Decision 02-01-001 January 2, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 3338-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)

ORDER GRANTING LIMITED REHEARING OF DECISION (D.) 01-03-082

On April 26, 2001 Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("Edison") [1](collectively the "Utilities"), Toward Utility Rate Normalization ("TURN") and Leprino Foods Company applied for rehearing of Decision (D.) 01-03-082. D.01-03-082 ("Accounting Decision") authorizes the Utilities to add a three-cent per kilowatt-hour (kWh) surcharge to their rates. The Accounting Decision also modifies the accounting rules we had developed to record the recovery of transition era cost recovery, and declines to declare an end to the AB 1890 mandated rate freeze.

[1] Edison may withdraw its challenge to the Accounting Decision pursuant to the settlement agreement entered into as of October 2, 2001 between Edison and the Commission in connection with the Filed Rate Doctrine litigation brought by Edison in federal court.

We have carefully considered all the arguments presented by the parties and are of the opinion that rehearing should be granted on the issue of whether the AB 1890 rate controls should be ended. We will also modify the Accounting Decision to clarify how we arrived at the amount of three-cent per kWh surcharge increase to rates. The need for rehearing on the other issues presented by the parties' applications for rehearing has not been demonstrated.

I. TURN ACCOUNTING PROPOSAL

PG&E and Edison (collectively "the Utilities") make numerous allegations regarding the unlawfulness of the Commission's adoption of the accounting modification proposed by TURN in its petition to modify E-3527 ("TURN Proposal"). The TURN Proposal requires that balances in the Transition Revenue Account ("TRA") be transferred to the Transition Cost Balancing Account ("TCBA") each month, whether negative or positive, in effect, netting the TRA and the TCBA. As we explained in the Accounting Decision, this change is a true-up which reconciles operating cost shortfalls with transition cost recovery, and places the transition costs rather than operating costs at risk during the rate freeze period, as contemplated by AB 1890.

The Utilities argue that the adoption of the proposal violates state statutes, the state and federal Constitutions, federal statutes, and equitable estoppel principles. Edison further maintains that the Commission should not have considered the TURN Proposal at all due to a conflict of interest. We find that none of these arguments challenging our adoption of the TURN Proposal is convincing.

A. Violation of AB 1890

The Utilities allege that the TURN Proposal violates AB 1890 in a number of respects. These arguments fail to identify any aspect of the statute which our adoption of the TURN Proposal has violated.

1. Conversion of Operating Costs to Transition Costs

According to the Utilities, the new accounting process converts operating costs into transition costs in violation of AB 1890 since TCBA amounts can now be used to recover operating expenses. In fact, the TURN Proposal creates no new transition costs. The TURN Proposal only alters the mechanism for tracking the recovery of those costs, and allows TCBA amounts, from earlier headroom in the TRA and other sources, to go toward operating cost recovery. Significantly, the amount of transition costs that could potentially be recovered during the transition period remains the same. Under the new system, the revenue available from all sources is combined, but transition costs are still separate costs. Further, since the TCBA and the TRA are our creations, and not derived from the statute, it is difficult for the Utilities to maintain that our changes in the functions of these accounts violates AB 1890.

The Utilities emphasize that we had earlier held, in Resolution (Res.) E-3527, that this type of an accounting change would convert operating costs into transition costs. We expressly disapproved these earlier holdings in the Accounting Decision. The apparent inconsistency is understandable, however, because we issued Res. E-3527 at a different time before the tremendous shortfall in operating expense recovery, and at that time the accounting change would have had a different effect. At that time, the AB 1890 provisions were generally allowing beneficial above-market rates for the purpose of transition cost recovery. We viewed it as unfair to allow anomalous operating expense shortfalls to be recovered under this beneficial scheme, in addition to the large transition cost recovery. The situation had changed by March of this year; with shortfalls in the TRAs, requiring the Utilities to apply all revenues from the transition period to recoup operating expenses no longer results in a windfall for them.

2. Ending the Rate Freeze Expeditiously

The Utilities contend that the TURN Proposal violates the AB 1890 requirement to end the rate freeze expeditiously. They point to the section 330 (t)[2], which provides that the transition to a competitive generation market should "be completed as expeditiously as possible." The Utilities' interpretation of that provision is not justified.

Section 368 (a) provides that rate levels should be frozen "until the earlier of March 31, 2002, or the date on which the commission-authorized [transition] costs… have been fully recovered." The Utilities maintain that since the TURN Proposal decreases the amount of transition cost recovery it delays the end of the rate freeze in violation of AB 1890.

The Utilities' argument is unconvincing because it is not at all clear that the adoption of the TURN Proposal will delay the end of the rate freeze. The rate freeze may end despite of the adoption of the TURN Proposal, and it had not been declared over before the TURN Proposal was adopted.

