STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

December 30, 2002

TO: ALL PARTIES OF RECORD IN APPLICATIONS 00-10-045, and 01-01-044

Decision 02-12-064 is being mailed without the Dissent of President Lynch. The Dissent will be mailed separately.

Very truly yours,

/s/ CAROL A. BROWN
Carol A. Brown, Interim Chief
Administrative Law Judge

CAB:acb

Attachment

Decision **02-12-064** December 19, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902-E) for an Order Implementing Assembly Bill 265.	Application 00-10-045 (Filed October 24, 2000)
Application of San Diego Gas & Electric Company (U 902-E) for Authority to Implement an Electric Rate Surcharge to Manage the Balance in the Energy Rate Ceiling Revenue Shortfall Account.	Application 01-01-044 (Filed January 24, 2001)

OPINION REGARDING SAN DIEGO GAS & ELECTRIC COMPANY'S REQUEST FOR A SURCHARGE TO RECOVER THE AB 265 UNDERCOLLECTION AND DECISION ADOPTING SETTLEMENT AGREEMENT

I. Summary

Today's decision addresses the relief requested by San Diego Gas & Electric Company (SDG&E) in the two above-captioned applications. SDG&E seeks authorization to impose a Revenue Shortfall Surcharge (surcharge) of $0.00349 per kilowatt hour (kWh) on residential, small commercial, and street lighting customers for a period of two years to recover the undercollected revenues resulting from the legislative enactment of a 6.5 cents per kWh rate ceiling on the rates of these customers.

A central issue in this proceeding are the power purchase contracts that SDG&E entered into with three entities in late 1996 and early 1997. These contracts are referred to in this proceeding as the intermediate term contracts.

This decision adopts the proposed settlement of June 14, 2002, which divides the profits from the intermediate term contracts between ratepayers and SDG&E's shareholders. This settlement will have the effect of reducing the undercollection resulting from the "AB 265" rate ceiling by $24 million. The reduction to the undercollection resulting from the adoption of this settlement, together with the expected true-up adjustment of the rates of the California Department of Water Resources (DWR), and other factors, including other matters currently before the Commission, have the potential to eliminate the undercollection by the end of 2003. SDG&E's request for a surcharge is therefore denied at this time.

II. Background

A. Procedural Background

On August 30, 2000, the California Legislature enacted Assembly Bill (AB) 265 (Stats. 2000, Ch. 328) as part of an effort to stabilize electric rates during the height of the energy crisis. AB 265 was signed into law on September 6, 2000 by Governor Davis as an urgency statute.

AB 265 provides, among other things, that the Commission establish an energy rate component ceiling of 6.5 cents per kWh for SDG&E's smaller customers. See Public Utilities Code § 332.1(b).[1] AB 265 also authorized the Commission to establish an accounting procedure to "track and recover the reasonable and prudent costs of providing electric energy to retail customers" that are "unrecovered through retail bills due to the application of the [rate] ceiling." (§ 332.1(c).) In addition, AB 265 requires that the "accounting procedure shall utilize revenues associated with sales of energy from utility-owned or managed generation assets to offset an undercollection, if undercollection occurs." (§ 332.1(c).)

On September 7, 2000, in response to AB 265, the Commission established a ceiling of 6.5 cents per kWh for the energy component of electric bills for SDG&E's residential, small commercial, and lighting customers in Decision (D.) 00-09-040. In accordance with § 332.1(b), this rate ceiling was made retroactive to June 1, 2000, and is to remain in place through December 31, 2002. AB 265 allows the Commission to extend the rate ceiling through December 2003, and to adjust the ceiling rate. (§ 332.1(b).)

AB 265 also directed the Commission to establish a voluntary bill stabilization plan for larger customers by allowing them to elect to have the energy component of their bills set at 6.5 cents per kWh, subject to true-

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

up after a year (former § 332.1(f)). The Commission established a voluntary program for larger customers in D.00-12-033.

Senate Bill (SB) X1 43 (Stats. 2001, Ch. 5), and subsequently, AB X1 43 (Stats. 2001, Ch. 6),[2] replaced the voluntary rate ceiling of 6.5 cents per kWh for SDG&E's larger customers in former § 332.1(f), with a mandatory frozen rate of 6.5 cents per kWh for all customers who are not subject to § 332.1(b). This frozen rate was to be made retroactive to February 7, 2001. The Commission implemented this portion of AB X1 43 in D.01-05-060. In addition, D.01-05-060 authorized SDG&E to establish a memorandum account to record the revenues and revenue shortfalls associated with this frozen rate. Since the voluntary bill stabilization program for larger customers was replaced with the frozen rate requirement, and because no customer was enrolled in the voluntary program, the Commission terminated the voluntary bill stabilization program in Ordering Paragraph 6 of D.01-09-059.

As a result of the AB 265 rate ceiling for small customers, as implemented by D.00-09-040, SDG&E accumulated an undercollection of hundreds of millions of dollars in the Energy Rate Ceiling Revenue Shortfall Account (ERCRSA).[3]

In D.01-11-029, as part of the settlement agreement resolving the reasonableness of SDG&E's procurement practices from July 1, 1999

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[2] SB X1 43 became effective on April 9, 2001. AB X1 43, which was virtually identical to SB X1 43, became effective on April 12, 2001.

[3] The ERCSA, which is a sub-account of the TCBA, was subsequently renamed the Energy Revenue Shortfall Account (ERSA) in Ordering Paragraph 5 of D.01-09-059.

through February 7, 2001, SDG&E reduced the undercollection balance in the ERCRSA by $100 million.

In D.01-01-061, the Commission directed the utilities to use all electricity resources under their control, i.e., utility-retained generation (URG), to serve existing customers at cost-based rates. SDG&E filed an application for rehearing of D.01-01-061 seeking clarification that the requirement to use URG at cost-based rates did not apply to the energy acquired in the intermediate term contracts that were entered into by SDG&E with Illinova Electric Power Marketing (Illinova), Louisville Gas & Electric Power Marketing, Inc. (LG&E), and Pacificorp. SDG&E's application for rehearing was denied in D.01-05-035. D.01-05-035 ordered SDG&E to comply with the URG order in D.01-01-061 by making the appropriate accounting adjustments to the intermediate term contracts.

On June 5, 2001, SDG&E filed a Petition for Writ of Review (Writ Petition) of D.01-01-061 and D.01-05-035 with the State Court of Appeal, while reserving its right to have its claim determined in federal court. The Writ Petition requests that the Court of Appeal issue a peremptory writ of mandate directing the Commission to correct the two decisions to specify that intermediate term contracts are the property of SDG&E's shareholders, and that the contracts may not be taken to serve SDG&E's retail customers at cost. SDG&E filed a subsequent complaint in federal District Court for declaratory and injunctive relief against the Commissioners. The complaint alleges that D.01-01-061 and D.01-05-035 constitute an unconstitutional taking, violate the Commerce clause, are preempted by federal law, and violate substantive and procedural due process.

Application (A.) 00-10-045, which was filed on October 24, 2000, seeks approval of several proposed measures related to AB 265. Among the proposed measures are converting the 6.5 cents per kWh ceiling for AB 265 customers to a frozen rate, and establishing guidelines for SDG&E's energy procurement. A.01-01-044, which was filed on January 24, 2001, requests authority to assess a surcharge of 2.3 cents per kWh on electric bills of its residential, small commercial, and street lighting customers in order to amortize the balancing account undercollection resulting from the establishment of the 6.5 cents rate ceiling in AB 265. In later testimony, SDG&E revised the surcharge to $0.00349 per kWh.[4] These two applications were consolidated in an oral ruling made at the February 16, 2001 prehearing conference held in San Diego.

Hearings were scheduled on the surcharge and related issues in an Assigned Commissioner's Ruling (ACR) dated April 30, 2001. However, on June 18, 2001, Governor Davis issued a news release announcing that DWR, SDG&E, and SDG&E's parent company, Sempra Energy (Sempra), had signed a Memorandum of Understanding (MOU) to settle numerous outstanding issues. In order to implement the MOU, several implementing decisions had to be issued by the Commission. In an ACR dated July 7, 2001, the schedule for the consideration of the surcharge, and the other issues raised in the two applications, was suspended to allow time for consideration of the MOU. The ruling noted that if the MOU was implemented, a majority of the issues in the two applications would be

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[4] This revised surcharge is based on SDG&E's forecast of the AB 265 undercollection of $222 million as of December 31, 2002, and assumes that the Commission had the authority to order SDG&E to sell the intermediate term contracts at cost to customers from February through December 2001.

moot. SDG&E noted in its July 16, 2001 motion to implement the MOU that if the implementing decisions provided for in the MOU were issued, the existing ERCRSA undercollection would be eliminated without the need for a surcharge. In an August 2, 2001 ACR, a schedule was established to allow the Commission to consider the individual components of the MOU before the end of 2001.

Although some of the implementing decisions were adopted by the Commission, the Commission rejected that portion of the MOU which would have settled the Writ Petition. Thus, in the ACR of March 28, 2002, the suspension of the surcharge issues ordered in the July 5, 2001 ruling was vacated, the scope of issues was updated, and a new schedule to process the two applications was established. Updated testimony was submitted by SDG&E and the other parties. Evidentiary hearings were held on June 24, 2002 through July 2, 2002, and the litigated issues were submitted on August 7, 2002 with the filing of the reply briefs.

SDG&E's updated testimony referenced that it had accrued a $168 million overcollection in its Transition Cost Balancing Account (TCBA) allocated to AB X1 43 customers. SDG&E indicated that it would file an advice letter seeking approval to return the overcollection to the AB X1 43 customers. SDG&E filed Advice Letter 1405-E on May 10, 2002. The advice letter requests expedited approval to return to AB X1 43 customers the $168 million overcollection in the TCBA as of March 31, 2002, including accrued interest. SDG&E seeks to return the balance over a 30-month amortization through a line-item credit on the customer bill.

In response to Advice Letter 1405-E, on November 7, 2002, the Commission issued Resolution E-3781 approving SDG&E's request to return the $168 million overcollection to AB X1 43 customers as a line item credit on their bills.

Although the surcharge issues were put on hold, the Commission took action to establish a DWR charge of 9.02 cents per kWh, for energy sold by DWR to SDG&E's retail end-use customers. This charge results in a remittance rate to recover DWR's revenue requirement and a system-average increase of 1.46 cents per kWh charged by SDG&E to its customers to collect the DWR revenue requirement. (See D.01-09-059.)

On June 14, 2002, SDG&E transmitted a letter to the Commissioners proposing that the federal litigation that it filed against the Commission regarding the intermediate term contracts be settled. Under the proposed settlement, SDG&E agrees that it will write off, and not collect from customers, $24 million of the current balance in SDG&E's Energy Revenue Shortfall Account (ERSA). The proposed settlement also provides that the $173 million in profits from the intermediate term contracts that SDG&E accrued prior to the Commission adoption of D.01-01-061, will remain the property of SDG&E for the sole account of its shareholders. The proposed settlement also provides that the $199 million in profits from the intermediate term contracts that SDG&E has booked to the benefit of ratepayers since the Commission adoption of D.01-01-061, or will book pursuant to the settlement, will remain with ratepayers. A copy of this proposed settlement is appended to this decision as Attachment 1.

Comments on the proposed settlement of the federal litigation were solicited in an assigned Commissioner's ruling dated June 18, 2002. Comments on the proposed settlement were filed by the City of San Diego, the Utility Consumers' Action Network (UCAN), and the Office of Ratepayer Advocates (ORA). An opportunity for the public to comment on the surcharge and the proposed settlement of the federal litigation was provided at public participation hearings in San Diego on August 14, 2002, and in Carlsbad on August 28, 2002. This Decision adopts the proposed settlement.

B. Background Of Accounts

SDG&E currently has three accounts which deal with URG costs, Competition Transition Charge (CTC) revenues, and the AB 265 revenue shortfall. These three accounts are the TCBA, the Purchased Electric Commodity Account (PECA), and the ERSA.

The TCBA was originally established in January 1998 to calculate SDG&E's transition cost recovery, consistent with AB 1890.[5]. When SDG&E's rate freeze transition period ended on June 30, 1999, the TCBA was revised to reflect only the recovery of ongoing transition costs.

The ERSA, formerly called the Energy Rate Ceiling Revenue Shortfall Account (ERCRSA), records the difference between the 6.5 cents/kWh statutory electric commodity rate ceiling and the actual commodity rate calculated by SDG&E's Schedule EECC (Electric Energy Commodity Cost). That is, the ERSA keeps track of the AB 265 undercollection. [6](See D.00-09-040 at p. 7; D.01-09-059 at pp. 40-41.) The applicable portion of the CTC revenues and other overcollections recorded to the TCBA are used to partially offset the AB 265 undercollection in the ERSA.

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[5] AB 1890, Stats. 1996, Ch. 854.

[6] A separate ERSA was established in D.01-09-059 to account for any revenue shortfall incurred as part of AB X1 43, which applied the 6.5 cent/kWh frozen rate to larger customers.

