR's Supplemental Testimony contains substantial revisions to Exhibit 1. The Supplemental Testimony increases the size of the bond offering

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[16] Exhibit 1, addition of deposits to accounts listed in the table on p. 13. This figure includes deposits to Debt Service Reserve Account, Bond Charge Collection Account, Priority Contract Account, Operating Account, and Operating Reserve Account.

[17] Exhibit 1, p. 16.

from $11.1 billion to $11.95 billion. It increases the amount of funds deposited to the reserve and operating accounts from $3.0 billion (27% of the $11.1 billion in bonds to be issued) to $3.6 billion[18] (30% of the $11.95 billion in bonds to be issued). DWR states that "The rating agencies are concerned that the Department may be obligated to purchase the Residual Net Short beyond the December 31, 2002 deadline for such purchases contained in Assembly Bill 1X."[19] In addition, DWR proposes a different schedule of debt service payments, resulting in a bond charge revenue requirement of $1.140 billion in 2003, but decreasing to $784 million in the "years 2005 through 2022."[20] DWR notes that its estimate anticipates an "A-level" rating, which will lead to an "all-in average" interest rate of 5.38%.[21]

### A. Discussion: Major Changes in DWR's Testimony Illustrate Need for Explanations of New Revenue Requirement and Suggest Mathematical Errors

DWR's proposed 2003 revenue requirement in its Supplemental Testimony is almost $300 million higher than that contained in its initial testimony (Exhibit 1). Since the major difference between the Supplemental Testimony and Exhibit 1 is the $850 million increase in the amount borrowed, we are puzzled as to how the revenue requirement for 2003 grew by such a large amount. DWR's testimony in this proceeding indicates that the

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18 Exhibit 1-a, addition of deposits to accounts listed in the table on p. 8. This figure includes deposits to Debt Service Reserve Account, Bond Charge Collection Account, Priority Contract Account, Operating Account & Operating Reserve Account.

19 Supplemental Testimony, p. 5.

20 *Ibid.*, p. 11.

21 Exhibit 1-A, p. 10.

carrying costs (or "negative spread") of reserves will be 2%-3% per year.[22] Thus, even if we use the high end of this range, an increase in reserve accounts of $850 million will add only $25.5 million to the annual revenue requirement, far less than the $300 million increase requested.

Moreover, the Supplemental Testimony surprisingly projects a dramatic decrease in revenue requirements from 2003 to 2004. Since DWR anticipates that payment of bond principal will not begin until 2004, we would have expected that the revenue requirement would increase slightly from 2003 to 2004, similar to DWR's projected revenue requirement in Exhibit 1. Instead, DWR's Supplemental Testimony projects a $356 million *decrease* in revenue requirement between 2003 and 2004. DWR's Supplemental Testimony fails to explain this anomaly.

Furthermore, we note that in Exhibit 1, the revenue requirement is $841 million in 2003 and $971 million for years 2004 through 2022. This leads to total payments on the $11.1 billion loan of $19.3 billion over 20 years. In the Supplemental Testimony, the revenue requirement is $1,140 million in 2003, and $784 million for years 2004 through 2022. This leads to total payments on the $11.9 billion loan of $16 billion over 20 years. Once again, this makes no sense – how can the total repayment amount decrease by $3.3 billion when the amount of borrowing goes up by $850 million and interest rates remain unchanged?

The record established by DWR's Supplemental Testimony does not explain these discrepancies to all parties. Therefore, DWR, in its comments on this proposed decision, should fully explain the following: 1) why does

[22] TR 6558:10-13.

increasing the bond offering by $850 million result in a $300 million increase in the 2003 revenue requirement; 2) in the Supplemental Testimony, why is the revenue requirement in 2004, which includes repayment of principal, $356 million less than the revenue requirement in 2003, which includes no principal payments? and 3) why does increasing the bond offering by $850 million lead to a $3.3 billion drop in the cost of loan repayment? In addition, DWR should indicate whether it is possible to establish revenue requirements for the bond-related costs that are more stable over the initial twenty years.

Absent a detailed explanation of these important matters, this Commission can only conclude that DWR's calculations in its Supplemental Testimony contain numerical errors. We see comments on this proposed decision as providing an opportunity for a full explanation to effected parties and the Commission. Parties will have an opportunity to respond to this explanation in their reply comments. The comments and reply comments will provide additional record on this issue.

In summary, DWR plans to borrow approximately $12 billion to repay the $6.6 billion to California's General Fund and $3.5 billion to retire an Interim Loan. The exact costs of retiring these bonds, the establishment of annual revenue requirements, and the determination of its reasonableness are, under the provisions of AB1X, the responsibility of DWR. Nevertheless, DWR's filings show such anomalous outcomes may be the product of calculation errors. We cannot tell from the testimony DWR provided.

We note that the Supplemental Testimony was also filed in DWR's own administrative process; DWR has the statutory authority to determine the reasonableness of the bond's revenue requirement and must created a separate opportunity for parties to file comments. Moreover, we note that DWR will present this Commission with its final 2003 revenue requirements for bond-related costs following its placement of the bonds according to the implementation procedures described in Section 8 below. Because DWR's Supplemental Testimony does not constitute a final 2003 revenue requirement, we consider it only as illustrative of DWR's ongoing work in placing the bonds and estimating their costs. In light of this ongoing effort, we find it reasonable to identify and accept the Supplemental Testimony as Exhibit 1-a. We stress that we do not use this exhibit as probative evidence to set the bond charge, but instead we will use these figures to help illustrate the applicability of our bond charge methodology over a range of financing possibilities and to identify numerical issues that require further explanation. Moreover, identifying the Supplemental Testimony as Exhibit 1-a ensures its incorporation into the official record of this proceeding and facilitates references to it.

## 4. Issues in Proceeding

The evidence and briefs make clear that a series of policy, legal and implementation questions require resolution in order for the Commission to impose a bond charge. These include the following:

1. Should the Commission exempt specific bundled electric customers and usages, such as residential consumption less than 130% of lifeline amounts or CARE-eligible and Medical Usage, from the bond charge?
2. What methodology should the Commission use to calculate a bond charge?
3. What are the likely consequences of the various policies under consideration in R.02-01-011 for bond charge amounts?
4. How should the Commission implement the methodology adopted to allocate and collect bond-related costs?

Answering these questions will enable the Commission to meet its statutory obligation of imposing bond charges sufficient to ensure the timely repayment of bond-related costs. We therefore address each question in turn.

## 5. Should the Commission Exclude Specific Bundled Customers or Electricity Consumption from the Bond Charge?

A central issue to the development of a surcharge to recover bond-related costs is determining who should pay these costs. As noted above, R.02-01-011 is determining whether and how DA and departing load (DL) customers should bear responsibility for bond-related costs. This proceeding, in contrast, will set the methodology for calculating a bond charge that those responsible for bond-related costs should pay. As a consequence, legal and policy arguments concerning whether DA or DL customers should pay bond-related surcharges fall outside the scope of this proceeding.

We do address whether certain bundled customers should pay for bond-related costs. In particular, we must determine the responsibility of CARE-eligible customers, residential customer usage below 130% of baseline, and medical baseline customers for the payment of bond charges.