Second, there is no clear mandate in AB 1890 to end the rate freeze as soon as possible. The purpose of AB 1890 was to expedite the transition to a competitive electric market and lower electricity prices. In the absence of lower electricity prices, and with no clear impact on the competitive generation market, ending the rate freeze would not further the purposes of AB 1890. Moreover, no provision in the statute is violated if the rate freeze continues. The only explicit statutory deadline for the rate freeze is that it shall end no later than March 31, 2002, and that will occur with or without the TURN Proposal. Therefore, any extension of the rate freeze that could result from the adoption of the TURN Proposal does not violate AB 1890.

[2] Unless otherwise noted, all section references are to the Public Utilities Code.

3. Recovery of Operating Costs before Transition Costs

The Utilities claim that our conclusion that “the utilities must first pay off operating costs incurred in providing service during the rate freeze and then may apply any remaining revenues to capital or stranded cost recovery” is in error, and is a “gross misinterpretation of AB 1890.” (PG&E App. at p. 28.) This argument is mistaken.

Although AB 1890 does not specifically state whether transition costs are to be recovered on a monthly basis or netted for the duration of the rate freeze, the statute provides that the Utilities, “shall be at risk for those [transition costs] not recovered…” during the rate freeze period. (Section 368 (a).) Since transition costs are at risk, and operating costs are not designated as “at risk,” by implication recovery of transition costs is residual. It was clearly not the intent of the statute to allow full transition cost recovery and an extreme shortfall in operating costs during the transition period.

The Utilities argue that the recovery of transition costs and operating costs are separate and that AB 1890 provides separate mechanisms for their recovery. Yet the Utilities fail to point to any provisions in the statute that specifically direct a category of funds to transition cost recovery. The Utilities cite the requirement that transition costs be measured by netting the “negative value of all above-market utility-owned generation-related assets against the positive value of all below market utility-owned generation assets.” (Section 367 (b).) This provision concerns the measurement of transition costs, as opposed to the means of their recovery, however.

The Utilities also refer to section 367 (c) which requires “[a]ll ‘going forward costs’ of fossil plant operation” to be recovered from generation revenue. This argument is entirely misplaced. Section 367 (c) essentially provides that going forward costs of fossil plant operation are <u>not</u> to be recovered in the manner of transition costs, but rather must be only recovered from specified generation revenue. Therefore, this section does not support the Utilities' argument concerning separation of operating and transition cost recovery.

Because the Utilities identify no provision in AB 1890 that has been violated, the Utilities' arguments concerning separate recovery of transition costs under AB 1890 lack merit.

4. Fair Opportunity

The Utilities contend that the adoption of the TURN Proposal deprives them of "a fair opportunity to fully recover the costs associated with commission approved generation-related assets and obligations…" (Section 330 (t).) In fact, the Utilities' "fair opportunity" under AB 1890 was the rate freeze scheme, which allowed, for a time, higher than market rates to be charged. As we have noted, both PG&E and Edison accepted the risk of variable energy costs. (Accounting Decision, at p. 29.) Therefore, the fact that unexpectedly high energy costs prevented the Utilities from recovering all of their transition costs does not mean that the Utilities lacked a "fair opportunity" to recover those costs.

PG&E argues that the unfairness lays in the fact that it had recovered transition costs, but then that recovery was undone. As we explained in the Accounting Decision, adoption of the TURN Proposal essentially resulted in a true-up for the entire transition period. The previous accounting method produced an anomalous result that could have allowed a large transition cost recovery, while operating costs went unrecovered. This contravened the basic intent of AB 1890. The TURN Proposal corrects this problem and makes the accounting treatment required by the Commission more consistent with the intent of AB 1890. Notably, the amount of transition costs the Utilities ultimately will recover is unclear, and has yet to be definitively determined.

B. Retroactive Ratemaking

PG&E argues that the adoption of the TURN Proposal violates the section 728 prohibition against retroactive ratemaking. Although Edison does not argue that adoption of the TURN Proposal is actual retroactive ratemaking, both Utilities maintain that the Decision constitutes retroactive rulemaking, which is beyond the Commission's powers.

PG&E's argument concerning retroactive ratemaking is misplaced because no rates are being changed as a result of the accounting change, and there is no direct impact on revenues. Rather, the TURN Proposal changes the accounting treatment of revenues already received by the Utilities so they are applied to operating expenses instead of transition costs. It does not provide any overall credit or debit for the Utilities which will result in a change of rates. For this reason, PG&E's reliance on City of Los Angeles v. Public Utilities Comm. (1972) 7 Cal.3d 331 is misplaced. In that case, the Court overturned a rate increase based on an order which had retroactively increased money due to Pacific Telephone and Telegraph Company. The accounting change at issue here will not either increase or decrease the Utilities' rates.

PG&E contends that the change impacts rates since it prolongs the end of the rate freeze. This argument fails for a few reasons. First, the TURN Proposal does not necessarily extend the rate freeze. The rate freeze had not ended before the accounting change, and, as we are deciding today, we will look at whether the rate freeze should be ended notwithstanding the adoption of the TURN Proposal. In addition, even if the TURN Proposal delays the end of the rate freeze it is not clear that this would result in an actual increase or decrease in rates, since there have been two rate increases in the form of surcharges during the pendency of the rate freeze.