The PECA (Purchased Electric Commodity Account), which was formerly called the ISO/PX Balancing Account, was established in July 1999 to provide for the full recovery of all of SDG&E's power procurement costs, i.e., PX (California Power Exchange) and ISO (California Independent System Operator) related costs, on behalf of bundled service customers. (See D.99-10-057, pp. 24-25.) As a result of D.01-01-061, SDG&E's URG costs were included in the PECA. Currently, SDG&E's URG costs are recovered through the PECA from the residual revenues from the Schedule EECC rates after disbursements are made to DWR for the power it procures for SDG&E's retail customers.

Prior to January 1998, SDG&E's energy costs were entered into SDG&E's Energy Cost Adjustment Clause (ECAC) balancing account and were balanced against the revenues from the ECAC portion of the AB 1890 frozen rates. The ECAC balancing account was terminated on December 31, 1997 because the AB 1890 transition period began. Once the transition period began, the energy costs above the PX market-clearing price were to be booked to the TCBA.

However, the TCBA did not begin on January 1, 1998 because the commercial operation of the ISO and the PX was delayed. Since the PX did not begin operations until April 1, 1998, for the first three months of 1998, SDG&E continued to acquire energy from resources other than the PX to serve its customers. During that three-month period, the Implementation Delay Memorandum Account (IPIDMA), was established by the Commission to record, among other things, fuel and purchased power costs for those three months.

Once the ISO and the PX began operation in March 1998, the mandatory bid/buy took effect and the IPIDMA was terminated. In

D.99-04-058, the Commission granted SDG&E's request to transfer the balance in the IPIDMA to the TCBA.

C. The Intermediate Term Contracts

In late 1996 and early 1997, SDG&E entered into power purchase contracts with: (1) Illinova; (2) LG&E; and (3) PacifiCorp. These contracts are referred to in this proceeding, and in the federal litigation, as the intermediate term contracts.

The Illinova contract was executed on October 22, 1996, and provides for the sale of power for three years from January 1, 1997 to December 31, 1999. The contract provides for the sale of system firm capacity and energy of 275 megawatts (MW) in 1997, 200 MW in 1998, and 200 MW in 1999, at the respective prices of 1.47, 1.59, and 1.7 cents/kWh.

The PG&E contracts consist of two contracts for the sale of power for 1998, 1999, 2000 and 2001. These contracts were executed on March 11, 1997. The first contract provides for the sale of energy of 50 MW per year for 1998 through the end of 2001 at the price of 1.975 cents/kWh per year. The second contract provides for the sale of energy of 100 MW per year for 1998 through the end of 2001 at the price of 1.95 cents/kWh per year. LG&E assigned both of the contracts to Avista Energy, Inc. (Avista) in October 1998.

The PacifiCorp contracts consist of four contracts for the sale of power for 1998, 1999, 2000 and 2001. These contracts were executed on March 24, 1997. The contract provides for the sale of firm energy of 100 MW in 1998, 1999, 2000, and 2001 at the price of 1.645 cents/kWh in each year.

III. Position of the Parties

A. SDG&E

SDG&E seeks resolution of the following issues in this proceeding: (1) whether the intermediate term contracts entered into by SDG&E in late 1996 and early 1997 are shareholder assets; (2) authorization to impose a surcharge of 0.00349 cents/kWh for two years, and to continue the collection of the CTC; (3) to determine which customers of SDG&E should be responsible for the repayment of the AB 265 undercollection. Due to the size of the undercollection, SDG&E asserts that the Commission must act immediately to manage the undercollection and establish a plan to amortize the balance.

The issue of refunding the AB X1 43 balancing account overcollection of approximately $168 million was presented to the Commission in Advice Letter 1405-E, and is pending before the Commission in a draft resolution and a draft alternative resolution.

SDG&E contends that the fundamental factual issue is whether the three intermediate term contracts are shareholder assets or not. SDG&E asserts that they are, and that the Commission cannot confiscate the profits from these contracts without providing SDG&E's shareholders with just compensation.

SDG&E asserts that the status of the intermediate term contracts as shareholder assets became an issue only after AB 265 was enacted because it appeared the Commission was going to require SDG&E to use those contracts to reduce the AB 265 undercollection. SDG&E asserts that such use is inconsistent with the contracts' character as shareholder assets.

SDG&E contends that the restructuring of the electric industry, as implemented by AB 1890, created substantial risk to SDG&E's

shareholders of stranded costs. According to SDG&E, the risk of stranded costs would come from unrecovered, uneconomic costs in the following manner:

> "[D]uring the four-year AB 1890 transition period (1998 through 2001) the differential between SDG&E's revenues under the frozen rate and SDG&E's costs of electric service would be calculated on a monthly basis. If in any month during the transition period SDG&E's costs to provide electricity exceeded the revenue it collected from the frozen rates it charged its customers, SDG&E would have no excess revenues (called 'headroom') to pay down its transition (or net uneconomic) costs. If SDG&E's revenues from frozen rates exceeded in any month SDG&E's costs of providing electricity to customers, that excess revenue would be headroom and allocated to paying down SDG&E's transition costs. If SDG&E was unable to pay off all its transition costs prior to March 31, 2002, then SDG&E shareholders, not ratepayers, would incur the entire loss resulting from those unrecovered, net uneconomic costs, denominated as 'stranded costs.' Thus, SDG&E shareholders bore all risk in the event transition costs were not fully recovered." (SDG&E Opening Brief, p. 16, footnotes omitted.)[7]

SDG&E asserts that it was concerned about its ability to recover all of its stranded, uneconomic costs in the time permitted by the Legislature. The primary factor in determining whether there would be headroom during the transition period was SDG&E's monthly variable cost of providing energy. This cost was based on the price of natural gas to fuel electric generation, and the market price of electricity. Under AB 1890, the market price of electricity would be the market-clearing price charged by the PX to SDG&E under the mandatory bid/buy. Thus, the full recovery

[7] SDG&E points out that ORA concurred with SDG&E witness William Reed's description" of "…the intricacies of AB 1890, and how SDG&E's hedging addressed risks under AB 1890." (See Ex. 121, p. 28.)

of transition costs by SDG&E was highly dependent on the price that SDG&E would have to pay the PX for power each month.

During the summer of 1996, SDG&E forecast its shareholders' stranded cost exposure at approximately $1.7 billion. SDG&E's management sought to minimize this exposure to its shareholders. Management determined that it could hedge this risk by negotiating attractively priced power purchase contracts so that it could create additional headroom to accelerate the recovery of transition costs.[8] SDG&E pursued the hedging strategy to protect its shareholders from potential losses.

SDG&E's Board of Directors, at Board meetings in October and November 1996, considered and approved the strategy of acquiring power purchase contracts to hedge the shareholder price risk. In October 1996, the Board was presented with a three-year contract with Illinova to purchase power for 1997, 1998 and 1999. It was made known to the Board that the power purchased for the first year of the Illinova contract was to supply a portion of SDG&E's short term power requirements for that year, and that the power for the second and third years was to implement SDG&E's shareholder price risk hedging strategy. SDG&E's management

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[8] According to SDG&E, if actual PX energy prices turned out to be less than the prices that SDG&E forecast for the PX, the headroom would be greater than anticipated thereby accelerating the payment of transition costs, even if shareholders lost some money on the power purchase contracts because they paid more for the power than they received for selling the power to the PX. However, if actual PX energy prices turned out to be more than the prices that SDG&E forecast for the PX, the profit from the power purchase contracts (bought below anticipated PX price, sold to PX above the contract price) would be used to reduce shareholders' exposure by crediting those profits to the TCBA, thereby effectively offsetting the reduction in anticipated headroom that would otherwise occur due to the increased PX prices.

also requested that the Board authorize execution of "up to 650 MW per year of supplemental purchased power agreements for the years 1998 through 2001 to hedge against energy market price changes." At the October 1996 Board meeting, the Board authorized SDG&E to pursue the hedging strategy by authorizing that portion of the Illinova contract for 1998 and 1999, and further authorizing SDG&E to execute more contracts up to an additional 650 MW per year for 1998 through 2001 to "hedge against energy market price changes."[9] (See Ex. 101, pp. 12-13, Attachments D-E.)

At the November 1996 Board meeting, SDG&E management presented the purchase power contracts with LG&E and Pacificorp. According to SDG&E witness Reed, the sole reason for these contracts was to hedge the shareholder price risk resulting from the frozen electric rates instituted by AB 1890, and had nothing to do with acquiring power to serve SDG&E's customers. The Board authorized the execution of those two contracts. (Ex. 101, p. 14, Att. F-G.)

SDG&E contends that although D.95-12-063, as modified by D.96-01-009, precluded SDG&E from entering into power purchase contracts for the purpose of supplying power for SDG&E's full service customers while the PX was in operation, that decision did not preclude SDG&E from acquiring power for other reasons, such as hedging the shareholders' AB 1890 price risk. SDG&E contends that other than the 1997 portion of the Illinova contract, none of the intermediate term contracts were entered into

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[9] SDG&E asserts that there was no regulatory or legal obligation requiring SDG&E to bring to the Commission's attention, or to receive authorization from the Commission for, power contracts entered into by SDG&E on behalf of shareholders.

by SDG&E, or approved by its Board, for any purpose other than as shareholder hedges against the AB 1890 price risk. Since the contracts were acquired and used to hedge the shareholders' potential losses, SDG&E asserts that the contracts had nothing to do with the provisioning of utility service to its customers.

SDG&E contends that from the time the intermediate term contracts were acquired from the outset, until the issuance of D.01-05-035, SDG&E treated the intermediate term contracts consistently as shareholder assets. SDG&E contends that the ratepayers did not bear any of the risks related to the contracts, and that SDG&E shareholders bore the administration costs related to the contracts until the issuance of D.01-01-061.

SDG&E witness Lee Schavrien testified that for calendar year 1997, SDG&E's energy costs were entered into SDG&E's ECAC balancing account. The 1997 portion of the Illinova contract, which SDG&E asserts was to provide power to SDG&E's bundled service customers in 1997, had its costs booked to the ECAC. Schavrien states that this was the appropriate regulatory accounting treatment in 1997 because the Illinova energy was required by SDG&E to provide utility service to its customers.

Since the PX did not begin operations until April 1, 1998, SDG&E could not obtain energy from the PX as mandated by AB 1890 and Commission decisions. For the first three months of 1998, SDG&E continued to acquire energy from resources other than the PX to serve its customers. During the first three months of 1998, SDG&E used the power from the intermediate term contracts to supply SDG&E's short term requirements. The costs associated with those contracts for those three months were booked to the IPIDMA. SDG&E asserts that this use was consistent with SDG&E's intent to use these contracts as a hedging instrument because the use of the contracts created more headroom than would have been created if SDG&E went out and purchased new supplies for customers in that period. Contrary to the arguments of the other parties, SDG&E asserts that the use of the contracts during the first three months of 1998 to provide energy to retail customers, did not amount to a dedication of these assets for utility customers. Even if the Commission finds that a dedication occurred, SDG&E contends that the dedication should be limited to those three months.

SDG&E contends that because the intermediate term contracts are shareholder assets, SDG&E accounted for these contracts in a manner different from the other generation assets recorded to the TCBA.[10] In any month when the revenues from the intermediate term contracts exceeded the costs, the net profits were booked in the cost portion of the TCBA as a negative cost, which reduced the positive current costs recorded in the TCBA for that month. If there was no net profit from the intermediate term contracts, nothing would be booked to the TCBA until there were sufficient profits generated in future months to offset all prior losses.[11] By crediting only net profits to the TCBA, SDG&E ensured that shareholders, and not ratepayers, would incur any losses from the transactions. The witness for the City of San Diego agreed that this would be the accounting result.

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[10] According to SDG&E, all of the costs and revenues of other generation assets were recorded in the TCBA.

[11] SDG&E witness Schavrien stated that SDG&E chose to use this method for the intermediate term contracts, instead of taking all profits and losses below the line, because crediting net profits against transition costs in the TCBA accomplished the objective of using the contracts to hedge shareholder energy price risk related to the recovery of transition costs.

SDG&E's first Annual Transition Cost Proceeding (ATCP) application, A.98-09-009, was filed on September 1, 1998. The purpose of the ATCP was to allow the Commission to determine the reasonableness of all costs and revenues booked to the TCBA for the period January through June 1998. SDG&E's testimony in the ATCP identified the intermediate term contracts and described how the net profits were being applied to reduce the transition costs. (Ex. 107, Att. 1; See 15 R.T. 1406-1407.) According to SDG&E, the Energy Division conducted an audit or review of SDG&E's TCBA entries for the six-month record period. The Energy Division report stated that it had performed a "regulatory review" of SDG&E's TCBA expenses, and its compliance with Commission decisions and the Public Utilities Code. (Ex. 107, Att. 2; See D.00-02-048, fn. 2, p. 3.) Page 10 of the Energy Division report stated in part:

> "SDG&E also included the profit from Purchased Power contracts that were not in rates prior to December 20, 1995. Energy Division could not find any Commission decisions that required SDG&E to record post-restructuring Purchased Power contract profits into its TCBA. SDG&E has since decided to remove the profit associated with these contracts from its TCBA." (Ex. 107, Att. 2, p. 10.)