Currently, these customers (and associated usage) are exempt from the 3 cents / kWh surcharge the Commission adopted for PG&E and SCE customers[23] and from the 1.46 cents / kWh rate increase the Commission adopted for SDG&E customers.[24] Furthermore, California Water Code Section 80110 states:

> " . . . In no case shall the commission [California Public Utilities Commission] increase the electricity charges in effect on the date that the act that adds this section becomes

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[23] D.01-05-064 (2001 Cal. PUC LEXIS 419)

[24] D.01-09-059 (2001 Cal. PUC LEXIS 857)

> effective for residential customers for existing baseline quantities or usage by those customers of up to 130 percent of existing baseline quantities, until such time as the department has recovered the costs of power it has procured for the electrical corporation's retail end use customers as provided in this division. . ."

As the July 26 ALJ Ruling noted, the interpretation of this statute may be critical to determining the size of the bond charges and the methodology for setting such charges. The ALJ Ruling also set the issue for briefing and resolution in this proceeding.

We therefore turn to the question of whether to exclude this usage from bond charges, and whether this exclusion rests on policy or legal grounds.

### A. Positions of Parties

SCE, ORA, and TURN urge the Commission to exempt residential sales below 130% of baseline, medical baseline, and CARE customer usage from the bond charge.[25]

Concerning the interpretation of Water Code Section 80110, SCE, PG&E, CLECA and EPUC state that it would be possible to assign responsibility for the bond charge to residential sales below 130% of baseline as long as some other charge is reduced. SCE and PG&E note that it would be possible to dedicate a revenue stream within their current rates to pay for the bond charge and to adopt offsetting rate decreases, thereby complying with the statute. CLECA and EPUC argue more broadly that all utilities can accommodate a bond charge within their current rates. PG&E, CLECA, and EPUC argue that the bond charge should apply to all usage.

[25] SCE, Opening Brief, p. 12; ORA, Opening Brief, p. 6; TURN, Opening Brief, p. 6.

SDG&E also argues that the bond charge should apply to all residential usage, but it does not argue that it can accommodate such a policy within its current rates. Instead, SDG&E concludes that Water Code § 80110 no longer applies:

> "Once the bonds are sold, DWR <u>will have recovered</u> those costs, to wit, the costs of power it has procured for the electrical corporation's retail end use customers. Buyers of the bonds will have provided the costs of power procured by DWR. Thus, this provision of Water Code 80110 will no longer restrict the Commission after the bonds are sold."[26]

SDG&E then states that exempting customers using less than 130% of baseline has no basis in costs. SDG&E further argues that such a policy will cause "an additional $16 million in annual residential commodity shortfalls."[27] SDG&E concludes that such a policy may increase the existing business to residential subsidy "to well over $50 million per year."[28]

ORA, TURN and SCE take exception to SDG&E's interpretation of Water Code § 80110. SCE argues:

> "Paying back the general fund and interim loan from bond proceeds is not 'recovery' of those amounts; collection from end-use customers of the Bond Charge is the actual 'recovery.' SDG&E thus incorrectly interprets Water Code Section 80110, when it concludes that issuance of bonds is tantamount to DWR's recovery of the cost of power it procured and will continue to procure for electrical corporations' retail end-use customers."[29]

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[26] SDG&E, Opening Brief, p. 4.

[27] *Ibid.*, p. 5.

[28] *Ibid.*, p. 5.

[29] SCE, Reply Brief, p. 4.

Then, in a case of rhetorical convergence, ORA, TURN and SCE each develop an analogy with the purchase of a home and the obtaining of a mortgage. ORA succinctly argues "[a]nyone knows that the house is not owned until the mortgage is paid off."[30]

### B. Discussion: Exempt Residential Sales Below 130% of Baseline, Medical Baseline, and CARE-Eligible Customer Usage from Bond Charges

Section 80110 of the Water Code became effective on February 1, 2001. On May 15, 2001, the Commission both interpreted and discussed at length how to implement rate design changes consistent with this statute:

> "This statute exempts from additional rate increases all residential electricity usage that falls within 130% of "baseline" usage. Baseline usage is defined in Section 739(a). That section requires the Commission to establish a quantity of natural gas and electricity that is necessary to supply a "significant portion of the reasonable energy needs of the average residential customer." The "baseline quantity" is defined to be between 50 and 60 percent of average residential consumption, with allowances for seasonal and climatic variations, Section 739(d)(1). The Commission is further directed to require the utilities to file residential rate schedules that provide for the baseline quantity to be the first or lowest block in an increasing block rate structure. Section 739(c)(1). In addition, the Commission is directed to "establish an appropriate gradual difference between the rates for the respective blocks of usage." Section 739(c)(1). In 1986, the Commission determined the initial baseline quantities in D.86087, 80 CPUC 182. Subsequent revisions and updates to the baseline

[30] ORA, Reply Brief, p. 3; *See* also SCE, Reply Brief, p. 4 and TURN Reply Brief, p. 3.

> quantities and applicable rates have been made in the utilities' general rate cases." [31]

As it interpreted this statute, the Commission noted that the statutory exemption sharply constrained its freedom to design rates:

> "Taken together, new Water Code § 80110 and Pub. Util. Code § 739, exempt over 60% of residential sales from the 3 [cents] /kWh rate surcharge we authorized March 27th. The resulting shortfall is significant: 64% of all Edison residential sales are exempt, and 62% of all PG&E residential sales are exempt. These use exemptions result in half of all residential customers--those who use less than 130% of baseline--being protected by statute from further rate increases."[32]

Subsequently, the Commission adopted a rate design that allocated the substantial revenue shortfall that arises from the exemption to all other consumption. In D.01-09-059, the Commission adopted a similar approach to allocating a rate increase for SDG&E's customers.

We plan to once again follow the policy of excluding from new charges residential sales below 130% of baseline, medical baseline, and CARE-eligible customer usage from the bond charge. First, the equity considerations that led us to exclude this usage from previous charges continue to apply. These exclusions are consistent with our own recent actions in D.01-05-064 and D.01-09-059, our last actions involving rates in response to California's electric crisis. Moreover, the actions to exclude these customers from new charges were taken only a year ago, and it makes little sense to reverse policy and impose a new charge now.

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[31] D.01-05-064 (2001 Cal. PUC LEXIS 419, *32-*33)

[32] *Ibid.*

Further, we believe that continuing to exclude this customer usage from the exceptional charges that have resulted from the electricity crisis is in the public interest. Excluding consumption up to 130% of baseline creates incentives for residential customers to conserve power. Excluding from new charges electricity usage by those with medical disability and low income simply continues previous pricing plans that serve the public interest.

Second, although it may prove possible to impose a bond charge on all usage consistent with the requirements of Water Code § 80110, excluding this usage from the bond charge is clearly consistent with the legislative intent behind this statute and inherently reasonable.

Third, although SCE and PG&E have stated that it is possible to dedicate a portion of some existing charge to the bond charges, there is no similar certainty that we can do so for SDG&E. In particular, there is no record on whether and how the Commission could impose a bond charge out on endusers in SDG&E's territory without raising the electricity charges all customers must pay.