Furthermore, there is no retroactive change to the original legislative policy that transition costs, rather than operating expenses, are at risk during the transition period. As we have explained, the accounting change is essentially a true-up, in order to effectuate the purposes of AB 1890. In this way it is similar to the adjustment in Southern Cal.Edison v. Public Utilities Com. (1978) 20 Cal.3d 813, contrary to PG&E's claims that Edison is inapposite. Edison holds that the application of a fuel adjustment clause that did not change ratemaking policy could not be considered retroactive ratemaking, despite the fact that in that case rates were changed. Here, the TURN Proposal is also an adjustment that is effectuating an earlier policy determination. Significantly, PG&E was on notice that the TRA and TCBA could be adjusted retroactively since the Commission had made its earlier adjustments to these accounts retroactive. (See Res. E-3527, 1998.)

PG&E challenges our holdings that the provisions of AB 1890 control over section 728. Contrary to PG&E's representations, we did not hold that section 728 is impliedly repealed. Rather, we stated that to the extent the mandates of AB 1890 conflict with those of section 728, AB 1890, as the more recent and specific legislation, controls. Our holdings on this point are correct, and since there is no conflict with section 728, in any event, PG&E's argument is unimportant.

The Utilities also argue that the adoption of the TURN Proposal is impermissible retroactive rulemaking. The Utilities' arguments fail to demonstrate that the retroactivity involved in the application of the TURN Proposal exceeds the scope of the Commission's powers.

Where there is uncertainty, regulations and statutes are generally considered prospective in effect. Retroactive regulations are allowable, however, as long as the agency has authority to act retroactively, and the regulation is clear in its intended retroactive application. (See Bowen v. Georgetown University Hospital (1988) 488 U.S. 204, 208.) Moreover, an exception to the rule that retroactive effect is disfavored is recognized where the new statute or regulation "merely clarifies the existing law. [Citations.] The rationale of this exception is that in such an instance, in essence, no retroactive effect is given to the statute [or regulation] because the true meaning of the statute has been always the same. [Citations.]" (Tyler v. State of California (1982) 134 Cal. App.3d 973, 976; accord Western Security Bank v. Superior Court (1997) 15 Cal. 4th 232, 241.)

In this case, the Accounting Decision is clear in its retroactive impact. Also, we have been granted ample authority by the Legislature, both in AB 1890 and in section 701[3], to effectuate any necessary accounting changes to further the purposes of the statute. Although PG&E argues that our retroactive regulatory authority must be more explicit, they provide no credible support for this proposition. Moreover, since the accounting change in question carries out the intent of AB 1890, it falls within the exception to the rule that retroactivity is disfavored. For these reasons, there is no legal bar to the retroactive application of the TURN Proposal.

C. Estoppel

PG&E argues that the Commission is equitably estopped from altering the rules for transition cost recovery. This argument fails because the standard for applying equitable estoppel against a government agency has not been met.

As PG&E notes, the standard for estoppel has been stated as follows:

> Generally speaking, four elements must be present in order to apply the doctrine of equitable estoppel: (1) the party to be estopped must be apprised of the facts; (2) he must intend that his conduct shall be acted upon, or must so act that the party asserting the estoppel had a right to believe it was so intended; (3) the other party must be ignorant of the true state of facts; and (4) he must rely upon the conduct to his injury.

(Driscoll v. City of Los Angeles (1967) 67 Cal.2d 297, 305.) In the case of estoppel against a government agency, the person asserting estoppel must also "demonstrate that the injury to his personal interest if the government is not estopped exceeds the injury to the public interest if the government is estopped." (Stewart v. City of Pismo Beach (1995) 35 Cal.App. 4th 1600, 1607.)

In this case, the elements for asserting estoppel against the Commission have not been met. Contrary to PG&E's assertions, we were not

[3] Section 701 provides that the Commission may do all things "necessary and convenient" in the exercise of its authority over public utilities, whether or not those things are specifically designated by the Legislature.

"apprised of the facts" at the time of Res. E-3527. We had no way of knowing what would occur in the wholesale energy market, and this change in the wholesale market is what made our original accounting system untenable. We did not and could not foresee that our original accounting system would result in a windfall in transition cost recovery while allowing operating costs to go unrecovered.

Also, PG&E fails to demonstrate that it relied our original accounting system to its detriment. Although PG&E is clearly displeased that we changed the accounting rules, it points to no action it would have done differently if the accounting rules had been different from the start, and no such action is obvious. As Edison states, the difference in the two accounting systems has no impact on the Utilities in months when there is headroom in the TRA. (Edison App., p. 6, fn 9.) For most of the period that the earlier accounting rules were in effect, there was headroom in the TRA, and therefore the change in rules had no impact during that time. Therefore, it is unclear how PG&E could have "relied for years on the Commission's prior rules" to its detriment. Moreover, since Res. E-3527 itself altered the accounts' mechanisms and had retroactive effect, PG&E was clearly on notice that these balancing accounts were subject to adjustment.