SDG&E contends that at the urging of the Energy Division auditor assigned to SDG&E's first ATCP, SDG&E agreed to reverse all of the accounting entries related to the intermediate term contracts out of the TCBA. SDG&E witness Schavrien testified that in his conversations with the Energy Division auditor, the auditor agreed with him that the consequence of reversing the intermediate term contract net profits from the TCBA would be that the profits and losses from those contracts would go below the line directly to shareholders. SDG&E witness Thomas

Whelan also spoke with the Energy Division auditor, and informed him that the removal of the profits from the TCBA would result in below the line treatment.

ORA's March 1999 report on SDG&E's first ATCP acknowledged that the Energy Division report had been completed, and that ORA had reviewed it. Nowhere in ORA's report did ORA criticize or disagree with the Energy Division report addressing SDG&E's accounting treatment of the intermediate term contracts.

SDG&E contends that the reversal of entries from the TCBA was reported in the Energy Division auditor's report, which was entered into evidence in the ATCP proceeding and considered by the Commission in SDG&E's first ATCP decision, D.00-02-048. (See D.00-02-048, p. 3.) SDG&E asserts that D.00-02-048 impliedly made a distinction between purchase power contracts that were eligible for transition cost recovery, and those that were not, i.e., the intermediate term contracts, by specifically referring to "eligible purchase power contracts." (D.00-02-048, p. 42.)

The TCBA accounting reversal took place in March 1999. SDG&E removed the intermediate term contract net profits, approximately $25.8 million, booked to the TCBA through January of 1999. Since there were no other regulatory accounts to show how SDG&E was using the intermediate term contracts to hedge the price risk created by AB 1890, SDG&E began to record the contracts below the line. This accounting treatment continued from February 1999 through January 2001. SDG&E contends that this accounting is consistent with the treatment of the intermediate term contracts as shareholder assets.

SDG&E's second ATCP for SDG&E was to allow the Commission to determine the reasonableness of all costs and revenues booked to SDG&E's

TCBA for the record period of July 1998 through June 1999. SDG&E witness Schavrien testified that during the second ATCP, ORA's auditor was provided with workpapers demonstrating the removal of the intermediate term contracts from the TCBA in March 1999. SDG&E contends that ORA's report in the second ATCP found that "… the entries made to the TCBA during the record period July 1, 1998 through June 30, 1999 are reasonable." (Ex. 107, Att. 3) In the Commission's second ATCP decision, D.00-10-048, the Commission concluded that "SDG&E's entries to its TCBA for the record period July 1, 1998 through June 30, 1999 (record period) are reasonable." In ordering paragraph 1 of D.00-10-048, the Commission stated that SDG&E's entries to its TCBA "for the record period July 1, 1998 through June 30, 1999 (record period) are adopted as set forth herein." (D.00-10-48, pp. 8-9.)

SDG&E contends that neither ORA nor the Energy Division objected to SDG&E's accounting of the intermediate term contracts in either of the two ATCP proceedings. Both of the ATCP decisions were consistent with treatment of the intermediate term contracts as shareholder assets.[12] SDG&E asserts that it consistently treated the intermediate term contracts as shareholder assets until the Commission precluded that treatment in D.01-05-035.

SDG&E witness Schavrien testified that SDG&E began to treat the intermediate term contracts in a manner inconsistent with their use as shareholder assets only after the Commission issued D.01-01-061, and SDG&E's application for rehearing of that decision was denied in

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[12] SDG&E states that it is not its position that the two ATCP decisions determined that the intermediate term contracts were shareholder assets.

D.01-05-035. D.01-01-061 ordered the three investor-owned utilities to use their URG to serve existing customers at cost based rates. SDG&E objected to the treatment of the intermediate term contracts in this manner because the contracts were shareholder assets. Selling the power from these contracts at cost to SDG&E's customers would deprive SDG&E's shareholders of any profits realized by selling the contracts at market prices.

D.01-05-035 ordered SDG&E to make the accounting adjustments so that the power from the intermediate term contracts were charged to customers at cost. SDG&E's Advice Letter 1328-E, filed on May 14, 2001, stated that SDG&E would make accounting adjustments to its balancing accounts to ensure that its customers would only pay cost for the power from February 1, 2000 forward. An accounting adjustment of $76.7 million was made to reverse the accounting that SDG&E had been making from February 1, 2001 through April 2001. From May 2001 through December 2001, as ordered by D.01-05-035, the intermediate term contracts were booked to the PECA at their actual cost.

In response to the City of San Diego's suggestion that SDG&E could have contributed the intermediate term contracts to ratepayers once the AB 1890 rate freeze was terminated, SDG&E asserts that this would have been contrary to management's fiduciary obligations to the corporation.

The other parties contend that the profits from the intermediate term contracts should be applied to offset the undercollection in AB 265 pursuant to §332.1(c). SDG&E asserts that the evidence demonstrates that the intermediate term contracts were not intended to be subject to AB 265, and that substantial legal precedents preclude the intermediate term contracts from being subject to AB 265.

SDG&E witness Schavrien testified that SDG&E never proposed to the Governor, the Legislature, or anyone else, that shareholder assets such as the intermediate term contracts be used to offset the undercollections caused by AB 265. When the Legislature was considering the adoption of AB 265, SDG&E had already reversed the net profits from the intermediate term contracts out of the TCBA, and was accounting for them below the line as shareholder assets. Since SDG&E considered the intermediate term contracts to be shareholder assets, SDG&E never discussed these contracts with the Governor and the Legislature. In addition, the first ATCP decision had already been issued, which SDG&E claims confirmed that the Commission was aware of the intermediate term contracts, and that SDG&E was going to remove the net profits from these contracts from the TCBA.

When SDG&E witness Schavrien made presentations regarding AB 265 to the Assembly's Utilities and Commerce Committee, he provided a package to the Committee that identified the URG assets that SDG&E believed should offset the AB 265 undercollection. SDG&E identified these assets as the Public Service of New Mexico contract, the Portland General Electric contract, the qualifying facility contracts, and San Onofre Nuclear Generating Station (SONGS). The list did not include the intermediate term contracts, as shown in Attachment 12 of Exhibit 108.

In sum, SDG&E asserts that since the intermediate term contracts are shareholder property, as opposed to assets dedicated to public use, any attempt by the Legislature or the Commission to apply the revenues from these contracts to the AB 265 undercollection without just compensation would amount to a taking and would violate the Fifth and Fourteenth Amendments to the United States Constitution. SDG&E asserts that the intermediate term contracts were never dedicated to public use, nor were they ever necessary or useful in the provisioning of utility service to the public. Thus, any attempt to use the revenues from the contracts to offset the AB 265 undercollection would amount to a taking.

SDG&E contends that the Commission should interpret the requirement in §332.1(c) of utilizing "revenues from utility-owned or managed generation assets to offset an undercollection," to apply only to those revenues historically recorded in the TCBA. That is, the §332.1(c) offset should only apply to assets dedicated to public use, and that it should not include the revenues from the intermediate term contracts which are shareholder assets.

According to SDG&E, the AB 265 undercollection on March 31, 2002 was $338 million, and on May 31, 2002 it was $324.7 million. SDG&E forecasts that the AB 265 undercollection, as of December 31, 2002, will be approximately $222 million. This reduction is accomplished, in part, through the end of year 2002 transfer to the TCBA of the proportionate share of the PECA overcollection, as described by SDG&E witness Schavrien in Exhibit 107. However, if the Commission lacks the authority to order SDG&E to sell the intermediate term contracts at cost to customers from February through December 2001, SDG&E contends that this forecast of the undercollection would be artificially low.

During the course of these proceedings, SDG&E has recommended that to recover the forecasted undercollection of $222 million, the Commission should authorize a .00349 cent per kWh surcharge for two years and continue the recovery of the CTC until December 31, 2004. At the end of the two-year period, the AB 265 undercollection would be eliminated, the surcharge would end, and the CTC rate would only be used to recover ongoing transition costs. Consistent with this recommendation, SDG&E proposed to adjust the surcharge, to be effective January 1, 2004, by an advice letter filed before the end of 2003, to reflect the forecasted December 31, 2003 balance in the AB 265 undercollection.

SDG&E has proposed that the surcharge be included as a separate line item on the bills of all customers subject to AB 265, including medical baseline and CARE customers, but excluding direct access customers. SDG&E believes that medical baseline and CARE customers should be responsible for the surcharge because they benefited from the AB 265 rate ceiling. All AB 265 customers, bundled and direct access customers would be responsible for the CTC charge.

SDG&E witness Schavrien provided testimony about what was being done to reduce the AB 265 undercollection. He stated that SDG&E has, and is continuing to apply 70% of all PECA overcollections to reduce the AB 265 undercollection. The PECA overcollection is being applied to the AB 265 undercollection because the PECA reflects the difference between SDG&E's electric commodity revenues charged under Schedule EECC (Electric Energy Commodity Cost) and SDG&E's recorded energy costs, after deducting revenues collected for and passed on to DWR for the energy it provides.[13] The 70% reflects the approximate percentage of SDG&E's bundled service customer usage who are subject to AB 265.

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[13] According to SDG&E, it charges its retail customers a commodity system average rate of 7.96 cents per kWh through its Schedule EECC for the total amount of energy delivered. This system average rate is charged for the energy provided by SDG&E's URG and the net short energy provided by DWR. When SDG&E's system average rate of 7.96 cents per kWh was developed, it was based on a DWR rate which was higher than the rate DWR now requires to recover its

SDG&E is also using the CTC rate to reduce the AB 265 undercollection. The CTC revenue requirement for 2002 is set at $115 million, the same amount that was used in 2001. SDG&E applies 60% of the CTC revenues to reduce the AB 265 undercollection, while the remaining 40% of the CTC revenues are allocated to customers not subject to the AB 265 legislation, i.e., the AB X1 43 customers. The 60% represents the approximate percentage of SDG&E's customer usage subject to AB 265 compared to all of SDG&E's electric customer usage, including direct access customers.

SDG&E and the other parties disagree about what monies could be used to reduce the undercollection after December 2001. ORA and UCAN believe that SDG&E will continue to incur overcollections in SDG&E's PECA account into 2003. SDG&E contends that this assumes that SDG&E's current system average rate will not change, which may not be the case. SDG&E believes that if the Commission decides to true-up SDG&E's DWR and URG related commodity rates with their respective actual revenue requirements in January 2003,[14] it is likely that the current excess revenues in the PECA will diminish or be eliminated, thus reducing the amount that can be used to reduce the AB 265 undercollection. ORA's

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revenue requirement. Since SDG&E's system average rate has not been changed, additional residual revenues have been generated which are included in the PECA overcollection. The other factor that contributes to the PECA overcollection is that SDG&E's URG costs have been below the 6.5 cent per kWh rate that was imputed into SDG&E's current system average rate.

[14] SDG&E states that its electric commodity rates are currently being examined in the URG cost recovery (A.02-01-015), the procurement rulemaking (R.01-10-024), and the DWR revenue requirement allocation (A.00-11-038). SDG&E contends that it is inappropriate to assume at this time that there will be substantial funds generated from either the CTC rate or PECA overcollections in 2003 that will be available to reduce the AB 265 undercollection.

witness agreed that once the Commission establishes a new retail electric commodity rate for SDG&E in 2003, that the contributions from the PECA to the AB 265 undercollection will not be significant.

SDG&E notes that the $115 million CTC revenue requirement may no longer be available to reduce the AB 265 undercollection. SDG&E has proposed in Rulemaking (R.) 02-01-011, the direct access proceeding, that for 2003, the CTC revenue requirement be used solely for the recovery of eligible ongoing transition costs. If this proposal is adopted in that proceeding, the CTC rate would no longer be available to reduce the AB 265 undercollection.

SDG&E also asserts that the other sources of potential funds that ORA and UCAN rely on to reduce the undercollection are questionable as well. ORA expects that the AB 265 undercollection will be reduced by $130 million because the Commission will rule in its favor that the intermediate term contracts are not shareholder assets. SDG&E has already reflected the overcollections from the tree trimming accounts through December 31, 2002 in its forecasted undercollection of $222 million. SDG&E also contends that the revenues from SONGS' Incremental Cost Incentives Procedure (ICIP) will not be available to offset the AB 265 undercollection beginning in 2004, and that the Commission rejected the proposal to revisit the treatment of SONGS in D.02-01-063. SDG&E also contends that UCAN's request to modify the interest rate applicable to the AB 265 balancing account is contrary to years of Commission precedent.

UCAN's expectation that there may be a $120 million refund resulting from an adjustment of DWR revenues is extremely speculative because it is unknown whether it will be available to reduce the AB 265 undercollection. Although the Commission has the discretion over how this potential refund is to be used, SDG&E believes that the Commission will use the refund to offset SDG&E's allocation of DWR's revenue requirements for 2003 because it appears that SDG&E's allocation of DWR's revenue requirement for 2003 will be greater than SDG&E's 2002 allocation. If the potential refund from DWR is used to offset the AB 265 undercollection, SDG&E contends that only 70% of the $120 million should be used to pay down the AB 265 undercollection and that the remaining 30% should apply to SDG&E's large customers.