As noted above, in response to this dilemma, SDG&E claims that the law does not preclude raising charges on any customers. SDG&E's proposes a novel legal theory – that Water Code § 80110 will not apply once the bond sale is complete because at that time DWR will have recovered the costs of the power it has procured. In rebuttal, ORA and SCE convincingly argue that a house is not paid for until the mortgage is paid off, and that DWR will not have recovered its costs until the bonds are repaid. Further, CLECA, SCE, and PG&E, and EPUC state that the Commission could apply a bond charge to all customers as long as this action does not lead to an increase in rates for the consumption excluded from electricity charge increases by Water Code § 80110.

We find that SDG&E's interpretation does not comport with a reasonable reading of the statute. Thus, we do not believe that we can legally allocate a bond charge that applies to all residential customers without also adopting some offsetting adjustment to ensure that charges do not increase on usage by residential customers up to 130% of baseline. Moreover, there is no record in this proceeding as to how we could to so for customers in SDG&E's service territory.

In summary, for policy reasons and to ensure compliance with AB1X, and the Legislature's intent for its enactment, we exclude residential sales below 130% of baseline, medical baseline, and CARE-eligible customer usage from the bond charge. First, we use the same policy reasoning and equity considerations contained in D.01-05-064 and D.01-09-059 and thereby find it reasonable to exclude this consumption from additional charges. Second, we find that this outcome is consistent with the legislative intent of AB1X and inherently reasonable. Third, we note that even if it was possible to craft some other policy that applies a bond charge to all customers in a way that complies with AB1X, the record in this proceeding does not show how we could accomplish this for consumers in SDG&E's service territory.

## 6. What Methodology Should the Commission Use to Allocate and Collect the Revenue Requirement for Bond-Related Costs?

Almost all parties propose that the revenue requirement for bond-related costs be allocated based on some measure of kWh. However, parties differ on which kWh should be included and whether the allocation should be adjusted to reflect certain specific factors. Parties, however, are more united in proposing to collect the revenue requirement for bonds on charges based on a customer's consumption.

### A. PG&E, CLECA, SDG&E, ORA: Allocate & Recover Bond Costs Based on kWhs

The simplest position of parties is to allocate and collect, on a uniform statewide basis, per kWh charges for all bond-related costs. Of the parties in this proceeding, PG&E, CLECA and SDG&E support a per kWh charge with no exemptions.[33] Although ORA proposes certain adjustments to the calculation of bond charges (as do CLECA and PG&E), ORA characterizes its position as allocating "the bond charge on a simple equal cent per kWh basis across the vast majority of kWh forecast to be sold in the service territory of investor-owned utilities (IOUs) in 2003, and 2004."[34] SCE similarly characterizes its position as a uniform allocation, yet it supports ORA's proposed adjustments to the assessment of bond charges.[35]

Moreover, ORA provides several rationales for assessing the bond charge on a simple equal cents per kWh basis. In particular, ORA notes the expected duration of the bond charges – 20 years, ORA concludes that with the "inevitable changes in customers and circumstances"[36] that will occur over this time period, these charges will be paid by customers who did not even live in California during the crisis and that some who did will not pay these charges if

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33 As discussed above, PG&E, and CLECA and SDG&E believe (albeit for different reasons) that an allocation of a bond surcharge to all customers would be consistent with the provisions of Water Code § 80110.

34 ORA, Opening Brief, p. 5.

35 There are essentially two adjustments: one is their proposed exclusion of bond charges on certain DA customers (This issue is beyond the scope of this proceeding and not considered here) and the second is a proposed adjustment to PG&E's per kWh surcharge based on power provided to the Western Area Power Administration (WAPA).

36 *Ibid.*, p. 4.

they move away. In light of the inability to link bond costs to a customer's consumption, ORA concludes that a simple per kWh charge is fairest.

In a similar vein, PG&E states:

> "The California Legislature and the Commission have determined that DWR's actions during the energy crisis were undertaken 'for the health, welfare, and safety of the people of this state' and on behalf or all ratepayers 'to ensure reliable electricity service and, therefore, all ratepayers should contribute to the effort to pay down the unprecedented debt incurred by the state to help weather the energy crisis.' (*See* AB X1, Section 7; D.01-09-060, mimeo at pp. 3, 6). PG&E's approach is consistent with this policy because it shares the burden of the cost of the 'energy crisis' on each customer based on usage. It is easy to explain to customers. It treats all California ratepayers equally."[37]

CLECA, in addition to the arguments listed above, notes that the bond charge will be small in relation to the overall cost of DWR power, and that this reduces "the need for utility specific allocation."[38]

### B. ORA: Adjust PG&E's Rates in Light of WAPA Contracts

ORA proposes one specific departure from a per kWh allocation of bond charges in this proceeding. ORA recommends "that the dollar impact of the forecast net sales by PG&E to the WAPA be assigned to PG&E's ratepayers."[39] ORA states that it "assumes that PG&E's ratepayers benefited from the contract between PG&E and WAPA"[40] concludes that they should bear

[37] Exhibit 100, p. 3-2.

[38] CLECA, Opening Brief, p. 3.

[39] ORA, Opening Brief, p. 6.

[40] ORA, Opening Brief, p. 8.

WAPA-related costs. Noting that PG&E must provide WAPA with substantial amounts of power in 2003 and 2004, ORA recommends inclusion of these amounts in the allocation of revenue requirement between utilities, and the subsequent assignment of this revenue requirement to PG&E's other retail customers. Thus, PG&E's customers would pay a higher bond charge than customers in the service areas of SCE or SDG&E. SCE supports this adjustment. PG&E opposes this position, arguing that it is simply an allocation based on a modified "net short" position, and, after citing ORA's own arguments for an equal allocation, argues that fairness requires the rejection of this position.

### C. TURN: Allocate Revenue Requirement Per D.02-02-052

TURN takes a very different approach. TURN states that "[w]hile the equal cents methodology has the advantage of simplicity, it ignores any and all differences among the three companies that resulted in their making very different contributions to the accrual of the DWR 'undercollection' during the first nine months of 2001."[41] TURN argues on behalf of the allocation factors previously used in D.02-02-052, stating that the allocation factors are "generally consistent with cost causation."[42] Finally, concerning ORA's proposed WAPA adjustment, TURN states "no WAPA adjustment is needed if that methodology [*i.e.* that of D.02-02-052] is followed here."

### D. PG&E: Adjust Bond Charge to Reflect Line Losses

PG&E also proposes an adjustment in the allocation of revenue requirement to different customer classes. PG&E states "DWR bond charges should be differentiated by voltage to reflect differential line losses for different

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[41] TURN, Opening Brief, p. 3.

[42] *Ibid.*, p.5.

service level voltages, but otherwise set equally on all included load."[43] PG&E argues that differentiating bond charges by service voltage appropriately reflects that less energy is needed "to serve a given quantity of electric consumption at transmission service voltage levels, relative to service at primary and secondary distribution service voltages."[44] CLECA supports PG&E's proposed voltage-based adjustments for line losses, and SCE states that it does not object to such an adjustment.