Finally, PG&E has no basis to conclude that its injury exceeds the public's injury if there is no estoppel. As discussed, the TURN Proposal ensures that operating costs be recovered prior to transition costs, in accord with the AB 1890 legislative scheme. PG&E's full recovery of transition costs at the same time it is unable to meet its operating costs does not serve the public interest.

Because a number of the elements for estoppel are not met, the Commission is not equitably estopped from adopting the TURN Proposal.

D. Confiscation

The Utilities argue that the adoption of the TURN Accounting Proposal constitutes a taking of their property in violation of the United States and California Constitutions. We do not agree that a taking has occurred because the type of losses which stem from economic forces are not protected by the Constitution, and the losses at issue stem from the Utilities' own business and regulatory strategies. Moreover, it is not yet clear the extent to which the Utilities will be able to recover their transition costs prior to the end of the rate freeze. Whether or not there is a threat of a taking, we will want to consider the extent of these losses when it is possible to do so, and we will explicitly consider whether some form of compensation is warranted.

According to the Utilities there is no chance for future transition cost recovery because they cannot sell their plants pursuant to AB 6X, and generation revenues no longer go directly toward transition cost recovery. They further contend that the California Procurement Adjustment (CPA) mandated by AB 1X eliminates any further opportunity for headroom.

Depending on when the rate freeze is ended, there are still possibilities for transition cost recovery. While it is true that the Utilities cannot now sell their generation plants, if these plants return to cost of service regulation to some extent their value can be recovered through rates. Moreover, contrary to the Utilities' assertions there has been headroom in the TCBA again in recent months since wholesale energy prices have significantly decreased. In addition, the CPA itself does not have any direct impact on headroom. We also note that other forms of compensation are possible and have not yet been foreclosed in the event we find that compensation is warranted.

Even if the Utilities could demonstrate that they have suffered permanent financial harm from the loss of transition costs, they have not shown that this would be a taking. Pursuant to Market Street Ry. v. Railroad Comm'n (1945) 324 U.S. 548, the government is not required to protect utilities against losses caused by the operation of market forces. In that case, the Supreme Court held that the rates allowed Market Street were not confiscatory, despite the fact that railway was unable to make a profit. The Court held that even though Market Street's investments in the railway may have been prudent, the government was not required to insure that Market Street make a profit on that investment, when economic forces, such as competition from other forms of transportation, were making Market Street lose money. "The due process clause… has not and cannot be applied to insure values that have been lost by the operation of market forces." (Id., at 567.)

E. Procedural and Substantive Due Process in Adoption of the TURN Proposal

PG&E contends that the adoption of the TURN Proposal violates "fundamental tenets of procedural and substantive due process." (PG&E App., at 36.) Yet aside from general complaints about unfairness, PG&E fails to identify how its due process rights have been violated. Therefore, these claims are unconvincing.

Adoption of the TURN Proposal is not unfair. Again, the TURN Proposal is necessary to effectuate the original intent of the statute. It would be difficult for PG&E to argue that its cost recovery absent the TURN Proposal was at all consistent with the AB 1890 scheme.

PG&E specifically takes issue with the retroactive impact of the accounting change. As discussed above, retroactive impact is generally acceptable under the Constitution, and is particularly appropriate where it is necessary to effectuate the purpose of the statute. The cases cited by PG&E to support its view are inapposite to the case at hand. One of the cited cases concerns a statute where retroactive application would conflict with the statutory purpose (In re Cindy B. (1987) 192 Cal. App. 3d 771), and in the other the Court found that the statute was not intended to have retroactive effect. (Russell v. Superior Court (1986) 185 Cal. App. 3d 810.) Moreover, PG&E's argument that the Legislature cannot retroactively impair contracts or abrogate vested rights is inapposite. In this case, PG&E had neither a contract nor a vested right.

Furthermore, regulated entities present a different situation. As the Supreme Court stated, "Those who do business in a regulated field cannot object if the regulatory scheme is buttressed by subsequent amendments to achieve the legislative end.'[Citations]." (Connolly v. Pension Benefit Guaranty Corp. (1985) 475 U.S. 211, 227.) This is particularly true in the instant case, where PG&E was on notice that these accounts were subject to retroactive adjustment. (Res. E-3527.)

F. Disqualification of the Commission

Edison claims that we never should have addressed the TURN Proposal at all because we are adversaries with Edison in a federal court action that could decide whether the TRA undercollection may be recovered. Edison argues that we were not impartial in adopting the TURN Proposal because we moved to dismiss Edison's federal court complaint on the ground that the adoption of the proposal would moot the entire lawsuit.

The Commission's Settlement with Edison makes these arguments moot; in any case they are without merit. The fact that we are defendants in a federal lawsuit, and the adoption of the TURN Proposal may have an impact on that litigation does not support a claim of bias. TURN's proposed changes were pending before us prior to the filing of the Utilities' federal court actions. We do not lose our authority over the matter or our obligations to the public merely because we are defendants in a lawsuit. Edison cites no authority supporting its assertion that we are somehow obligated to suspend any action in a matter subject to a court's review during the pendency of that review. Indeed, it would be an absurd result if a party could call a halt to all regulatory action simply by challenging a related action in court.