SDG&E contends that since SDG&E's AB 265 bundled customers received most of the benefits under AB 265, only those bundled customers, and not direct access customers, should incur the AB 265 surcharge. However, SDG&E proposes that direct access customers continue to be responsible for paying the CTC rate.

SDG&E believes that there are approximately 4200 current direct access customers who received AB 265 benefits amounting to approximately $21.4 million. However, given the computer and billing limitations of SDG&E, it would be extremely difficult to identify, for each current direct access customer, the amount of AB 265 benefits that they received. Although SDG&E is not proposing that current direct access customers be responsible for the proposed surcharge, SDG&E agrees that direct access customers should be responsible for some of the AB 265 undercollection by paying the CTC rate for 2003 and 2004. Due to the migration of customers from bundled service to direct access, and in and out of SDG&E's service territory, SDG&E contends that the collection of the full amount owed by each customer who benefited from AB 265 is practically impossible. Thus, according to SDG&E, its generalized approach for recovering the AB 265 undercollection is the only feasible option. SDG&E states that UCAN's witness Marcus agreed that although many of SDG&E's direct access customers should be responsible for at least some portion of the AB 265 undercollection, properly apportioning the undercollection among SDG&E's direct access customers would be extremely difficult given the limitations of SDG&E's computer and billing systems. (13 R.T. 1291-1292, 1320.)

SDG&E witness Schavrien testified that the Commission has effectively converted SDG&E's electric commodity rate into a frozen or fixed rate as a result of D.01-09-059. In that decision, a fixed retail commodity system average rate of 7.96 cents per kWh was established. Embedded in the system average rate is 6.5 cents per kWh for energy provided from SDG&E's URG. The remaining component of the charge reflects the rate assigned for energy purchased by DWR. Other Commission proceedings are looking at SDG&E's retail commodity system average rate, and SDG&E believes that the resulting new electric rates will be effective January 1, 2003. SDG&E recommends that the statutory ceiling under AB 265 should end, effective January 1, 2003, so that the new rate can be fully implemented.

Contrary to UCAN's assertion that the 98% figure that SDG&E uses in the proposed settlement of the federal court litigation is fictional, SDG&E maintains that the percentage figure must be viewed in the context of what occurred during the time period from June 1, 2000 through the end of 2001.

B. City of San Diego

The City of San Diego asserts that SDG&E has the burden of proving that the intermediate term contracts are not "utility-owned or managed generation assets" within the meaning of AB 265 and §332.1, and are not "utility retained generation" as defined by the Commission in D.01-01-061. SDG&E has not met that burden. The City of San Diego contends that the documents pertaining to the power purchase contracts demonstrate that the generation that was being purchased was to meet the needs of SDG&E's retail customers, and not to hedge shareholder price risk. The City of Diego contends that D.96-12-088 and D.97-12-021 prohibited SDG&E from entering into bilateral power purchase contracts outside of the PX for any purpose. Thus, the intermediate term contracts are utility-owned or managed generation assets within the meaning of AB 265, that the contracts are URG within the meaning of D.01-01-061, and the revenues from the intermediate term contracts must be used to offset the undercollection in SDG&E's AB 265 balancing account as required by the legislation.

The City of San Diego argues that at the time of drafting or voting on AB 265, the Legislature did not know of the three intermediate term contracts. These contracts were identified for the first time when A.00-10-045 was filed, which took place after the enactment of AB 265. Subsequent testimony and hearings reveal that the intermediate term contracts were providing power to SDG&E at 1/10th of the then-prevailing wholesale market costs, and that SDG&E was realizing hundreds of millions of dollars in revenues and profits from selling this power into the power market.

The City of San Diego contends that the past accounting used by SDG&E for its generation assets is irrelevant to whether the asset is under SDG&E's ownership and control. Even if the intermediate term contracts are considered to be shareholder assets, the City of San Diego asserts that there would be no unconstitutional taking if the revenues from the intermediate term contracts were used to offset the AB 265 undercollection. The City of San Diego asserts that the Legislature has plenary authority to enact legislation governing the regulation of public utilities, including the disposition of generation under the control of SDG&E.

The City of San Diego contends that §332.1 prohibits an adjustment in the AB 265 rate ceiling until the accounting procedure mandated by AB 265 has been fully and properly implemented by the Commission, and such an adjustment is found to be in the public interest. This implementation includes using the revenues from the utility-owned or managed generation assets, which means using all the revenues from the intermediate term contracts to offset any undercollection of wholesale electric costs incurred by SDG&E on behalf of those customers. In addition, D.01-01-061 requires that all generation under the control of SDG&E be provided at cost to its customers.

The City of San Diego contends that after properly accounting for all the costs and revenues in the ERSA account, including accounting for the intermediate term contracts, SDG&E's request for a revenue shortfall surcharge should be rejected and no adjustment of the AB 265 rate ceiling is necessary. In addition, until it is determined in this proceeding that SDG&E has complied with AB 265, there is no basis for the Commission to settle the federal litigation with SDG&E.

C. California Farm Bureau Federation

The California Farm Bureau Federation (Farm Bureau) is interested in ensuring that the TCBA overcollection of $168 million is refunded to AB X1 43 customers. Resolution E-3781 has in fact assigned this amount as a credit to the AB X1 43 customers, as requested in SDG&E's Advice Letter 1405-E

The Farm Bureau states that SDG&E witness Schavrien provided additional direct testimony at the hearing regarding the $168 million TCBA overcollection. Schavrien testified that this overcollection did not include the AB 265 customers' share of the intermediate term contract revenues. Instead, the recommended refund of $168 million only includes the AB X1 43 customers' 30% share ($23 million) of the $77 million in intermediate term contract revenues. Aside from the $23 million, the $168 million overcollection is made up of $104 million in excess URG revenues booked to the TCBA, and $41 million in excess CTC revenues collected from AB X1 43 customers. (11 R.T. at pp. 1083, 1110-1113.)

The Farm Bureau requests that the Commission include in this decision a finding that SDG&E properly calculated the $168 million refund for AB X1 43 customers in Advice Letter 1405-E, and that the overcollection should be refunded these customers as recommended by SDG&E in that advice letter.

The Farm Bureau agrees with the other customer representatives that the revenues associated with the sales of energy from utility-owned or managed generation assets must be provided at cost to utility customers. However, the Farm Bureau disagrees with the assertions of the City of San Diego, ORA, and UCAN that "all" of the revenues associated with the intermediate term contracts must be used to offset the AB 265 undercollection. The Farm Bureau contends that §332.1 requires only that the Commission "utilize revenues associated with sales of energy from utility-owned or managed generation assets to offset an undercollection...." It is incorrect to presume that all of the revenues associated with the intermediate term contracts must be allocated only for the benefit of the AB 265 customers. Accordingly, the Commission must allocate a portion of the revenues from the intermediate term contracts to the AB X1 43 customers. Such an allocation would be consistent with the equitable process of allocating URG costs and revenues to all customers.

D. Federal Executive Agencies

The Federal Executive Agencies (FEA) point out that the City of San Diego and UCAN have stated that AB 265 requires that "all" profits from the intermediate term contracts must be applied to reduce the balance in the ERSA, and that ORA asserts that the net profits from the intermediate term contracts must be used to offset the AB 265 undercollection. FEA contends that nowhere in AB 265 does it specify that "all" revenues associated with the sales of energy from utility-owned or managed generation assets must be used to offset an undercollection. FEA asserts that the Legislature intended, by requiring an "accounting procedure," that the revenues allocable to the AB 265 customers be used to reduce the undercollection resulting from the AB 265 ceiling, and that the revenues allocable to non-AB 265 customers must be allocated to non-AB 265 customers.

FEA recommends that the Commission make clear in this decision that the accounting procedures required by AB 265 mandate that an appropriate amount of the profits from the intermediate term contracts be allocated to non-AB 265 customers. FEA points out that this is consistent with D.01-09-059 at page 28, where the Commission directed SDG&E to allocate its URG to all customer classes, not just to small customers.

E. Office of Ratepayer Advocates

In order to fully implement AB 265, ORA asserts that $130.64 million in intermediate term contract profits that were accrued from June 2000 through January 2001, plus interest, should be booked to the PECA. In addition, the $150.76 million in profits from February 2001 through December 2001 that were already credited to ratepayers pursuant to D.01-01-061 should be affirmed. ORA contends that with the intermediate term contract profits properly booked to the PECA, the expected PECA overcollection, and anticipated 2003-2004 CTC revenues, the AB 265 undercollection can be recovered without SDG&E's proposed rate surcharge.

ORA takes the position that the net revenues and profits associated with the intermediate term contracts must be used to offset the AB 265 undercollection because those contracts are "utility-owned or managed generation assets" subject to §332.1. ORA asserts that nothing in §332.1 qualifies or defines "utility-owned or managed generation assets" so as to exclude the intermediate term contracts from offsetting an undercollection.

ORA asserts that SDG&E has failed to make a compelling argument as to why the intermediate term contracts should be excluded from the provisions of AB 265. SDG&E first raised the claim that the intermediate term contracts were shareholder assets when SDG&E applied for rehearing of D.01-05-035. It was only after the passage of AB 265 did SDG&E attempt to convince the Commission that the intermediate term contracts should be considered shareholder assets. The Commission has never found, explicitly or implicitly, that the intermediate term contracts are shareholder assets.

SDG&E's claim that the intermediate term contracts are shareholder assets is contrary to the actions which SDG&E took, and to Conclusion of Law 33 in the Preferred Policy Decision (D.95-12-063, as modified by D.96-02-009 [64 CPUC2d 1, 91]). That Conclusion of Law states: "Utility property, such as a generation asset, that has received revenue recovery through rates is used and useful in the performance of the utility's duties to the public until such time as the Commission determines otherwise."

SDG&E admits in its opening brief at page 28 that it applied for and received dollar-for-dollar revenue recovery of the contract costs through the IPIDMA for the period between January and March 31, 1998, as well as through the ECAC for periods prior to 1998. Since SDG&E received recovery for these contracts, ORA contends that the contracts were used and useful until the Commission decides otherwise.

SDG&E's assertion that the contracts were shareholder assets is also contrary to the restrictions in the Preferred Policy Decision. The Preferred Policy Decision required the utilities to purchase all of their energy needs from the PX and to sell all of their generation into the PX, and prohibited contracts between the utility and affiliated generation companies and hedging transactions.

SDG&E's claim that the Commission, in approving SDG&E's TCBA entries in the first ATCP found that the intermediate term contracts to be shareholder assets, has no reasonable basis in law or fact and must be rejected. SDG&E relied on the Energy Division's report in that ATCP which stated:

> "SDG&E also included the profit from Purchased Power contracts that were not in rates prior to December 20, 1995. Energy Division could not find any Commission decision that required SDG&E to record post restructuring Purchase Power

> contract profits into its TCBA. SDG&E has since decided to remove the profit associated with these contracts from its TCBA." (Ex. 107, p. 11.)

ORA asserts that despite the plain language of the above quote, SDG&E interpreted that language to mean that the Energy Division recommended that net contract revenues be removed from the TCBA. ORA contends that the Energy Division's finding plainly stated that SDG&E decided to reverse the accounting of the contract profits, and that SDG&E's own testimony indicates that this is exactly what SDG&E did. Although SDG&E states that it reversed the accounting of the net contract profits from the TCBA as a result of discussions with the Energy Division auditor during the regulatory review of SDG&E's TCBA entries, ORA contends that the auditor did not recommend reversal of the entries from the TCBA. Instead, the Energy Division merely concluded that it was unable to locate any Commission decisions that required SDG&E to book the net contract profits to the TCBA.

ORA asserts that the Commission's finding in its decision in the first ATCP that "SDG&E's entries to the TCBA are appropriate" cannot reasonably be interpreted to constitute an implicit finding that intermediate term contracts are shareholder assets. ORA contends that the Commission could not have made this finding in the first ATCP because the record, in particular SDG&E's own filings, was silent on this issue. SDG&E's testimony in the ATCP contained only one paragraph which described the intermediate term contracts, and a description of how the PX revenues were applied to transition costs. However, SDG&E's testimony did not state that the contracts were for hedging purposes.

ORA points out that in D.01-05-035, the Commission found that SDG&E "failed to establish a line of authority exempting the purchase contracts from our interim order in D.01-01-061…." (D.01-05-035, p. 16.) ORA asserts that SDG&E also failed in this proceeding to establish that the Commission exempted the intermediate term contracts from the Commission's ratemaking authority, and that the intermediate term contracts are to be excluded under AB 265.

SDG&E's argument that it entered into the intermediate term contracts for the exclusive purpose of hedging against shareholder price risk has no support in either Commission decisions or in SDG&E's own actions and statements. ORA states that SDG&E acknowledged in a letter from Sempra's Jim Cassie to State Senator Brulte that the Commission denied SDG&E's request to hedge commodity price risk in D.96-12-088. (See Ex. 127, Ex. WAM-6; Ex. 104, Att. 1.) ORA contends that SDG&E had no authority from the Commission to purchase forward contracts and to bid those into the PX to hedge commodity price risk. ORA asserts that the record is clear that SDG&E continued to execute its bilateral contracting plan even in the absence of authority from the Commission to enter into the bilateral contracts. ORA contends that accepting SDG&E's argument that it was only hedging against the AB 1890 risk would reward SDG&E for circumventing Commission authority.