### E. EPUC, CLECA and Modesto: Adjust Bond Charge on Departing Load Customers to Exclude Revenue Requirements

Although issues associated with DL were assigned to R.02-01-011, certain parties, including EPUC, Modesto and CLECA proposed adjustments to bond charges based on the structure of the bond financing. We have not addressed the elaborate discussion from these parties regarding DL customers, as well as the responses by TURN, PG&E, and SCE, because the issues raised are outside the scope of this proceeding. We note that pursuant to the August 13, 2002 ALJ Ruling, the evidentiary record of this proceeding was incorporated into R.02-01-011. That is the proper forum for these arguments, and we make no determinations of these issues in today's decision.

### F. Discussion: Allocate and Collect Bond Charges Based on All Non-Excluded kWh Consumption

We will allocate and collect the bond-related costs on a simple per-kWh basis, spread over all customer usage, with the exceptions of residential sales below 130% of baseline, medical baseline, and CARE-eligible customer usage. This policy makes sense for several reasons. First, as ORA points out, the long

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[43] PG&E, Opening Brief, p. 12.

[44] *Ibid.*, p. 12.

period over which the bond charges will be collected breaks the linkage between those for whom the power was purchased and those responsible for repayment. In addition, these bond-related costs were incurred to stabilize the grid, which benefited everyone. Thus, the assessment of a bond charge is simply a mechanism for raising the revenues needed to repay these bond-related costs. In light of these considerations, absent a rational reason to exclude particular usage or customers, it is reasonable and equitable to allocate these bond-related costs over the largest base of customers on a simple per kWh usage basis.

Second, because the purpose of the bond charge is simply to raise revenues to pay for bond-related costs, the simplicity of the per-kWh fee recommends it. It is transparently fair to all who must pay it.

Third, the one thing that the Commission knows from the period of the energy crisis is that the prices paid for power had no relationship to the economic concept of "reasonable" costs. Thus, the use of the principle of "cost causation" to allocate bond-related costs, as recommended by TURN, is unwarranted, for this principle assumes that the underlying costs are reasonable.

In particular, TURN suggests that we allocate these bond-related costs consistent with a modified "net short" position, as adopted in D.02-02-052. TURN fails to note, however, that D.02-02-052 did not allocate past responsibility for energy purchases, but instead allocated responsibility for current and ongoing purchases by DWR on behalf of the customers in the service territories of investor-owned utilities. Thus, it is reasonable to allocate the bond-related costs based on the demand for power of the utilities. Moreover, unlike the crisis period, the relationship between power prices and power costs currently better meets the principles of "cost causation" ratemaking than did the prices of power that produced these bond-related costs.

Moreover, as we observed in D.02-02-051, we are not dealing with routine costs arising from utility operations:

> "The establishment of a separate Bond Charge also recognizes the nature of the costs that DWR will finance with its bond transaction. These are costs that DWR incurred at the height of the crisis. . . Because the costs that DWR incurred to save the grid have future benefits, they should be amortized over time."[45]

In addition, as we noted in D.02-02-051, we have broad discretion in assessing a Bond Charge:

> "The Commission's authority under Pub. Util. Code § 451 and § 701 to impose rate mechanisms such as Bond Charges extends to situations where the charge is not in proportion to the direct benefit received by each customer paying the charge. (Footnote omitted) This would be the case, for example, for future ratepayers who will pay Bond Charges despite the fact that they only received the benefits of DWR's grid-stabilizing activities, and did not receive any of the electric power that was procured by DWR during the height of the electricity crisis."[46]

From this discussion, it is clear that the Commission did not contemplate a strict adherence to the economic principle of "cost causation" in allocating responsibility for bond-related costs. We believe that it would not be equitable to do so.

PG&E's argument (which SCE and CLECA support) to make a voltage-related adjustment to the bond charge because it took less power to serve high voltage customers is not persuasive. In our view, this argument does not

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[45] D.02-02-051, p. 49.

[46] *Ibid.*, p. 50.

warrant a departure from the equitable principle of assigning bond responsibility to each kWh of bundled consumption not otherwise excluded. As noted in D.02-02-051, some people who have never lived in California will pay these costs even though they consumed no power during the crisis period. In light of this harsh fact, making an adjustment based on a customer's service voltage lacks a reasonable basis.

Even ORA, whose testimony and brief state that the purpose of this charge is to fund bond-related costs, succumbs to the temptation to allocate WAPA-related costs based on the notion that PG&E's customers obtained some benefit from these contracts, and therefore should pay a higher share of bond-related costs. As PG&E and TURN point out, ORA's proposal to allocate a revenue requirement based on power provided to WAPA and then collect it from other PG&E customers introduces a revenue requirement allocation based on one factor contributing to the "net short" position. We reject a strict adherence to the principle of "cost causation," for the reasons stated above. Thus, we find that this argument does not warrant a departure from our equitable decision to allocate the Bond Charge on all non-excluded consumption by bundled customers.

## 7. Consequences of Other Commision Policies on the Bond Charge: What are the Key Projected Bond Surcharge Scenarios Pending Policy Determinations in R.02-01-011?

Through discussions at the PHC and the Workshop, it became clear that the issuance of the bonds would require that the Commission adopt a methodology for setting bond surcharges before the details of the bond financing could be completely determined. Moreover, key decisions concerning whether any bond charge should be imposed on DA customers are to be considered in R.02-01-011 and consequently fall outside the scope of this proceeding. As a consequence, this proceeding must calculate the bond-related charges associated with a range of plausible policy scenarios. The purpose of this analysis is to estimate bond charges in order to guide the Commission; the purpose is not to adopt specific bond charges. Setting the final bond charge to recover bond-related costs can only be done after the bonds have been placed and DWR has determined its final 2003 revenue requirement for bond-related costs.

In this proceeding, parties provided and updated estimates of usage and revenue requirements that are key to setting bond charges. Exhibits 201 (of SCE) and 304 (of SDG&E) were received into evidence during the course of the hearings. Exhibit 101-Revised (of PG&E) was received into evidence as a late-filed exhibit via an ALJ Ruling on August 15, 2002. Exhibit 101 updates Exhibits 201 and 304 by including an estimate of PG&E's 2003 DL (which was unavailable in Exhibits 201 and 304) and revises PG&E's forecast of exempted load to reflect higher baseline amounts adopted in D.02-04-026. In all other major elements, the data in the exhibits is identical. These estimates of electric consumption provide the basis for setting the methodology to calculate the initial bond charges.

Table 1 below provides the estimates of the bond charges needed to cover a range of bond-related costs under a variety of policy related assumptions. We develop three different scenarios representing four different levels of bond-related costs. These assumptions do not prejudge our decision in R.02-01-011 whether to impose bond charges on DA and DL customers, but to illustrate the likely range of bond charges under four different cases. Pursuant to the Rate Agreement, bond charges may be imposed on DA customers only after a

Commission order providing for such charges becomes final and unappealable under California law.[47]

Case 1 models the 2003 revenue requirement contained in DWR's Exhibit 1. This exhibit projects that the annual bond-related revenue requirement will total $842 million in 2003. Case 1 includes a total of $11.1 billion of bonds.