G. Equal Protection

PG&E maintains that adoption of the TURN Proposal for PG&E and Edison but not San Diego Gas & Electric Company ("SDG&E") violates the Equal Protection clause, because SDG&E was never required to net its transition cost recovery against its operating cost recovery when its rate freeze ended. This argument lacks merit.

Equal Protection requires that all persons similarly situated shall be treated alike. PG&E and Edison are not similarly situated to SDG&E in this case. SDG&E's rate freeze ended before there were tremendous operating cost shortfalls for the California utilities. Therefore, the same considerations do not apply to SDG&E's situation. Also, in addition to the fact that SDG&E's original rate freeze has been over for a year, SDG&E is now subject to new legislation and a new rate freeze. For these reasons, SDG&E is differently situated from the other utilities.

H. Filed Rate Doctrine

Both Utilities argue that the adoption of the TURN Proposal does not defeat their federal filed rate doctrine claims. This argument is not a claim of error regarding the Accounting Decision, which does not create any filed rate problems or discuss the filed rate doctrine. Thus, this argument is not properly the subject of a rehearing application.

I. Recovery of QF Costs

PG&E contends that to the extent the Accounting Decision "diverts payments for QF power to cover other procurement costs, and does not allow PG&E to recover those costs after the rate freeze ends," it is preempted by the Public Utilities Regulatory Policies Act (PURPA). (PG&E App., at 41.) These contentions are premature. According to PG&E, if the TCBA amounts go towards covering operating costs, there may be an insufficient amount left for PG&E's avoided-cost-based QF costs, a category of transition costs. It is entirely premature for PG&E to conclude that the remaining TCBA amounts will be insufficient to cover these costs, as PG&E appears to recognize by framing its argument in terms of "to the extent" these costs are not met. PG&E fails to demonstrate it will be unable to recover these QF costs at the end of the rate freeze.

II. GENERATION MEMORANDUM ACCOUNT REVENUES

The Utilities allege that the Accounting Decision errs in crediting Generation Memorandum Account (GMA) revenues to the TRA to offset procurement costs. They argue that, as with the netting of the TCBA and the TRA, this accounting change is confiscatory and illegally retroactive. In addition, the Utilities maintain that transferring the GMA overcollections to the TRA violates section 367 (b), which they claim requires these revenues to go toward transition cost recovery. PG&E also maintains that it is error to allow only credits, and not debits, to be transferred from the GMA, because therefore generation costs will go uncollected. These arguments are unconvincing.

For the reasons discussed in the preceding sections, applying the GMA revenues to operating costs through the TRA is not legal error. The accounting change is necessary to effectuate the purposes of AB 1890, which provides that the utilities are at risk for whether they will be able to recover all their transition costs. The change is not confiscatory and there is no prohibition against its limited retroactive impact.

The Utilities' arguments concerning section 367 (b) are based on a misinterpretation of that section. According to the Utilities, section 367 (b) requires the value of generation assets that are above book value to go toward recovery of transition costs. Section 367 (b) provides, in relevant part:

> These uneconomic costs [which the commission shall identify] … shall:
>
> (b) Be based on a calculation mechanism that nets the negative value of all above market utility-owned generation-related assets against the positive value of all below market utility-owned generation related assets.

Contrary to the Utilities' contentions, this section merely provides a method for calculating transition costs, and does not mandate a method for recovering those costs. Therefore there is no violation of section 367 (b) as long as we use this method for measuring transition costs, as we have been doing. There is simply no revenue stream mandated by section 367 (b) which the new accounting procedures could misdirect.[4]

Moreover, section 367 (b) does not even concern the revenues at issue here. Section 367 (b) only refers to measuring the value of the generation assets, not the revenue from the assets. All we have done in the Accounting Decision is credit those revenues to the TRA. Therefore, although those revenues may be relevant to a determination of the value of the assets, diverting the actual revenues to a different account cannot be seen as violating the statute in any manner.

PG&E also complains that the transferring credits from the GMA to the TRA without transferring undercollections or debits, unfairly deprives them of the ability to recoup their generation costs. In general, since only overcollections are credited to the TRA, in the months that there are overcollections, the Utilities' costs are met. We recognized that this system may still result in some unrecovered costs, when we stated, "we will consider any adjustments, including addressing monthly GMA undercollections, needed, as we consider the interaction of AB 6X, AB 1X, and § 367 (c) with regard to recording the monthly balance." (Accounting Decision, at 35.) Because we explicitly said we would address any undercollections at a future time in this proceeding, the Utilities have no basis to apply for rehearing of that issue at this time.

III. ADOPTION OF THE THREE CENT PER KILOWATT HOUR SURCHARGE

TURN's application for rehearing takes issue with the three cent per kilowatt hour surcharge adopted in the Accounting Decision. TURN argues that the Decision violates the substantial evidence rule, since the maximum level of surcharge

[4] We may have referred at times to this value netting process as recovery as a shorthand. The fact remains, however, that technically under the statute, the section 367 (b) netting process raises or lowers the amount of transition costs and does not impact their recovery.

supported by the record was two cents per kWh, the amount of the rate increase sought by each utility in this phase of the proceeding. As noted in the Accounting Decision, both PG&E and Edison claimed they needed to increase retail rates by an additional two cents per kWh. According to TURN, even if the Commission believed that each utility had met its burden of proof in support of its requested increase, the largest amount of increase it could award was two cents per kWh.