ORA also asserts that SDG&E did not inform the Commission or the Legislature that the intermediate term contracts were being used solely as a hedge against the AB 1890 price risk until after AB 265 was enacted. In SDG&E's first ATCP, SDG&E did not discuss using these contracts solely as hedging instruments. Nor did SDG&E inform the Legislature during deliberations over AB 265 of its intention to use the contracts solely as a price risk hedge, even though it had ample opportunity to do so, or that it intended to keep the profits from the intermediate term contracts. ORA asserts that instead of announcing that it was using the intermediate term contracts for hedging, SDG&E publicly stated its intention to use the contracts to provide power to its customers by telling the FERC in August 1999 that it "wants to be able to sell outside the PX obligation to supply the electric commodity needs of its bundled customers with the same level of flexibility available to … other competitors that are now operating in California." (Ex. 127, p. 8, Ex. WAM-1.)

ORA also states that until SDG&E reversed the booking of net contract profits from the TCBA, SDG&E's accounting of contract costs and revenues was consistent with its accounting treatment of other URG assets. ORA asserts that the decision to remove the contract profits from the TCBA was a unilateral move on the part of SDG&E.

ORA contends that the surcharge which SDG&E seeks is unnecessary. ORA asserts that the adoption of ORA's recommended adjustment for the intermediate term contracts, the application of the 2003-2004 CTC revenues, and the PECA overcollection will make the surcharge unnecessary. SDG&E has assumed for purposes of this proceeding that there will be no PECA overcollection in 2003 available to offset the AB 265 undercollection. But in R.02-01-011, SDG&E has proposed that its CTC and electric commodity rates be maintained at current levels. If that proposal is adopted, ORA contends that a PECA overcollection will be available to reduce the AB 265 undercollection.

ORA expects that there will be a PECA overcollection in 2003 and 2004, even if SDG&E's electric commodity rates are not frozen at their current levels. With SDG&E's proposal to keep current rates in place, ORA expects an even higher PECA overcollection amount than if rates were adjusted downward.[15] On an annual basis, any overcollection recorded in the PECA will be transferred to the TCBA, and the amount attributable to AB 265 customers will be used to reduce the AB 265 undercollection.

Given the anticipated CTC revenues and the PECA overcollection, and assuming adoption of an adjustment of $130.64 million related to the intermediate term contracts, ORA contends that there is no need to impose the surcharge as proposed by SDG&E. In addition, ORA points out that this proceeding and R.02-01-011 need to be coordinated on the issue of the recovery of the AB 265 undercollection.

F. Utility Consumers' Action Network

UCAN contends that no rate increase is warranted. UCAN asserts that SDG&E's residential customers already pay the highest electric rates in California, if not in the country. Adding an additional surcharge upon the state's highest electric rates would be inequitable and unwarranted.

UCAN contends that the AB 265 undercollection can be eliminated within a year and a half without the need for any rate increase. This can be accomplished by taking the following action: (1) AB 265 requires that all of the profits from the intermediate term contracts must be applied to reduce the balance in the ERSA; (2) apply to the ERSA undercollection any

[15] ORA asserts that SDG&E's current system average commodity prices are higher than DWR and URG costs combined. In addition, SDG&E's currently adopted DWR rate was set based on a lower, outdated sales forecast. Thus, DWR's revenue is approximately $120 million higher than SDG&E's share of the DWR revenue requirement. The DWR revenue requirement is reflected in the PECA. Thus, if rates are frozen at current levels, the future PECA overcollection will be significantly higher than what can be expected if the rates were adjusted.

additional monies coming from the DWR allocation adjustment, tree trimming surpluses, performance based ratemaking (PBR) electric distribution sharing adjustments, and setting the balancing account interest rate at 59.254% of the short-term paper rate to reflect the zero cost deferred taxes; (3) do not subject SDG&E's customers to a rate increase to accelerate the payment of the ERSA undercollection; (4) medical baseline and CARE customers should not be assessed any surcharge for accelerated payment of the ERSA; (5) SDG&E's small business and residential customers who were served by direct access providers during the November 2000 through January 2001 time frame should not be required to pay the portion of the CTC surcharges that are allocated to repayment of the ERSA; and (6) SDG&E's bills should be revised so that payment of the ERSA is reflected as a separate line-item, instead of being lumped into the CTC line-item charge.

UCAN asserts that there is no crisis relating to the recovery of the AB 265 amounts, particularly if the Commission's intermediate term contract decision is upheld. According to SDG&E's TCBA filings, the AB 265 undercollection at the end of 2001was $358 million. This amount is expected to decline to $222 million by the end of 2002. At this rate of recovery, UCAN asserts that the undercollection would be amortized in under two years.

UCAN also asserts that there are two trends which could increase the rate recovery. As noted by SDG&E, SDG&E's payments to DWR will decline significantly. UCAN states that this will create more headroom to pay off the AB 265 balance in 2003. Also, if there is still a balance in the AB 265 account at the beginning of 2004, the ICIP for SONGS will expire. If actual nuclear costs are 1 cent per kWh less than the ICIP, this will generate about $33 million per year of additional revenue that could be used to retire the AB 265 balance. In addition, if the $120 million refund from the adjustment of DWR's revenue occurs, and it is applied to the ERSA, this could pay off the AB 265 balancing account before the end of 2003.

UCAN asserts that AB 265 requires that the Commission apply all of the profits from the intermediate term contracts to offset the balancing account created by §332.1. UCAN contends that the legislative intent was for the Commission to utilize the revenues associated with the sales of energy from utility-owned or managed generation assets.

Although SDG&E contends that these intermediate term contracts are shareholder assets that are not subject to regulatory oversight, UCAN asserts that no such exemption or condition exists. UCAN contends that the Commission should reject SDG&E's claim that the intermediate term contracts are shareholder assets. UCAN asserts that AB 265 requires that all of the profits that SDG&E made from its intermediate term contracts must be applied to offset the balancing account created by §332.1. UCAN states that AB 265 did not condition or qualify the phrase in AB 265 that "The accounting procedure shall utilize revenues associated with sales of energy from utility-owned or managed generation assets to offset an undercollection, if undercollection occurs." Since the intermediate term contracts were owned by SDG&E, managed by SDG&E, and were sales of energy for generation, UCAN asserts that the revenues must be used to offset any undercollection. UCAN contends that the evidence shows that the intermediate term contracts were not shareholder assets, and that SDG&E failed to depose or subpoena the Energy Division auditor for this proceeding.

UCAN also asserts that since SDG&E representatives helped write the language contained in AB 265, to the extent there is any ambiguity; it should be construed against SDG&E. UCAN also contends that SDG&E misled the public and policymakers into thinking that there were no contracts in existence from which SDG&E was reaping profits. UCAN contends that the letter from Sempra's Cassie to Senator Brulte stated that in 1996 and in 1997, SDG&E sought to enter into energy contracts and was ordered by the Commission to buy only from the power exchange. UCAN asserts that the letter implies that SDG&E never had the authority to enter into any bilateral contracts, either for shareholders or ratepayers. UCAN contends that the central issue in this proceeding is if the Legislature knew about the intermediate term contracts, and would the Legislature have exempted the contracts from being applied to the undercollection if they knew.

As noted earlier, the AB 265 undercollection can be reduced by the refunds from the one-way tree trimming balancing account in 2001-2003. Based on past experience, UCAN estimates that this will amount to about $10 million per year. UCAN also proposes that any amounts that might be generated by sharing from the existing electric distribution PBR allocated to the electric department between 2001 and 2003 should be assigned to reduce the undercollection instead of being refunded to customers through a bill credit.

UCAN also recommends that on a going forward basis, that the balancing account interest rate for this account be set at 59.254% of the short-term paper rate. This would reflect that zero cost deferred taxes finance over 40% of the balancing account, that SDG&E will have use of this tax refund for a longer period of time, and that the tax refund will provide interest-free capital instead of having to borrow money.

UCAN objects to SDG&E's plan to include the surcharge on the rates of CARE and medical baseline customers. UCAN contends that these customers were not required to pay any increased rates for any portion of Southern California Edison Company's past power debts, and SDG&E's customers should be similarly exempted. UCAN also notes that the inclusion of the surcharge on these customers is a change from what SDG&E originally recommended when A.01-01-044 was filed.

UCAN contends that direct access customers, who did not contribute to the size of the AB 265 undercollection from June 2000 to February 7, 2001, should not be required to pay the portion of the CTC surcharges that are allocated to the repayment of the ERSA. UCAN asserts that it would be unfair to these customers if they were forced to repay the balance that they did not create, because they paid higher direct access rates without the benefit of the 6.5 cents/kWh cap. According to UCAN, the current CTC revenues are being applied almost totally to the repayment of the balancing account.

UCAN recommends that a practical and equitable method of dealing with these direct access customers is to exempt any residential customer or business customer under 100 kW who was a direct access customer during the period from November 2000 through January 2001 from paying the portion of the current CTC charge that goes toward the payment of the balancing account.[16] Alternatively, UCAN recommends

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[16] UCAN states that the November 2000-January 2001 period shows that the majority of direct access customers were signed up with SDG&E during that time period. It is also representative of a period when the size of the ERSA was

that the Commission order SDG&E to verify the period during which the largest number of residential and small business customers were served by direct access providers, and to propose a more feasible means of exempting this subset of customers from the surcharge.

UCAN points out that in SDG&E's opening brief at page 87, SDG&E states that the equity issue is bona fide, and that SDG&E's solution is to relieve the direct access customers from having to pay the proposed rate surcharge. UCAN points out, however, that SDG&E does not explain how it will distinguish between bundled and direct access customers. If SDG&E's proposal is to exempt current direct access customers from the unwarranted surcharge, with no consideration as to whether those customers were responsible for accruing the undercollection, such a proposal should not be accepted.

UCAN proposes that SDG&E be ordered to revise its bill to show the AB 265 ERSA payments as a separate line item, instead of using the CTC rate component to recover these costs. UCAN proposes that the CTC rate component should only be used for costs in excess of market from contracts and other elements of tail CTC rather than for repayment of the AB 265 undercollection.

Regarding the proposed settlement agreement for the federal litigation, UCAN points out that it is not an all-party agreement and that none of the other active parties in this proceeding support the settlement. Even if it is viewed as a settlement under the Commission's rules, UCAN contends that the settlement must be viewed as a contested settlement.

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growing, yet 35,000 direct access customers were not contributing to the ERSA undercollection.

UCAN also contends that SDG&E's claim that shareholders are receiving 98% of the profits from the intermediate term contracts is a deceptive proposal. UCAN contends that the proposed settlement agreement simply amounts to splitting the contract profits between customers and shareholders on an approximately 50/50 basis. UCAN contends that SDG&E has no colorable claim of entitlement to the 50% share.

IV. Discussion

A. Introduction

The issues raised in this proceeding, and the evidence that was developed, impact the AB 265 surcharge that is being requested by SDG&E. In addition, the issues and the evidence developed in this proceeding have an impact on the AB X1 43 overcollection, and directly relate to the substance of the Writ Petition before the Court of Appeal and the proposed settlement of the federal litigation involving D.01-01-061 and D.01-05-035.

In this decision, we are addressing only two issues: (1) SDG&E's request for the AB 265 surcharge; and (2) SDG&E's proposed settlement of June 14, 2002. However, in order decide these issues, it is necessary for us to review the arguments and the evidence that the parties have raised.

B. AB X1 43 Overcollection

AB X1 43 imposed a frozen electricity rate of 6.5 cents per kWh on large customers, i.e., on non-AB 265 customers, and allowed any revenue shortfall to be recovered from these customers. However, instead of a shortfall, SDG&E asserts that there is a balancing account overcollection of approximately $168 million for these AB X1 43 customers. SDG&E proposed in Advice Letter 1405-E to return this overcollection as a credit to the rates of these large customers. SDG&E proposed in Advice Letter

1405-E to return this overcollection as a credit to the rates of these large customers. SDG&E's proposal was approved by the Commission on November 7, 2002 when it issued Resolution E-3781.

C. AB 265 Surcharge Request

1. Introduction

SDG&E has requested that a two-year surcharge of 0.00349 cents/kWh be imposed on all AB 265 customers. In addition, SDG&E has requested that the CTC rate recovery continue for that two-year period, and that all customer groups pay this charge. SDG&E recommends that this proposal be authorized by the Commission so that the forecasted AB 265 undercollection of $222 million can be recovered from its customers in a timely manner in order to preserve SDG&E's financial well-being. The City of San Diego, ORA and UCAN argue that the surcharge is unnecessary, and that the AB 265 undercollection will be eliminated over time if certain offsets are allowed or continued.

A key issue regarding SDG&E's surcharge request has to do with the net profits that were derived from the intermediate term contracts that SDG&E entered into in late 1996 and early 1997. The power from those contracts was sold into the market by SDG&E during the period from April 1998 until the Commission ordered SDG&E in May 2001 to make the necessary accounting adjustments to comply with the requirement in D.01-01-061 that URG be first used to serve existing customers at cost-based rates.