Case 2 models the 2003 revenue requirement contained in DWR's Exhibit 1-a. This exhibit increases the revenue requirement to $1,140, almost $300 million above Case 1.[48] Under this proposal, DWR increases its reserves by $850 million and increases the total net bond proceeds to $11.95 billion.[49]

Case 3 models the 2004 revenue requirement contained in DWR's Exhibit 1. It is based an annual revenue requirement for bond-related costs of $971 million and a total of $11.1 billion in bonds.

Case 4 models the 2004 revenue requirement contained in DWR's Exhibit 1-a. The revenue requirement of $784 million, is a $356 million decrease in the revenue requirement over Case 2, as reflected in Exhibit 1-a. As noted earlier, there is no apparent reason for this large drop in revenue requirement.

As we are proposing to allocate the costs of these bonds over all non-excluded kWh, the exercise to calculate the bond-related surcharges is

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[47] As noted previously, the Commission will address the issue related to the departing load customer in a separate opinion from the decision regarding the direct access customers.

[48] We discussed this dramatic increase in revenue requirement and the need for a fuller explanation in Section 4, above.

[49] We note that this increase in the size of the bond issue is consistent with the Amended and Restated Addendum to Summary of Material Terms of Financing Documents, dated August 8, 2002.

straightforward once we have estimates of electricity consumption. Each row in Table 1 corresponds to a different assumption of the number of gigawatt-hours (GWh) that will be responsible for paying bond-related costs.

Row A (Total Load Minus Excluded Residential) corresponds to the total California load, but follows the policy adopted in this decision, of excluding residential sales below 130% of baseline, medical baseline, and CARE-eligible customer usage. Row A assumes that the bond charge would also be imposed on both DA and DL customers.[50] Under this assumption, there would be an estimated load of 132,158 GWh over which to spread the bond related costs. As Table 1 indicates, such a policy will lead to bond charges ranging from .5932 cents/kWh (corresponding to Case 4) to .8626 cents/kWh (corresponding to Case 2).

Row B (Total Load Minus Excluded Residential and DL) corresponds to the total California load, but excludes residential sales below 130% of baseline, medical baseline and CARE-eligible customer usage and excludes projected DL from the bond charge. Under this assumption, there would be an estimated load of 131,065 GWh over which to spread the bond related costs. As Table 1 indicates, such a policy will lead to bond charges ranging from .5982 cents per kWh (corresponding to Case 4) to .8698 cents per kWh (corresponding to Case 2). Thus, at least initially, policies to either exclude or include DL in paying for

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[50] As discussed earlier, these scenarios are purely illustrative and we are in no way prejudging any decisions that will be issued in R.02-01-011. Nevertheless, parties did provide information on this matter, and we have included it in our analysis.

bond-related costs will impact bond-related charges of less than .007 cents per kWh.[51]

Row C (Total Load Minus Excluded Residential, DA and DL) corresponds to the total California load, but excludes residential sales below 130% of baseline, medical baseline and CARE-eligible customer usage from the bond charge. In addition, it does not apply the bond charge to DA and projected DL (policies under consideration in R.02-01-011). This leaves an estimated load of 106,222 GWh over which to spread the bond-related costs. Table 1 indicates that under this assumption bond charges will range from .7381 cents per kWh (corresponding to Case 4) to 1.0732 cents per kWh (corresponding to Case 2).

Row C is most representative of the initial bond charges. D.02-02-051 states, "absent such a decision that has become final and unappealable, ESP power will not be included in the determination of Bond Charges."[52] Since it may take at least a few months for such a determination concerning DA customers and their receipt of electricity from ESPs to become final and unappealable, it is most likely that the bond charge will start at the levels close to those contained in Row C.[53] Finally, we conclude this discussion by once again noting that the exhibits used to create Table 1 were incorporated into the record of R.02-01-011.

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[51] This figure is the difference between the bond charges in Row A and Row B.

[52] D.02-02-051, *mimeo.,* p. 90, (2002 Cal. PUC LEXIS 170, *171) cited in PHC 10, TR 404:11-28. The ultimate source of this language is the Rate Agreement by and Between State of California DWR and State of California, Public Utilities Commission, Section 4-3, which is Appendix C to D.02-02-051 and may be found at 2002 Cal. PUC LEXIS 170, *196.

[53] If the figures contained in Exhibit 1-a are accurate, Case 2 forecasts the 2003 bond charge and Case 4 the bond charge for subsequent years.

In summary, our analysis indicates that the methodology that we have adopted to set initial bond surcharges – a cents per kWh charge applying to all bundled customers with the exemption of residential sales below 130% of baseline, medical baseline, CARE-eligible customer usage – will result in per kWh charges along the lines of entries in Row C of Table 1. This analysis is purely illustrative – the exact charges will be determined only after the bonds have been issued, DWR has determined and submitted its 2003 final revenue requirement for bond-related costs to the Commission, and the Commission has approved conforming advice letters filed by the utilities.

## Table 1: Bond Charge Scenarios

| | **Total**[a] (GWh) | **Case 1**[b] $842 Rev. Req. ($MM) Bond Charge (cents/kWh) | **Case 2**[c] $1,140 Rev. Req. ($MM) Bond Charge (cents/kWh) | **Case 3**[d] $971 Rev. Req. ($MM) Bond Charge (cents/kWh) | **Case 4**[e] $784 Rev. Req. ($MM) Bond Charge (cents/kWh) |
|---|---|---|---|---|---|
| **A. Total Load Minus Excluded Residential** (Consists of non-excluded bundled load, direct access, which would require a final and unappealable decision in R.02-01-011, and departing load. | 132,158 | 0.6371 | 0.8626 | 0.7347 | 0.5932 |
| **B. Total Load Minus Excluded Residential and DL** **(**Consists of non-excluded bundled load, and direct access customers, which would require a final and unappealable decision in R.02-01-011) | 131,065 | 0.6424 | 0.8698 | 0.7409 | 0.5982 |
| **C. Total Load Minus Excluded Residential, DA, and DL** (includes only non-excluded bundled load) | 106,222 | 0.7927 | 1.0732 | 0.9141 | 0.7381 |

Case 1 corresponds to the 2003 revenue requirement request of DWR as described in Exhibit 1.

Case 2 corresponds to the 2003 revenue requirement request of DWR as described in Exhibit 1-a (Supplemental Testimony of August 13, 2002, based on a bond issue of $11.95 billion).

Case 3 corresponds to the 2004 revenue requirement projected by DWR in Exhibit 1.

Case 4 corresponds to the 2004 revenue requirement projected by DWR in Exhibit 1-a (Supplemental Testimony of August 13, 2002, based on a bond issue of $11.95 billion).

Row C best describes the likely initial surcharge rates, which will remain in effect until a decision in R.02-01-011 becomes final.

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[a] Entries in this column are based on information provided in Exhibits 101, 201, and 304.
[b] Entries in this column are based on revenue requirements in Exhibit 1 for year 2003. The cents per kWh surcharge results from division of the revenue requirements by total consumption included in a row.
[c] Entries in this column are based on revenue requirements in Exhibit 1-a for year 2003. The cents per kWh surcharge results from division of the revenue requirements by total consumption included in a row.
[d] Entries in this column are based on revenue requirements in Exhibit 1 for year 2004. The cents per kWh surcharge results from division of the revenue requirements by total consumption included in a row.
[e] Entries in this column are based on revenue requirements in Exhibit 1 for year 2004. The cents per kWh surcharge results from division of the revenue requirements by total consumption included in a row.