After reviewing the Accounting Decision and TURN's application for rehearing, we realize it is not clear as to how we arrived at the three cent increase, when it appears that all the Utilities asked for was two cents. After the Utilities filed their applications, wholesale energy costs continued to escalate, and the State Legislature passed emergency legislation, AB 1X, authorizing CDWR to step in and purchase power for the use of utility customers. AB 1X further directed the Commission to implement regulations for the DWR to be reimbursed for power purchases. This was the situation we faced at the time of the hearings in Phase I of this proceeding. Thus, we had to consider the Utilities' request for rate increases in response to the escalating energy crisis, as well as ensure that DWR was made whole for its power purchases.

While the Utilities limited their *immediate* requests to a 30 percent increase, the applications were based on recovery of past as well as future procurement costs and included trigger mechanisms for future rate increases of upwards to 76 percent for Edison's residential users by January 2003, and approximately 40 percent for PG&E's residential users by December 2001. We did not consider the Utilities' plans insofar as they provided for recovery of past procurement costs, since past recovery was not part of the Phase I hearings. As such, we did not have a complete record demonstrating exactly how much the Utilities would need on a going-forward basis only. However, it was apparent that some rate relief was necessary to make sure the Utilities could comply with their statutory duty to provide adequate electric service to their customers on a going-forward basis.

In addition, we also had to pave the way for the State to be reimbursed for its power purchases, and took that into consideration in evaluating the Utilities' request for rate relief. The Accounting Decision must be read in conjunction with its companion decision issued the same day, D.01-03-081, which directs the Utilities to segregate and transfer to DWR monies collected by the Utilities for power sold by DWR to the Utilities' retail end use customers. As we explained in the Accounting Decision, at the time we recognized that ordering the Utilities to reimburse DWR would increase financial pressure and further compromise the integrity of the state's electrical system. At the time, we also anticipated having to further allocate a portion of the rate increase to DWR once we obtained its revenue requirement and established the Fixed DWR Set Aside under AB 1X. In our discretion and judgment, therefore, we determined that a three-cent increase would accomplish these goals, in hope that further rate increases would not be necessary. This rationale is not clear, however, in reading the Accounting Decision, and thus we will modify the Decision to provide our reasoning behind the three-cent increase.

The other problem raised by TURN's rehearing application is the sufficiency of the record itself supporting the amount of the rate increase. As stated above, we recognize that the record was not complete at the time we issued the Accounting Decision. Unfortunately, the situation required an immediate response and we could not wait for firm numbers from DWR or the Utilities. In such situations, we have broad authority to act and grant relief in emergency circumstances on an interim basis, provided we make appropriate findings. The Supreme Court upheld our authority in this regard in at least two cases. See City of Los Angeles v. PUC, 7 Cal.3d 331, 102 Cal.Rptr. 313 (1972); TURN v. PUC, 44 Cal.3d 870, 245 Cal.Rptr. 8 (1988). As these cases demonstrate, the Commission may raise rates on an interim basis where there is a showing of an emergency situation or undue hardship, and where further proceedings are underway.[5]

[5] TURN v. PUC was not limited to just an emergency situation, but involved a situation "in which fairness to both the utility and the public required immediate action." 44 Cal.3d at 879.

We have made appropriate findings to justify the interim rate increase as a response to an emergency situation, and have been further developing a record to support it. We made several findings supporting our determination that the current energy crisis and the financial problems facing the Utilities compromised the integrity of the state's electrical system. These include findings concerning excessive wholesale electricity prices that have jeopardized the financial viability of the Utilities and their ability to serve their customers (Findings of Fact 8, 20); the independent reviews of PG&E and Edison confirming the serious financial problems facing the Utilities (Findings of Fact 12-19); power sellers that will not or cannot sell additional power into California's grid (Finding of Fact 24); suppliers refusing to sell natural gas to PG&E, which it needs to purchase on behalf of its natural gas customers (Finding of Fact 24); and that blackouts across the state in March were attributable in part to the refusal of energy suppliers to sell electricity to the ISO and the utilities because of concerns that they might not be paid (Finding of Fact 26). We also found that pressure on utility finances would increase when the utilities begin to segregate revenues applicable to DWR purchases from existing rates and remit these revenues directly to DWR, as required by ABX1 (Finding of Fact 21).