SDG&E contends that the net profits from the intermediate term contracts belong to its shareholders. SDG&E argues that since the intermediate term contracts are shareholder assets, the net revenues from those contracts cannot be used to offset the AB 265 undercollection. The

City of San Diego, ORA and UCAN argue that the intermediate term contracts are "utility-owned or managed generation assets." As such, the net revenues from the intermediate term contracts must be used to offset the undercollection in the ERSA as required by AB 265. The Farm Bureau and FEA contend that only the AB 265 customers' portion of the net revenues from the intermediate term contracts should be used to offset the undercollection, and that the revenues allocable to non-AB 265 customers must be allocated to the non-AB 265 customers.

The offset provision appears in §332.1(c), which was added to the code by AB 265. Section 332.1(c) provides:

> "The commission shall establish an accounting procedure to track and recover reasonable and prudent costs of providing electric energy to retail customers unrecovered through retail bills due to the application of the ceiling provided for in subdivision (b). The accounting procedure shall utilize revenues associated with sales of energy from utility-owned or managed generation assets to offset an undercollection, if undercollection occurs. The accounting procedure shall be reviewed periodically by the commission, but not less frequently than semiannually. The commission may utilize an existing proceeding to perform the review. The accounting procedure and review shall provide a reasonable opportunity for San Diego Gas and Electric Company to recover its reasonable and prudent costs of service over a reasonable period of time."

2. The Relevancy Of The Character Of The Intermediate Term Contracts

The parties to this proceeding have focused in on the issue of whether the intermediate term contracts are shareholder assets or assets dedicated to the use of utility customers. All of the parties seem to believe that the characterization of the intermediate term contracts should control whether the net revenues from those contracts should be used to offset the AB 265 undercollection.

We note that the arguments and the evidence over whether the intermediate term contracts are shareholder assets, or assets dedicated to the use of utility customers, are conflicting. On the one hand, SDG&E acknowledges that the 1997 portion of the Illinova contract was used to serve SDG&E customers in 1997, and during the first three months of 1998, the power from all three contracts was used to supply electricity to its customers. The Preferred Policy Decision specifically states that: "Utility property, such as a generation asset, that has received revenue recovery through rates is used and useful in the performance of the utility's duties to the public until such time as the Commission determines otherwise." (64 CPUC2d 1, 49-50, COL 33, p. 91.) Presumably, a determination that a generation asset is no longer used and useful would only come after a §851 request is made to the Commission by the utility, which never occurred with respect to the intermediate term contracts. In addition, Sempra's letter to Senator Brulte implies that SDG&E was prohibited from engaging in hedging transactions by the Commission. The events surrounding the Energy Division regulatory review of the TCBA in the first ATCP, as evidenced by SDG&E's written testimony in Exhibit 107, could also support a finding that SDG&E's hedging strategy was not disclosed to the Commission. All of the evidence cited above could lead us to conclude that the intermediate term contracts were used by SDG&E for the benefit of utility customers.

On the other hand, an argument could also be made that with the exception of 1997, and possibly the first three months of 1998, the intermediate term contracts were treated by SDG&E as shareholder assets, and such treatment was approved by the Commission. Such an argument finds support in the documents discussing hedging at SDG&E's Board of Director meetings in October and November 1996, SDG&E's written testimony in Exhibit 107 for the first ATCP which described the intermediate term contracts and how they were treated in the TCBA, the Energy Division auditor's review of the TCBA entries and adjustment and his discussions with SDG&E witnesses, and the Commission's first and second ATCP decisions which incorporated the reviews by the Energy Division and ORA of the TCBA entries and adjustments. All of the evidence cited above could lead us to a contrary conclusion that the intermediate term contracts were treated as shareholder assets.

When all of this evidence is looked at in the aggregate, SDG&E's testimony supporting its position that the intermediate term contracts are shareholder assets not dedicated to public utility use was particularly strong, because evidence was provided by percipient witnesses to the negotiation, approval, use, and regulatory accounting of those contracts and buttressed by documentary evidence. By contrast, the evidence provided by witnesses for the City of San Diego and ORA that the intermediate term contracts are ratepayer assets had obvious weaknesses including lack of relevant supporting documentary evidence and lack of percipient witnesses. This balancing of the evidence in the aggregate provides abundant support for us to find that the adoption of the June 14, 2002 proposed settlement agreement is both supported by the record evidence in this proceeding and provides a just and reasonable basis to resolve the outstanding issues surrounding the intermediate term contracts.

Moreover, whether the intermediate term contracts are the private property of SDG&E's shareholders (and therefore cannot be taken for the benefit of SDG&E's ratepayers without the payment of just compensation) or have been permanently dedicated by SDG&E to public utility use is a question of fact for the Commission:

> "Whether or not dedication has occurred is a factual issue, to be determined on a case-by-case basis. Courts caution that 'to hold that property has been dedicated to a public use is not a trivial thing, and such dedication is never presumed without evidence of unequivocal intention.' (Allen, 179 Cal. at 85, citations omitted)."

See, D.01-08-061; 2001 Cal. PUC LEXIS 512, *14, *15.

The California Supreme Court has made it abundantly clear that, while a utility cannot voluntarily withdraw property dedicated to public utility use from that use, a utility is free to use property not dedicated to public use (i.e. private property) as it sees fit unimpeded by Commission regulation. For example, the Court stated in a case involving Richfield Oil Corporation:

> "Although Richfield could not withdraw property from a use to which it had been dedicated without the commission's consent or escape regulation by converting all or a part of a public utility service into a nonpublic utility service [citations omitted], Richfield remains free to use property it has not dedicated to public use as it sees fit so long as it does not dedicate such property or prejudice any public utility obligations it may have assumed. [citations omitted]."

See, *Richfield Oil Corporation v. Cal. Pub. Util. Comm'n*, (1960) 54 Cal.2d 419, 435-436. The Commission acknowledges this legal principle:

> "We must recognize that the dedication concept is still vital in California public utility law (*Richfield Oil Corporation v. Public Utilities Commission* (1960) 54 C.2d 419), and that the law is clear that an order directing a public utility to devote its property to some

> other use than the public use to which the utility has dedicated the property cannot be justified as an exercise of the police power. In dealing with public utilities, regulation of use within the dedicated use is as far as the police power may be extended, and when exceeded, it is always void for unreasonableness and may, depending upon the form and character of the order, be also void as an attempt to take property without compensation (*Pacific Telephone etc. Co. v. Eshleman* (1913) 166 C.640, 680)."

See, *Houchen v. Pacific Bell*, D.97-01-005; 70 CPUC 2d 567, 568; 1997 Cal. PUC LEXIS 5, *2

By dedicating its assets to a public use a utility submits those assets to the reasonable rate regulation of the Commission. By contrast, property not dedicated to public use that is taken for a governmental use (what we would have here) is analyzed as an "actual taking" (*Loretto v. Manhattan Teleprompter CATV Corp.* (1982) 458 U.S. 419, 427) requiring the State to pay for the property taken (*Yee v. Esco*ndido (1992) 118 L.Ed.2d 153, 162).

It has long been the law in California that the Commission will run afoul of the aforementioned constitutional limitation should the Commission compel a public utility to dedicate to public use its private property not theretofore dedicated to public use:

> "The provisions of this act [Public Utilities Act] could not authorize the commission to compel such corporation [the utility] to dedicate additional property to public use without additional compensation. When a corporation voluntarily devotes a part of its property to public use, it is to be presumed that it makes the dedication because it is satisfied with the return which it expects to receive, and in that way it is deemed to have been compensated for such dedication. But when it is forced to devote to public use additional property which it has not dedicated to public use, or is compelled to extend its service to supply uses or territory not embraced in the original dedication, it must, under our constitutional

> provisions, as a condition precedent, be compensated for the value of the new property taken or new use exacted.

See, *Atchison, Topeka and Santa Fe Railway Company v. Cal. R.R. Comm'n*, (1916) 173 Cal. 577, 584-585.

3. SDG&E's Proposed Settlement Is In The Public Interest

As the foregoing discussion demonstrates, there are arguments on both sides of the question of whether the intermediate term contracts should properly be treated as ratepayer or shareholder assets. However, the adoption by the Commission of the proposed settlement of the federal litigation that SDG&E offered on June 14, 2002 would make it unnecessary for us to resolve this question. There are a number of reasons that lead us to conclude that SDG&E's proposed settlement is reasonable in light of the whole record of this proceeding, consistent with law and in the public interest and that the Commission should accordingly approve it.

We first address the question of whether the intermediate term contracts are shareholder assets or are assets dedicated to the use of SDG&E's customers. The record evidence on this question is conflicting, and based on the close balance of the relative equities involved, an "all or nothing" decision on this point would be unfair either to ratepayers or to SDG&E's shareholders.

The Commission's decisions that required SDG&E to book the profits from the intermediate term contracts for the benefit of ratepayers (D. 01-01-061 and D. 01-05-035) did not take effect until February 1, 2001. SDG&E has accordingly, to date, nominally retained the profits from these contracts for the period from April 1998 through January of 2001. The amount of these profits that SDG&E has, to date, nominally retained include the following: $67 million for the period from April 1998, when

SDG&E began taking power under the intermediate term contracts, until June 2000, when AB 265 took effect, and $130 million for the period from June 2000 through January 2001.

Although SDG&E has nominally retained, to date, $197 million in profits from the contracts, SDG&E has effectively foregone $100 million of these profits in connection with another settlement approved by the Commission. In D.01-11-029, the Commission approved a settlement, offered by SDG&E and ORA, in the Third Annual Transition Cost Proceeding (A.00-10-008), under which SDG&E agreed to write down the AB 265 undercollection by $100 million. The specific issue resolved in that settlement was the reasonableness of SDG&E's energy procurement activities from July 1, 1999 through February 7, 2001. Although the issue of the treatment of the intermediate term contracts as ratepayer or as shareholder assets was before the same parties in other proceedings at the time of that earlier settlement, this issue was not an explicit part of the settlement of A.00-10-008.

The Commission's approval of the $100 million settlement in A.00-10-008 was just one of the implementing decisions required of the Commission as a result of the MOU between SDG&E and the State (through DWR). SDG&E's agreement to the settlement of A.00-10-008 for a $100 million write-off was part of the totality of agreements made in the MOU, which included, among other things, Commission approval of all "CPUC Implementing Decisions" specified in the MOU. Thus, in the view of SDG&E, its agreement to the settlement of A.00-10-008 had the effect of reducing its profits from the intermediate term contracts by $100 million even though the terms of the settlement in A.00-10-008 did not state that the profits from those contracts would be the source of these funds.

Because SDG&E, acting in compliance with the Commission's decisions, has already booked a substantial portion of the profits from the intermediate term contracts to offset the AB 265 undercollection and has booked another significant portion of said profits to credit the TCBA for large commercial and industrial customers, it would work a substantial hardship on all SDG&E customers if SDG&E were to prevail on the merits in either the federal or state litigation. SDG&E believes that if it had not been restricted by the Commission's decisions in D.01-01-061 and D.01-05-035, and had it been able to sell the power from the contracts on the open market without any regulatory restriction, it would potentially have been able to recoup more than $350 million in profits from the contracts for the period from February through December 2001. In light of the potential exposure to ratepayers, the Commission agrees with SDG&E that the costs and risk of further litigation in the federal lawsuit is not in the public interest and that a settlement of this dispute is in the mutual interests of the Commission and SDG&E, in the interest of SDG&E's ratepayers, and in the public interest.

The Commission further agrees with SDG&E that the allocation to ratepayers of the $175 million that SDG&E has already booked to the benefit of ratepayers pursuant to Commission Decisions D.01-01-061 and D.01-05-035, plus the additional $24 million that SDG&E will book to the benefit of ratepayers pursuant to the proposed settlement, and the allocation to SDG&E's shareholders of the $173 million in profits from the contracts that SDG&E has nominally retained, represent a fair and reasonable apportionment of the litigation risk that the Commission and SDG&E respectively bear in the federal and state litigation. Although this decision has reviewed the intermediate term contracts in this proceeding, as D.01-05-035 at page 10 noted we would, today's decision does not revisit the decisions that the Commission made in D.01-01-061 and D.01-05-035 with respect to the intermediate term contracts.

4. The Resulting Reduction to the AB 265 Undercollection

Since the intermediate term contracts were made subject to the URG requirement in D.01-01-061, the net revenues generated for the period from February 1, 2001 through December 31, 2001 have already been accounted for as directed by the Commission in the PECA. As a result of the Commission's adoption of SDG&E's June 14, 2001 proposed settlement, the AB 265 undercollection will be reduced by an additional $24 million.

As ORA points out, the profits from the intermediate term contracts for the period from June 2000 through January 31, 2001 have not been credited to the PECA. The net revenues for this eight-month period amount to $130 million plus interest. Although AB 265 was signed into law on September 6, 2000, the rate ceiling was made retroactive to June 1, 2000. Since the offset provision in §332.1(c) relates to the undercollection created by the rate ceiling, ORA believes that the offset of utility-owned or managed generation assets should begin on June 1, 2000 and end on January 31, 2001.