## 8. How Should the Commission Implement the Methodology Adopted to Allocate and Collect Bond-Related Costs?

This decision has adopted a methodology of allocating and collecting bond-related costs from all kWh except from those customers and usage not held responsible for this charge. At this time, several uncertainties remain. In particular, we do not have a final figure specifying the exact level of bond-related costs since the bonds have not yet been issued and DWR has not yet determined its final 2003 revenue requirement for bond-related costs. Moreover, we have not reached a final determination on which kWh we will include in recovering bond-related charges.

We do, however, know that we have excluded all residential sales below 130% of baseline, medical baseline usage, and CARE-eligible customer usage from the bond surcharge, consistent with previous Commission decisions and permitted by our statutory authority. The latest estimate of the non-excluded bundled consumption is 106,222 GWh.

Because R.02-01-011 is still examining whether the DA and/or DL customers will be made responsible for bond charges in whole or in part, the total electric usage and/or customer base that will bear the bond charge is currently uncertain. In addition, as we noted previously, under the terms of the Rate Agreement, the electric consumption by ESP's will not be included in the determination of the bond charges until a decision ordering such a charge "has become final and unappealable."[54]

To ensure smooth implementation of the bond surcharges consistent with this provision of the Rate Agreement, an ALJ Ruling of August 8, 2002 solicited

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[54] D.02-02-051, *mimeo.*, p. 90.

parties' ideas on: 1) whether the bond-related costs allocated to non-bundled customers in R.02-01-011 should depend on when the decision becomes final and unappealable; 2) if the answer to 1 was no, then what ratemaking treatment would best ensure this outcome; and 3) which regulatory accounting treatments and amortization of balances the Commission should use?

Thus, an implementation process must accomplish several things. To finance the bonds, the Commission must adopt a bond charge that will produce revenues sufficient to cover DWR's bond-related costs. Moreover, the implementation process must permit the investor owned utilities to file tariffs and modify their billing systems to implement the adopted bond charge methodologies. Finally, we must adopt a process that permits the modification of bond surcharges and balancing accounts to reflect the determinations reached in R.02-01-011, while recognizing that collection of these charges will not begin until that decision has become final and unappealable.

### A. Positions of Parties: Create Balancing Accounts

In reply briefs, AReM, PG&E, TURN, SCE and SDG&E all agreed that responsibility for bond-related costs should not depend upon the date when a decision in R.02-01-011 becomes final and unappealable. No party argued otherwise.

Concerning which process would best meet the goal of holding parties responsible for bond-related costs, parties made different proposals. SCE proposed a balancing account structure that refrains from charging non-bundled customers until a final and unappealable decision is reached, but tracks bond-cost responsibilities in sub-accounts. Following a final decision in R.02-01-011, the sub-accounts in surplus are distributed and sub-accounts in deficit are recovered through modifications of bond charge amounts.

PG&E recommends a similar approach, but asks that DWR have responsibility for tracking under and over payments. PG&E also recommends amortization of surpluses / deficits on a 1 to 6 basis – *i.e.*, that a one-month surplus or deficit be either amortized or made up over the subsequent 6 months. SDG&E supports avoidance of under or over payments, but sees no unusual ratemaking needed to reach this result. AReM similarly recommends tracking through regulatory accounts.

TURN also favors tracking, but recommends the initial imposition of a charge on DA customers with rebates to follow when the decision on non-exemption, if made, becomes final and unappealable, unless the Commission believes the Rate Agreement prevents this policy. In the case that the Commission finds that the Rate Agreement prevents the immediate collection from DA customers, TURN recommends policies similar to those proposed by other commenting parties.

Concerning the billing system implementation of billing changes, SDG&E states that it can implement a system with no exemptions in 30 days, but it will require 45 days to make billing changes that make "simple exemptions." More complicated exemptions will take longer. PG&E states that it could implement changes in time to permit the transmission of funds to DWR beginning on January 1, 2003. SCE states that it can implement a bond-charge line on customer bills by January 1, 2003.

Finally, we note that SDG&E proposed adopting a surcharge that averaged 2003 and 2004 projected revenue requirement.

### B. Discussion: Use Advice Letter Process with Balancing Accounts to Implement Policies Adopted

One of our main goals is to adopt regulatory procedures that set an initial charge and provide revenues to DWR starting in advance of

January 1, 2002. In addition, our goal is to adopt regulatory procedures that will hold consumers responsible for the bond-related costs from the moment the Commission assigns responsibility. We note that all parties agree that this is the appropriate course of action for the Commission to take.

Because the Rate Agreement prevents the imposition of a charge for bond-related costs based on electric power provided to customers by ESPs until a decision to do so becomes final and unappealable, our implementation will initially assess a charge on all non-excluded consumption of bundled customers sufficient to raises all the revenues needed to repay the bond costs. We will set this initial charge by dividing DWR's final 2003 revenue requirement for bond-related costs by 106,222 GWh, the consensus forecast of non-excluded bundled consumption for 2003.

In addition, we will create a balancing account to track all payments to DWR so that we can subsequently adjust total under or over payments by customer classes. We therefore order SCE, SDG&E, and PG&E to create Bond-Charge Balancing Accounts (BCBA) and to share data on total non-excluded consumption and remittances to DWR. Although each utility is creating its own balancing account, over and under payments are determined on a common, statewide basis.

If the Commission decides to assess bond-related costs on additional customer classes for bond-related costs in R.02-01-011, each utility should create relevant subaccounts in its BCBA effective on the date when the bond charge is first implemented or when a decision is first adopted deciding this matter in R.02-01-011, whichever is latest. For each customer class held responsible for bond charges, there will be a subaccount tracking the class's cost responsibility, consumption, billed charges, and under or over payments.

If at the time of the initiation of the bond charges (as discussed below), the Commission has decided to hold both bundled and DA customers equally responsible for bond-related costs, then the BCBA would operate as follows:

**Table 2: Proposed Operation of BCBA**

| Assumptions | Bundled | DA | Total |
|---|---|---|---|
| Load | 900 | 100 | 1000 |
| Bond Related Revenue Requirement | | | $10 |
| Actual Initial Bond Charges ($/kWh) while awaiting finalization of decision | $.0111 | 0.0 | |
| Ratemaking-related Bond Charges | | | $.01/kWh |

**Operation of the BCBA:**

| | | | |
|---|---|---|---|
| Bundled Customer Subaccount | | | |
| Bundled Customer Cost Responsibility | | | 900 x $.01/kWh = $9 |
| Actual Bundled Customer Billed Charges | | | 900 x $.011/kWh = $10 |
| Bundled Customer Overpayment | | | $1 |
| | | | |
| Direct Access Customer Subaccount | | | |
| Direct Access Cost Responsibility | | | 100 x $.01/kWh = $1 |
| Actual DA Billed Charges | | | 100 x $.00/kWh = $0 |
| DA Customer Underpayment | | | $1 |

Note: subaccounts will include interest.