This situation requires consideration of a number of complex issues that could not be immediately and fully addressed at the time we issued the Accounting Decision. We will have a full and considered review of the need and justification for the rate increase. A proceeding is underway to determine the revenue requirements of Edison, PG&E, and San Diego Gas & Electric related to retained generation, Qualifying Facilities (QFs), bilateral contracts, and ancillary services. This will give us firm numbers as to the Utilities' revenue requirements. In addition, we anticipated that a portion of these rate increases would be allocated to DWR upon receipt and analysis of DWR's revenue requirement. We are currently determining the calculation, allocation, rate design and implementation of DWR's revenue requirement and Fixed DWR Set Aside. Therefore, we will have a full consideration of these issues and a complete record justifying the need for the rate increase. Of course, we can then evaluate whether adjustments are in order if revenues exceed costs. Accordingly, we deny TURN's application for rehearing on this issue.

IV. NOTICE OF RATE INCREASE TO UTILITY CUSTOMERS

TURN next claims that the Commission adopted the three cent per kWh without first providing notice to the utilities' customers, in violation of Public Utilities Code section 454. The relevant portion of section 454 provides:

> 454 (a) …Whenever any electrical, gas, heat, telephone, water, or sewer system corporation files an application to change any rate, other than a change reflecting and passing through to customers only new costs to the corporation which do not result in changes in revenue allocation, for the services or commodities furnished by it, the corporation shall furnish to its customers affected by the proposed rate change notice of its application to the commission for approval of the new rate. …The notice shall state the amount of the proposed rate changed expressed in both dollar and percentage terms for the entire rate change as well as for each customer classification. …

TURN states that the Utilities sent notices to their customers describing the relief sought in their applications that, if granted in full, would have yielded a maximum cumulative rate increase of three cents per kWh, including the one cent adopted in D.01-01-018. According to TURN, the cumulative rate increase of four cents per kWh adopted in the Accounting Decision exceeds the level of potential rate increase noticed in customers' bills.

In response, Edison argues that it did comply with section 454 by sending its customers a special mailing providing them notice of its Application. Edison also argues that nothing in section 454 limits the Commission's authority to authorize a rate increase in excess of what Edison noticed.

We find TURN's argument without merit. Section 454 requires the Utilities to provide notice of what rate increases they are applying for, not necessarily what the Commission will do. The notices sent out informed customers that the Utilities sought an immediate rate relief of approximately 30 percent , but that under the trigger mechanism it could go much higher. As explained above, the total relief requested could actually have been as high as 40 percent for PG&E customers and 76 percent for Edison customers. The relief granted was within the overall range of relief requested by the Utilities. Accordingly, we find that utility customers did receive adequate and sufficient notice of the Utilities' application for a rate increase.

V. AB1X REQUIREMENTS FOR RATE INCREASE

Leprino argues that AB 1X requires that any rate increase done as an exception to the rate freeze must be based on information provided by DWR regarding the revenue requirements occasioned by its power purchases. As Leprino notes, Water Code section 80110, enacted as part of AB 1X, states that DWR shall be entitled to recover its revenue requirement "…and shall advise the commission as the department determines to be appropriate." At the time of the Accounting Decision, DWR had not advised the Commission regarding the revenue requirement. According to Leprino, since the Commission created no record with respect to DWR's revenue requirements, it was not authorized by section 80110 to increase rates.

Leprino's arguments are without merit. Water Code section 80110 merely requires that DWR provide the Commission information substantiating its revenue requirement in order for the Commission to determine the amount of the DWR Fixed Set Aside. It does not prevent us from increasing rates when necessary and when consistent with its other statutory obligations. We have other statutory duties to maintain a safe and adequate supply of energy, and we found that the emergency situation warranted an immediate increase in rates. In addition, AB 1X expressly continues the Utilities' obligation to serve their customers. Since the Utilities were not released from procurement responsibilities for their net short, we determined a rate increase was necessary to fulfill this statutory obligation given the financial status of the Utilities at the time. And as explained above, we will have further hearings implementing DWR's revenue requirements.

VI. UTILITY PAYMENTS PRIOR TO ESTABLISHMENT OF DWR'S REVENUE REQUIREMENT

Edison claims that the Accounting Decision improperly requires payment of funds to DWR in violation of AB 1X. Edison argues that it cannot be ordered to pay funds to the DWR until DWR sets a revenue requirement. These arguments are without merit. First, the Accounting Decision does not directly order funds to be paid to DWR. It merely states that the three cents per kWh increase shall be added to generation related rates for PG&E and Edison that are adopted in Ordering Paragraph 1 of D.01-03-081 for the purpose of all of the calculations required by that decision dealing with the transfer of funds to DWR. It further orders PG&E and Edison to provide revenues from the generation related rates and the three cent increase to DWR immediately, consistent with D.01-03-081. Thus the Accounting Decision merely makes clear that the three cent increase is to be included in the calculations set forth in D.01-03-081, and reiterates our directive that these monies be paid immediately to DWR. Secondly, Edison is incorrect that it cannot be ordered to pay funds to the DWR until DWR sets a revenue requirement. In D.01-03-081, we did not allocate utility revenues, but established procedures to ensure that the Utilities properly segregate and transfer those revenues that they collected from retail end use customers on DWR's behalf. We note that challenges to D.01-03-081 have been rejected at the Commission and at the state appellate court.