We decline to adopt the recommendation of ORA regarding the offset period and the offset revenue amount that should be adopted. As already noted above, the June 14, 2002 settlement offered by SDG&E represents a fair and reasonable apportionment of the litigation risk that the Commission and SDG&E respectively bear on this issue in the federal litigation and should accordingly be adopted by the Commission.

The Farm Bureau and FEA contend that the Commission should only allocate a portion of the revenues from the intermediate term contracts to offset the AB 265 undercollection. They contend that the allocation should reflect the allocation of URG to all customer classes.

We decline to adopt the recommendation of the Farm Bureau and FEA. Since SDG&E's advice letter to credit the $168 million overcollection to AB X1 43 customers has been approved, large customers will receive a credit on their future bills. AB 265 customers, on the other hand, face a forecasted undercollection of $222 million. AB 265 customers should be protected from further rate increases, and the adoption of SDG&E's proposed settlement will move us affirmatively toward the achievement of that objective. This will reduce the expected AB 265 undercollection to approximately $198 million.

5. Other Sources Of Reducing The Undercollection

The parties opposed to SDG&E's request for a surcharge have also made other recommendations regarding how the AB 265 undercollection can be eliminated.

One key recommendation that UCAN suggested is to use the $120 million true-up adjustment that DWR has indicated that it will make to SDG&E's rates. This adjustment would true-up DWR's forecasted and actual revenue requirements in 2001 and 2002. (See D.02-02-052, pp. 77-82; D.02-03-062, pp. 29-30.) SDG&E witness Schavrien estimates this adjustment at $120 million, and that the AB 265 customers' share would be 70% of the $120 million. (12 R.T. 1179-1182.) Schavrien testified that the "Commission can choose to apply it to the ERSA account, which San Diego would not oppose, or it could choose to true it up against the … rate that has to be paid to CDWR for 2003." (12 R.T. 1181-1182.)

If $84 million (70% of the $120 million) of the expected adjustment from DWR is used to reduce the AB 265 undercollection, this would reduce our estimated undercollection of $198 million, after the adoption of SDG&E's proposed settlement, to $114 million in 2003. Other kinds of potential offsets have been mentioned by the parties as well, some of which are dependent on the outcomes of other proceedings. SDG&E also points out that it estimates the AB 265 undercollection will be eliminated in the fourth quarter of 2005 if no surcharge is imposed and the current CTC rate continues. (See Ex. 108, p. 3, Att. 10.)

It is apparent from the evidence that there are viable options for reducing the AB 265 undercollection other than imposing a surcharge on customers' rates. These options should be pursued instead of burdening AB 265 customers with an additional increase in rates. Accordingly, the assigned Commissioner should coordinate with the Energy Division staff in the other proceedings in which the $120 million true-up adjustment is being discussed, to determine whether $84 million of it can be used to reduce the AB 265 undercollection.

Based on the evidence presented, the additional $24 million offset, the potential $120 million refund, other possible overcollections that could be used to offset the AB 265 undercollection, and the detrimental impact that the surcharge would have on the rates of SDG&E's AB 265 customers, the request for a surcharge of 0.00349 cents/kWh for a period of two years on SDG&E's AB 265 customers is denied.

In order to keep the Commission abreast of the AB 265 undercollection, SDG&E shall file a quarterly report in this docket, beginning on the first business day in January 2003, and continuing on the first business day of each succeeding quarter until the AB 265 undercollection is eliminated, detailing the AB 265 undercollection and all offsetting adjustments to the undercollection.

6. Rate Ceiling

Section 332.1(b) provides in pertinent part that if the Commission finds it to be in the public interest, the rate "ceiling may be extended through December 2003 and may be adjusted as provided in subdivision (d)."

SDG&E and ORA recommend that the Commission allow the 6.5 cents/kWh rate ceiling to terminate on December 31, 2002. By ending the rate ceiling, this will allow the Commission to implement the new DWR and URG revenue requirements for 2003. No other party has expressed an interest in extending the rate ceiling. We find that the rate ceiling should be allowed to terminate on December 31, 2002.

7. Miscellaneous

As mentioned in the positions of the parties, other issues have been raised in connection with the surcharge that SDG&E requests. However, since this decision denies SDG&E's request for a surcharge, those surcharge-related issues are moot and do not require further discussion.

V. Comments on Alternate Proposed Decision

Pursuant to Rule 77.1, the proposed decision of the ALJ was mailed to the parties on September 24, 2002, and this proposed alternate decision was mailed to the parties on October 10, 2002. In accordance with Rules 77.5 and 77.6, comments to the proposed alternate decision were filed with the Commission's Docket Office by October 17, 2002, and no reply comments were permitted. Comments were submitted by SDG&E, the City of San Diego, ORA, UCAN and FEA.

A. Responses to Comments of the Parties

SDG&E's comments were supportive of the proposed alternate decision, and recommended a number of non-substantive changes to the body of the document, the findings of fact, the conclusions of law and the ordering paragraphs in order clarify the record. Most of these recommended changes have been incorporated herein.

FEA's comments simply reiterated its earlier comments in this matter to the effect that the Commission should only allocate a portion of the revenues from the intermediate term contracts to the AB 265 undercollection. For the reasons set forth in section IV.C.4 above, we decline to adopt FEA's recommendation.

The comments of the City of San Diego, ORA and UCAN raised a number of issues that essentially boil down to two main points: (1) the proposed alternate decision does not comply with the Commission's Rules of Practice and Procedure, specifically, the settlement procedures set forth in Rule 51 et seq. of those Rules; and (2) the June 14, 2002 settlement proposed by SDG&E that this alternate decision would adopt is illegal, unjustified and not in the public interest. For the reasons set forth below, we reject both of these lines of argument.

The Rule 51 argument that these parties raise is unpersuasive. SDG&E's June 14, 2002 proposed settlement agreement was presented to the Commission and the Commissioners as the defendants in federal litigation instituted by SDG&E. Such litigation is simply outside the ambit of the Commission's Rules of Practice and Procedure. Those Rules pertain to proceedings before the Commission to which the Commission is not a party and have no direct or implied applicability to a decision by the Commission to settle federal court litigation against it. As a result of, and in light of, the very thorough record developed in this proceeding, which is amply discussed above, we determine the terms of the proposed settlement to be reasonable and in the public interest, particularly in combination with the other ordering paragraphs of this alternate decision. Our determination to adopt the June 14, 2002 proposed settlement agreement in the federal litigation as part of this decision justifies the remainder of the decision that determines that no surcharge is necessary and that the AB 265 undercollection can be recovered through alternative means within two years. Thus, we are prudently and reasonably exercising our discretion to resolve this proceeding in a manner that concurrently eliminates outstanding litigation, resolves all issues pertaining to the intermediate term contracts, resolves the issues pertaining to the recovery of the AB 265 undercollection, and upholds the validity of prior Commission decisions.

Moreover, as has already been noted above, even though Rule 51 et seq. do not apply to a Commission determination to settle federal litigation against the Commission and the Commissioners, all the fundamental due process protections built into Rule 51 to insure adequate review of, and comment upon, a proposed settlement by interested parties have in fact been complied with many times over in this proceeding. The record in this proceeding, as well as the text of this decision, reflect the facts that parties received the settlement agreement well in advance of its consideration by the Commission; had an opportunity to, and did, comment on it in writing; had an opportunity to submit and did submit testimony on it; had an opportunity to and did cross-examine SDG&E witnesses on it; had an opportunity to and did addresses it in briefs and reply briefs, and had an opportunity to and did address it publicly in two public participation hearings held in San Diego and Carlsbad. In short, the proposed settlement agreement has been thoroughly and publicly aired. Consequently, the due process arguments that the City of San Diego and

ORA raise in their comments ring hollow and do not provide a persuasive rationale for the Commission to decline to adopt the proposed settlement as part of its decision of this matter.

The City of San Diego, ORA and UCAN also argue that this decision, which adopts SDG&E's June 14, 2002 proposed settlement agreement, does not reflect the record in this proceeding and is contrary to the public interest and hence, is illegal. We disagree.

This decision takes a comprehensive view of the equities involved in this proceeding. This decision also takes into consideration the complexities of the law pertaining to unconstitutional "takings" and dedication of private property to public use, the evidence of whether such dedication occurred, the substantial contributions SDG&E shareholders have already made toward reduction of the AB 265 undercollection, the outstanding state and federal litigation between SDG&E and the Commission addressing the legality of certain Commission decisions pertaining to the AB 265 undercollection, the Commission's obligation to interpret the language of AB 265 in a manner consistent with constitutional proscriptions, and the conditions under which a surcharge is necessary to eliminate the remaining AB 265 undercollection. Further, this decision correctly acknowledges the litigation risks involved in a "winner take all" outcome, and determines that the outcome most reasonable and in the public interest given all the complexities surrounding the intermediate term contracts, AB 265 and the AB 265 undercollection is the adoption of the terms of the June 14, 2002 proposed settlement agreement. That settlement agreement requires SDG&E shareholders to reduce the AB 265 undercollection by an additional $24 million and removes the cloud of litigation surrounding the legality of the Commission's actions in

Decisions 01-01-061 and 01-05-035. In that vein, the settlement agreement ensures that the $175 million in profits that SDG&E has booked to the benefit of ratepayers since Commission adoption of D.01-01-061 will not be reversed and, further, that the Commission (and possibly SDG&E's ratepayers) will not be exposed to potential damages in the hundreds of millions of dollars.

It is simply incorrect for the City of San Diego, ORA and UCAN to contend that the outcome reached by this decision overlooks the evidentiary record of the proceeding. To the contrary, section III of this decision provides a detailed and thorough discussion of the evidence presented by the parties, in particular, evidence on the key factual question on which our decision turns, namely, whether the intermediate term contracts were "utility-owned or managed generation assets" within the meaning of P.U. Code §332.1(c), as the City of San Diego, ORA and UCAN contend, or shareholder assets exempt from the application of that statute, as SDG&E contends. All of the evidence adduced by the parties on this key point directly bears on, and contributes to the rationale for, our decision herein. As noted above, this evidence is conflicting. It is entirely within our discretion to weigh and rule on this conflicting factual evidence in a manner that results in a reasonable compromise rather than an all-or-nothing outcome.

We would also note that the amount of factual evidence relevant to deciding this key question already presented in this proceeding is sufficiently detailed and extensive that it is unlikely that any further hearings in this proceeding would adduce such additional factual evidence on this point as to alter our judgment, set forth in this decision, as to how this key question should be decided.

The City of San Diego, in particular, seems to think that it would be improper for this Commission to issue a decision in this matter approving the June 14, 2002 proposed settlement agreement without conducting a legal analysis as to why the intermediate term contracts are not covered by AB 265. In making this argument, the City of San Diego mischaracterizes a factual determination as a legal one. However, it is not necessary for us to explicate the legal rationale for our decision when the decision we are making is a factual one. We agree that if the intermediate term contracts were in fact "utility-owned or managed assets," AB 265 mandates that the profits from those contracts would be credited to reduce the AB 265 undercollection, but that is not the question to be decided here. What we have to decide is not why, but whether the intermediate term contracts are, as a matter of fact, "utility-owned or managed assets." As we have said above, this is not a question that the record evidence in this proceeding gives an easy, or an easily defensible, answer to. The City of San Diego is accordingly wrong is asserting that it would be legal error for us to issue this decision.

We must respond to one other point raised by both the City of San Diego and by ORA, namely, the implication that the adoption of the proposed June 14, 2002 settlement agreement is somehow not favorable to ratepayers. To the contrary, the ratepayers gain the lion's share of the benefit resulting from the adoption of the proposed settlement agreement. The undisputed evidence in the proceedings below is that during the period from June 2000 through December 2001 (in which AB 265 would have been applicable to SDG&E's revenues from the intermediate term contracts if those contracts were unquestionably ratepayer rather than shareholder assets), SDG&E accrued $305 million in profits from the sale of power associated with the intermediate term contracts. The proposed settlement allocates $199 million, slightly over 65% of that profit, to ratepayers, and $106 million, or slightly less than 35% of that profit, to shareholders. It is not credible to claim, as the City of San Diego and ORA appear to do, that such an allocation of profit as between ratepayers and shareholders is somehow unfair to ratepayers or not in the public interest. Given the conflicting nature of the evidence on the key factual question that is resolved via the settlement effectuating this allocation, and the resulting uncertainty and risk associated with a litigated outcome of the federal litigation between the Commission and SDG&E, such a claim is particularly misplaced.

Moreover, when the $100 million in reduced profits that SDG&E agreed to in the settlement of A.00-10-008 (which SDG&E, at least, considers to be related to its profits from the contracts) is deducted from this allocation, SDG&E is left, in its view, with only $6 million out of the total of $305 million of profits from the contracts from June 2000 through December 2001, a mere 2% of the total. Seen in this light, the deal for ratepayers resulting from our adoption of the June 14, 2002 proposed settlement agreement in this decision is a very good one, indeed.