When a Commission decision that determines whether and which ESP customers are responsible for bond costs becomes final and unappealable, the actual billed bond charge will be revised. In the example above, the new billed charge applying to both bundled and DA customers would be $.01/kWh. The balance in the Bundled Service Customer Subaccount would be refunded to bundled service customers through a surcredit. Similarly, the underpayments in the Direct Access Customer Subaccount would be made up through a surcharge. PG&E's suggestion that surcharges and surcredits be made up in a one to six ratio (the undercollection arise from one month of no charges be made up over the 6 ensuing months) seems reasonable, but we will not decide this matter now. Instead, parties should make amortization proposals in the advice letter filing, discussed below, which shall be made 10 days after a Commission decision that assigns responsibility to DA customers becomes final and unappealable. At that time, the Commission will have information concerning the size of the under and overpayments and can directly consider the consequences of different amortization programs on electric rates.

To implement this decision, DWR should file its final 2003 revenue requirement for bond-related costs with the Energy Division once the bonds have been placed and DWR has determined its bond-related charges.

The three investor-owned utilities should begin to make changes in their billing systems immediately so as to facilitate the implementation of this decision by November 15, 2002. The Commission long ago required the IOUs to create these customer classes, and we cannot delay until January 1, 2003. The modifications to the billing systems should enable the printing of the bond charge on a separate line on the customer's bill.[55] We note that SDG&E and SCE

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[55] We note that the Commission approved service agreements between DWR and SDG&E (D.01-09-013), DWR and SCE (D.01-09-014) and a service arrangement between DWR and PG&E (D.01-09-015). Subsequently, the Commission approved modifications to DWR's agreements with SDG&E (D.02-04-048) and SCE (D.02-04-047). At DWR's request, pursuant to Water Code § 80106(b), the Commission subsequently ordered PG&E to comply with the terms of a servicing arrangements (D.02-05-048). Finally, the Commission approved amendments to the Servicing Agreements for SCE (D.02-07-039) and SDG&E (D.02-07-040). Each of the servicing agreements and the servicing arrangement provide for a separate line item on the Consolidated Utility Bill for bond charges.

stated that they could implement such changes within 30 days of a Commission order, and we order them to do so.

PG&E requests that the Commission authorize a delay in the implementation of a new line on the customer's bill until the completion of its installation of a new billing system. PG&E states that it will offer consumers an explanation via a bill insert that a bond charge has been imposed, and will implement a separate line on the bill as soon as possible. PG&E's approach seems reasonable, and we authorize it to postpone implementation of the billing line until February 1, 2003, at the latest.

The utilities shall make a compliance advice letter filing 5 days after the filing of DWR's 2003 final revenue requirement for bond-related costs with the Energy Division, but in any event, no sooner than November 10. SDG&E, SCE and PG&E shall file compliance advice letters that impose a per kWh hour charge on non-exempt bundled consumption. SDGE, SCE, and PG&E shall calculate a uniform per kWh surcharge by dividing the 2003 revenue requirement for bond-related costs by 106222 GWh. The advice letters will be effective on filing or on November 15, whichever is later, subject to post-filing review by the Energy Division. Remittances to DWR should commence with the receipt of bond-related charges.

As mentioned above, the filing should also establish a Bond Charge Balancing account for each utility to track bond-related charges and cost responsibilities as described above. In addition, if it is ultimately determined that cost responsibility for bond-related costs will be imposed on ESP power, the utilities should immediately create subaccounts for each customer class held responsible for bond-related costs. These subaccounts will track costs and payments until a decision imposing cost responsibility on ESP power becomes final and unappealable.

Within 10 days of a decision assigning cost responsibilities for ESPs becomes final and unappealable, the utilities should make a new advice letter filing to impose payments on those held responsible for bond-related costs and to amortize over and under payments in BCBA sub-accounts. These changes will go into effect when adopted by the Commission. This amortization will not adjust any charges previously billed for DWR's bonds, rather it will assign future cost responsibility for DWR's overall bond charges in an equitable fashion.

In subsequent years, consideration of the bond charge will be part of the annual proceeding to set a charge to recover DWR's retail revenue requirements. Further, we note that the bond charge may change at other times, pursuant to Sections 5.1(a) and 5.1(d) of the Rate Agreement.

Concerning the rate implications of this decision, we note that PG&E has stated "incorporating the DWR bond charge will not affect bundled customers' overall rates."[56] Thus, this bond charge should not raise the rates paid by PG&E's bundled customers, at least initially.

SCE notes that it "operates under the Settlement Rates adopted in D.01-05-064."[57] This indicates that this bond charge should not affect the rates of SCE's bundled customers, at least initially.

SDG&E's testimony does not directly address this point, but seems to presume that the bond charge will be a separate levy, with no offsetting rate

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[56] PG&E, Brief, p. 7.

[57] Exhibit 200, p. 7.

reductions elsewhere.[58] It is also unclear to us whether there is sufficient room in SDG&E's current rates to recover all of SDGE's authorized costs and the bond charge without affecting the overall rate levels. For this reason, we will order SDG&E to establish a balancing account to track its remittances to DWR and to seek a rate change to recover any resulting shortfall in its own collections due to these remittances in the DWR Revenue Requirement Phase of this proceeding. In that Phase, we will simultaneously consider whether any changes are needed to accommodate DWR bond charges on an ongoing basis.

Finally, we decline SDG&E's suggestion to create an average charge to cover the revenue requirements for 2003 and 2004. Properly calculated, DWR's revenue requirement shows both how much money DWR needs and when it needs it. If DWR actually needs more money in 2003 and 2004 to pay bond-related costs, we cannot delay recovery to a date after the money is needed.

## 9. Comments

The proposed decision of ALJ Sullivan was mailed to the parties in accordance with § 311(d) of the Pub. Util. Code and Rule 77.1 of the Rules of Practice and Procedure. Opening comments were filed on _________________. Reply comments were filed on ______________________.

## 10. Assignment of Proceeding

Commissioner Lynch is the assigned Commissioner and ALJ Sullivan is the assigned Administrative Law Judge in this proceeding.

## 11. Rehearing and Judicial Review

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

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58 *See* Exhibit 302, pp. 2-4.

Therefore, Section 1731(c) (applications for rehearing are due within 10 days after the date of issuance of the order or decision) and Section 1768 (procedures applicable to judicial review) are applicable.

## Findings of Fact

1. The California DWR owes approximately $6.5 billion to the General Fund and $3.5 billion on an interim loan. The debts were incurred in the months following the January 17, 2001 declaration of a state of emergency which required DWR to purchase electricity for California consumers.
2. DWR plans to refinance these debts through a bond offering of approximately $12 billion.
3. The "Rate Agreement By and Between State of California Department of Water Resources and State of California Public Utilities Commission" (Rate Agreement) states that the Commission will impose charges sufficient to provide for the payment of all bond-related costs incurred by DWR.
4. The proposed sale of bonds at close to $12 billion will be the largest municipal bond sale in history.
5. Certain contracts for power, called priority contracts, have a higher priority for repayment than bond costs, an unprecedented arrangement.
6. Several contracts include terms that pass through the costs of natural gas, and fluctuations in the price of gas will lead to fluctuations in the price of power.
7. In a typical municipal bond offering, the borrowing entity has the power to provide a dedicated stream of revenues.
8. The Commission, not DWR, will set bond charges.
9. The factual circumstances listed in Findings of Fact 4, 5, 6, 7, and 8, have resulted in a complicated credit structure with multiple reserve accounts.