VII. PROCEDURAL DUE PROCESS

PG&E claims that the entire process leading up to the Accounting Decision has been devoid of any meaningful process. PG&E cites several examples, including (1) the refusal to consider whether the rate freeze was over during the late December hearings, (2) the short time period allowed for filing testimony and conducting the hearings, (3) the refusal to allow meaningful cross-examination of the independent auditors, (4) the timing of the draft decision, which was issued 24 hours before the final vote, (5) the insertion of new language in the final version with no opportunity for comment, which requires PG&E to forward money to DWR that it has yet to collect in rates, and (6) the decision to impose certain losses on the utilities by rewriting the accounting rules after the fact, while at the same time removing any of the benefits of AB 1890.

These arguments are not convincing. We determined that we were not prepared to perform the necessary evaluations to find that the requirements of AB 1890 for ending the rate control period have been met. PG&E fails to demonstrate how this violates its due process rights. Moreover, it was urgent to conduct hearings on these proposals as quickly as possible, given the Utilities' claims of financial distress and the need to safeguard the state's energy supply.

PG&E fails to provide any authority to support its argument concerning the 24-hour comment period on the proposed decision. Although 24 hours is a short period for comments, PG&E is well aware that the State of California and the energy utilities have been in a time of crisis, and that it has been necessary to expedite many of the decisions the Commission has issued. Also, the Utilities had ample opportunity to analyze and comment on these issues in prior filings in this proceeding, including Concurrent Briefs filed on March 5, 2001, and the Utilities' responses to TURN's petition to modify Resolution E-3527.

Finally, the fact that PG&E may not like the outcome of the Accounting Decision does not amount to a due process violation. As explained elsewhere in this memo, PG&E's arguments concerning the adoption of TURN's accounting proposal and what PG&E characterizes as the removal of any of the benefits of AB 1890 are without merit.

VIII. UTILITY RESPONSIBILITY FOR NET SHORT POSITION

Edison argues that the Accounting Decision requires the Utilities to cover their net short position without granting them sufficient revenues with which to purchase power. According to Edison, forcing it to cover its net short position while imposing an artificially low generation rate violates the Takings clause of the Fifth Amendment. Edison claims that we must allow the Utilities to pass through the full costs of power to customers if those purchases must be made by the Utilities. Edison also complains that the rate increase is insufficient to allow it to cover its net short, since the Commission ordered all of the three cent increase, and more, to be paid to DWR.

Edison’s arguments are premature at best. Edison makes generalized claims about its alleged inability to cover its net short position, without pointing to any evidence in the record supporting its claims. We accordingly deny Edison’s application for rehearing on this issue.

IX. THE END OF THE AB 1890 RATE FREEZE

Both PG&E and Edison argue that the Commission unlawfully failed to declare that the rate freeze was over, presenting somewhat different arguments why this is so. Many of the Utilities’ arguments were considered and rejected by the Commission in the Accounting Decision and will not be repeated here. However, after reviewing the applications for rehearing we are of the opinion that it would be prudent for the Commission to now reconsider the issue of whether the AB 1890 rate controls should be ended. New legislation, AB 6X in particular, has materially affected the implementation of AB 1890. We wish to reconsider the viability of maintaining the AB 1890 rate controls in light of these recent legislative changes.

Further proceedings will address the impact of AB 6X on the AB 1890 rate freeze paradigm, and the actual date of the end of the rate freeze. We anticipate that the issues involved in this determination are legal as opposed to factual, and the Commission can adequately resolve the issue of ending the rate freeze after briefing by the parties. We accordingly will direct the ALJ Division to set a schedule enumerating the issues to be addressed. We further note that we must also determine the extent and disposition of stranded costs left unrecovered, and will address this in proceedings subsequent to our determinations regarding the rate freeze.

Therefore **IT IS ORDERED** that:

1. Decision 01-03-082 shall be modified as follows:

    a. On page 9 after the first full paragraph, the following paragraph shall be inserted: "Both Utilities included in their RSPs trigger mechanisms which would automatically increase rates if undercollected power costs exceeded a certain level. The Utilities claim that further rate increases, as implemented through the proposed trigger mechanism, may be necessary if their financial condition continues to worsen."

    b. On page 15, the first sentence of the last paragraph shall be changed to: "This rate increase is subject to several conditions."

    c. On page 15, the following paragraph shall be inserted after the fourth paragraph: "We also grant an increase of three cents per kWh to be collected by SCE and PG&E. Although this amount is higher than the Utilities' immediate request, we do not adopt the Utilities' proposed trigger mechanisms for further rate increases. However, we anticipate that this amount will be enough to stabilize the state's energy supply system and pave the way for DWR to be reimbursed for its power purchases, without the need for future rate increases."

2. Limited rehearing is granted on the issue of whether rate controls under AB 1890 should be ended. We direct the ALJ Division to issue an expedited briefing schedule enumerating the issues to be addressed.

3. Rehearing on all remaining issues in the applications for rehearing of Decision 01-03-082, as modified herein, is denied.

This order is effective today.

Dated January 2, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

I dissent.

/s/ HENRY M. DUQUE
Commissioner