10. Exhibits 1 and 1-a indicate that DWR plans to fund reserve accounts at between $3.0 and $3.6 billion.

11. The reserve balances provide bondholders with additional security, protecting the revenues designated for repayment of bonds from preemption by priority contracts.

12. The reserve balances help maintain a quality investment-grade credit rating for DWR's indenture.

13. As a result of the additional security provided to bondholders and the higher credit rating that the reserves produce, the reserves can help to lower overall costs of bonds.

14. The exact annual revenue requirement needed to support the bonds will not be known until the bond financing is complete.

15. It is possible to determine the reasonableness of methodologies for setting charges to recover bond-related costs based on the preliminary financing information presented by DWR in Exhibits 1 and 1-a.

16. DWR will present the Commission with its final revenue requirement for bond-related costs following its completion of the indenture.

17. The Rate Agreement provides that the Commission shall impose bond charges in an amount that is sufficient in total to provide for the timely payment of bond-related costs.

18. The Rate Agreement requires that bond charges be imposed based on the aggregate amount of electric power sold to customers in the service areas of PG&E, SCE, and SDG&E, regardless of whether the power is sold by DWR, the utility, or under particular circumstances, by an ESP.

19. D.01-05-064 exempted the consumption of CARE-eligible customers, residential usage below 130% of baseline, and usage by medical baseline customers of PG&E and SCE from the 4 cents per kWh surcharge.

20. D.01-09-059 exempted the consumption of CARE-eligible customers, residential usage below 130% of baseline, and usage by medical baseline customers of SDG&E from a 1.46 cents per kWh rate increase.

21. The long period over which the bond charges will be collected breaks the link between those for whom the power was purchased and those responsible for repayment.

22. The bond charge is a mechanism to raise revenues to pay for bond-related costs.

23. A bond charge imposed equally on all non-exempt kilowatt-hours has a simple structure that is easy to implement and is transparent and fair to all that must pay it.

24. During the period of the energy crisis, the prices charged for power had no relationship to the costs of generating electricity. Thus, the assumptions in the economics principle of allocating costs on the basis of cost causation are not met.

25. Since the bond-related costs will be repaid over almost twenty years, over time those paying the surcharges will frequently be different than those for whom the costs were incurred.

26. D.02-02-052 did not allocate past responsibility for energy purchases, but instead allocated responsibility for current and ongoing purchases by DWR on behalf of the investor owned utilities.

27. D.02-02-051 noted that the Commission has broad discretion in assessing a bond charge.

28. It is not reasonable to make departures from a methodology of allocating bond-related costs on an equal-per-kWh bond charges to reflect the voltage of a consumer's power.

29. It is not reasonable to make departures from a methodology of allocating bond-related costs on an equal-per-kWh bond charges to impose WAPA-related costs on PG&E's customers.

30. The Rate Agreement states that absent a decision that has become final and unappealable, power provided to customers by Energy Service Providers will not be included in the determination of bond charges.

31. If DWR borrows $11.95 billion, it projects a 2003 revenue requirement for bond-related costs of $1,140 million, and a 2004 (and subsequent years) revenue requirement of $784 million.

32. Based on DWR's assumptions, if residential sales below 130% of baseline, medical baseline, and CARE-eligible customer usage are excluded from the bond charges, we estimate that all other bundled consumption will pay a projected charge of between 0.7427 and 1.0732 cents per kWh in 2003 and between 0.7381 and 0.9141 cents per kWh in 2004. This result also assumes the adoption of a methodology that assigns a uniform charge to all non-excluded consumption. Bond charges at this level will remain in effect until a decision concerning whether Direct Access customers should pay bond-related costs becomes final and unappealable.

## Conclusions of Law

1. It is reasonable to adopt a uniform bond-related surcharge on all non-excluded consumption.

2. Pursuant to Water Code Section 80110, the determination of the reasonableness of the costs associated with DWR's bond offering rests with DWR, not the Commission.

3. Pursuant to the Public Utilities Code, the authority to set a bond charge rests with the Commission, not DWR.

4. Pursuant to Section 80110 of the Water Code, DWR is entitled to recover as a revenue requirement amounts necessary to finance the proposed bonds that will be issued by DWR.

5. The Commission should adopt bond charges in amounts sufficient to pay the bond-related costs.

6. Pursuant to California Water Code Section 80110, the Commission should not increase electricity charges for existing baseline quantities or usage by those customers up to 130 percent of existing baseline quantities at this time.

7. It is reasonable to exclude residential sales below 130% of baseline, medical baseline, and CARE customer usage from the bond charges.

## O R D E R

**IT IS ORDERED** that:

1. Within five days following Department of Water Resources (DWR) determination of a "final" revenue requirement for the bond issue, DWR should submit the revenue requirement to the Energy Division and serve that revenue requirement on parties in this proceeding.

2. San Diego Gas and Electric Company (SDG&E), Southern California Edison (SCE) and Pacific Gas and Electric Company (PG&E) shall begin making changes to their billing systems to impose bond charges consistent with the methodology of collecting an equal-cents-per-kilowatt-hour (kWh) on all

non-excluded bundled electricity consumption, as defined herein. Those bond charges shall be reflected as a line item on customer's bills. SCE and SDG&E shall implement a separate bond charge line on the customers' bill. PG&E shall implement a separate bond charge line on customers' bills no later than February 11, 2003.

3. Five days following the filing of DWR's 2003 revenue requirement for bond-related costs in this proceeding (but in any event no sooner than November 10, 2002), SDG&E, SCE and PG&E shall file compliance advice letters that impose a per kWh charge on non-exempt bundled consumption (as defined herein). SDGE, SCE, and PG&E shall calculate a uniform per kWh charge by dividing the 2003 final revenue requirement for bond-related costs by 106,222 gigawatt-hour (GWh). The advice letters will be effective upon filing, subject to review by the Energy Division for compliance with this order.

4. SCE, SDG&E, and PG&E shall establish Bond Charge Balancing Accounts consistent with the discussion herein to track payments of bond-related charges by customer classes. The details of these accounts should be described in the advice letters filed pursuant to Ordering Paragraph 3.

5. SCE, SDG&E, and PG&E shall establish sub-accounts to track bond charge payments and responsibilities consistent with the customer usage that R.02-01-011 deems responsible for paying bond-related costs.

6. Within 10 days after a decision assigning cost responsibilities for ESPs becomes final and unappealable, the utilities shall make a new advice letter filing to impose bond charges on those held responsible for bond-related costs and to amortize over and under payments in the sub-accounts of the Bond Charge Balancing Account. These changes shall be effective as of the date adopted by the Commission.

7. SDG&E shall establish a balancing account to track its remittances to DWR and allow it to seek a rate change, to the extent necessary, allow it to recover its own authorized costs despite these increased remittances to DWR.

This order is effective today.

Dated ________________________, at San Francisco, California.

# ATTACHMENT A

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