B. Responses to Proposed Revisions of the ALJ's Proposed Decision

Subsequent to the issuance of the proposed alternate decision, several proposed additions were made to the proposed decision prepared by the ALJ in the proceeding. One of these proposed additions by the ALJ, relating to the alleged relevance of the Commission's affiliate transaction rules, is problematic and misleading in several important respects and accordingly requires a detailed response.

The ALJ proposes adding language to the effect that SDG&E's treatment of the intermediate term contracts as shareholder assets somehow violated the Commission's affiliate transaction reporting requirements and that SDG&E should not be allowed to argue that these contracts were shareholder assets while allegedly ignoring Commission decisions requiring "these kinds of affiliate transactions" to be reported to the Commission.

However, this proposition is fundamentally flawed. It both ignores the very clear evidentiary record developed on the ownership of the contracts as well as the intended and actual use of the contracts, and it refers to documents never entered into evidence and never addressed by any of the parties in hearings or in briefs. The argument also appears to assume that SDG&E's parent company, Sempra Energy, is an affiliate of SDG&E. It is not. (see, D.98-08-035, Appendix B, page 1).

(1) There was NEVER any affiliate transaction that took place related to the intermediate term contracts. The contracts are attached to the testimony of Mr. Reed (Ex. 101). Each of the contracts are signed by Mr. Reed as a representative of SDG&E. Contrary to the statement in the proposed new language in the ALJ's proposed decision to the effect that SDG&E "failed to list or disclose the use by Enova Corporation or Sempra, SDG&E's parent companies, of the intermediate term contracts for hedging purposes," the impetus for entering into the contracts came directly from, and entry into the contracts was directed by, SDG&E's Board of Directors. As reflected in the SDG&E Board of Director meeting minutes attached to the testimony of SDG&E witness Reed (Attachment D and F to Ex. 101), Mr. Reed was authorized to execute the contracts as an officer of SDG&E for the express purpose of hedging SDG&E shareholder price risks related to the implementation of AB 1890 (Ex. 101, pp. 11-14). Specifically, Mr. Reed testified:

> "…consistent with Board direction to more fully implement its shareholder price risk mitigation strategy, SDG&E negotiated purchases for power for the years 1998, 1999, 2000, and 2001. These bids had nothing to do with acquiring power to serve SDG&E's customers; under AB 1890 and the Commission's Preferred Policy Decision SDG&E was required to procure electric energy for its full service customers directly from the PX under the mandatory bid/buy. SDG&E's intent was simply to acquire power on the wholesale market at advantageous prices that would be resold through the PX at the market clearing price. The power sought by these bids was not intended to be used in the provision of SDG&E's utility services. The sole and only reason SDG&E negotiated purchases in October/November of 1996 for power for the years 1998 through 2001 was to mitigate price risk resulting from the frozen electric rates instituted by AB 1890." Ex. 101 at 13.

Moreover, during his cross-examination by the attorney for the City of San Diego, Mr. Reed was asked a number of questions about affiliate involvement in the contracts. Mr. Reed's responses (to the effect that SDG&E was the purchasing party, that neither Sempra nor Enova were counterparties to these contracts, that the contracts were never assigned to either Sempra or Enova, and that had any such assignment ever taken place, the Commission's affiliate transaction rules would have been complied with) were clear and never contradicted. See, Tr. 1034-1039.

Consequently, the facts on the record are quite clear that SDG&E entered into the intermediate term contracts in its own account, and not for the benefit of, or on behalf of, any affiliate. Moreover, SDG&E was providing neither goods nor services to any affiliate at any time during the course of its involvement in the contracts. Finally, SDG&E never assigned the contracts to anyone, be it an affiliate or otherwise. Thus, the Commission's affiliate transaction rules never came into play with respect to the intermediate term contracts.

(2) SDG&E has, and had at the time of entering into the intermediate term contracts, the legal authority to acquire assets for use by shareholders. The proposition that a regulated public utility may acquire an asset and not dedicate it to public service, and that such an asset is not subject to the jurisdiction of the Commission, has strong legal underpinnings.

For example, while recognizing that Pacific Telephone and Telegraph Company ("Pacific") was a public utility regulated by the Commission, the California Supreme Court stated that under its charter Pacific could also engage in activities of a non-utility nature, and whether those non-utility activities were within the regulatory scope of the Commission was a question of law and fact. In pertinent part, the California Supreme Court stated:

> "Pacific is a private corporation engaged in the public utility telephone business within this state. As such its services, property and charges are subject to the recognized supervision of the commission. However, under its charter Pacific may also engage in activities of a non-utility nature. … It is sometimes a question of mixed law and fact as to whether a particular activity is within the regulatory scope of the commission. Here we must look to the nature of the activity furnished under this tariff schedule as well as the question of dedication, to determine the jurisdictional issues presented." Coml. Communications v. Public Util. Com. (1958) 50 Cal. 2d 512, 518.

As was Pacific, SDG&E is a private corporation engaged in business as a public utility whose charter, specifically its articles of incorporation, allow it to engage in activities of a non-utility nature.[17] Therefore, while SDG&E's primary business is unquestionably the provision of public utility service, SDG&E is not precluded, legally or otherwise, from pursuing objectives outside of its public utility obligations. Such activities include exercising its fiduciary responsibility to protect its shareholders from potential losses, such as stranded costs from the implementation of AB 1890. Assets acquired by SDG&E in the pursuit of that objective are not automatically under the jurisdiction of the Commission simply because SDG&E is a regulated public utility. As noted above, an asset acquired by a regulated public utility must be dedicated to public use before it can be subject to the jurisdiction and rate regulation of the Commission.

This legal tenet is also reflected in numerous Commission decisions. For example, in D.94-02-045 the Commission addressed the very common situation in which a utility acquired assets (real property) in 1963 that were not necessary or useful for the provision of utility service at that time. Much later, in 1990, the utility decided to use the property for a utility parking facility. Only upon that occurrence was the property considered (and acknowledged by the Commission) as dedicated to public use. The issue before the Commission was whether property dedicated to public service in 1990 should be added to rate base at its historical cost or at its

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[17] The first page of SDG&E's Articles of Incorporation states:

> "The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code."

1990 fair market value. *In the Matter of the Application of California Water Service Company*, D.94-02-045; 1994 Cal. PUC LEXIS 78, *6, *7; 53 CPUC 2d 287, 290. Until the property was actually dedicated to utility service, neither was it subject to the rate regulation of the Commission nor were its costs included in rate base. In fact, the Commission acknowledged that until 1990 the property was clearly a shareholder asset and shareholders bore all risks the property would never be useful for utility purposes. *Id.* at *23, *24.

Another example, and possibly more analogous to the intermediate term contracts, is a case in which Southern California Edison Company ("SCE") was granted a Certificate of Public Convenience and Necessity to construct a 100 megawatt coal gasification combined cycle demonstration project. SCE was a part owner and the primary operator of the project. One of the questions before the Commission was whether the project was dedicated to public use, thereby making the project a public utility subject to the Commission's jurisdiction. The Commission determined that since the primary purpose of the project was to ascertain the commercial feasibility of the coal gasification process and not to provide electricity to SCE's ratepayers, the project facilities were not dedicated to the public use. The pertinent portion of the Commission's analysis is as follows:

> "Edison pursuant to contracts negotiated with each participant will purchase all coal that is processed into gas and will own all the electricity generated by the combined-cycle unit. Gas or electricity produced by the Project is not directly available for sale to any other party. Furthermore, the primary purpose of the Project is to demonstrate the commercial feasibility of a coal gasification-combined cycle facility. The Project will not be constructed as a generating resource to provide gas or electricity to the public but as an

> experimental facility to allow the participants to test different types of coal at a gasification-combined cycle plant.
>
> "For the foregoing reasons, we find that although this Project falls within the literal language of Section 216, the Project is not a public utility as long as the participants do not dedicate the Project facilities to public use. Such a finding, however, also precludes Edison's request that its $25 million capital contribution be included in rate base. Both the staff and Company witnesses agreed that nonpublic utility property is not properly included in rate base." *Southern California Edison*, D.92115, 4 CPUC 2d 195, 210, 211.

Like the SCE coal gasification facility, SDG&E's acquisition and use of the intermediate term contracts had nothing to do with SDG&E's provision of utility service to its customers. As the Commission recognized in the preceding decisions, a prerequisite for utility assets to be "subject to public utility regulation by this Commission" is dedication to public use. Under the guidance of the various California Supreme Court decisions, which this Commission has cited approvingly numerous times, dedication can only be found if the facts demonstrate that there was an unequivocal intent that the asset be intended to serve the public.

Consequently, SDG&E had the legal right to enter into the intermediate term contracts with the intent to use them to hedge shareholder price risk under AB 1890 and violated no statute or Commission decision in so doing.

(3) There is no evidentiary or record support for the proposed new language, and it therefore cannot be included in any Commission decision. The proposed additional language refers to, and relies upon, various Affiliate Transaction Reports submitted by SDG&E to the Commission over a five-year period. These reports were never addressed by any party in testimony, were not entered into evidence or even marked as an exhibit for reference purposes, and were not addressed or discussed even tangentially in any party's brief. In short, there is nothing in the record supporting any of the statements made concerning these reports. Because there is nothing in the record regarding these reports, SDG&E has never had the ability to address the references to these reports now proposed to be added to the ALJ's proposed decision. Thus, as a fundamental matter of fairness and due process, the allusion to this outside-the-record material in the proposed new language is improper and should not be included in any Commission decision in this case.

VI. Assignment of Proceeding

Commissioner Wood is the assigned Commissioner and ALJ Wong is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. AB 265 was part of the legislative effort to stabilize electric rates during the height of the energy crisis.

2. AB 265 was signed into law on September 6, 2000 as an urgency statute.

3. Section 332.1(b) provides for the establishment of a rate ceiling of 6.5 cents per kWh for SDG&E's smaller customers.

4. AB 265 authorized the Commission to establish an accounting procedure to track and recover the unrecovered difference between the rate ceiling and actual rates.

5. Section 332.1(c) requires that the accounting procedure utilize revenues associated with the sales of energy from utility-owned or managed generation assets to offset an undercollection, if an undercollection occurs.

6. At the time SDG&E entered into the intermediate term contracts SDG&E was prohibited from entering into power purchase contracts for the benefit of its customers that covered the period of time the mandatory bid/buy from the PX was in effect.

7. SDG&E's use of the intermediate term contracts for the period January through March 1998, due to the inability of the PX to initiate operation until April 1998, did not reflect an intent by SDG&E to permanently dedicate the intermediate term contracts to public utility use; rather it reflected SDG&E's intent to avoid the purchase of more expensive power from the market at that time which would have reduced SDG&E's ability to recover shareholder stranded costs.

8. The only legislative history in the record pertinent to AB 265 supported by both oral and documentary evidence is the testimony of Mr. Schavrien addressing his presentation to the legislature which identified the generation assets of SDG&E subject to the offset provision of §332.1(c) and did not include the intermediate term contracts; Mr. Schavrien's written presentation was attached to his rebuttal testimony.

9. ORA has consistently not objected to SDG&E's accounting in its TCBA for the intermediate term contracts, either when the entries for those contracts were backed out of the TCBA or subsequent TCBA reports that did not include those contracts; the Commission has approved all SDG&E TCBA accounting for the contracts.

10. The rate ceiling required by AB 265 was established in D.00-09-040 for SDG&E's residential, small commercial, and lighting customers.

11. The rate ceiling was made retroactive to June 1, 2000, and is to remain in place through December 31, 2002.

12. Section 332.1(b) allows the Commission to extend the rate ceiling through December 2003, and to adjust the ceiling rate.

13. AB X1 43 imposed a mandatory frozen rate of 6.5 cents per kWh on non-AB 265 customers, which was implemented by the Commission in D.01-05-060.

14. D.01-05-060 authorized SDG&E to establish a memorandum account to record the revenues and revenue shortfalls associated with this frozen rate.

15. The AB 265 undercollection was recorded in the ERCRSA, which was subsequently renamed the ERSA.

16. In D.01-11-029, as a result of a settlement, the AB 265 undercollection was reduced by $100 million.

17. D.01-01-061 directed the utilities to use their URG to serve existing customers at cost-based rates.

18. SDG&E filed an application for rehearing of D.01-01-061 seeking clarification that the URG requirement did not apply to the intermediate term contracts.

19. SDG&E's application for rehearing of D.01-01-061 was denied in D.01-05-035, and SDG&E was ordered to comply with the URG requirement by making the appropriate accounting adjustments to the intermediate term contracts.

20. On June 5, 2001, SDG&E filed its Writ Petition with the Court of Appeal regarding D.01-01-061 and D.01-05-035.

21. SDG&E subsequently filed a federal lawsuit against the Commission alleging, among other things, that D.01-01-061 and D.01-05-035 constitute an unconstitutional taking.

22. SDG&E's request for an AB 265 surcharge was filed in A.01-01-044, and the surcharge amount was subsequently revised to .00349 cents per kWh.

23. DWR, SDG&E, and Sempra signed a MOU to settle numerous outstanding issues, which required several implementing decisions to be issued by the Commission.

24. If all the implementing decisions provided for in the MOU were issued, the AB 265 undercollection would be eliminated without the need for the proposed surcharge.

25. Although some of the implementing decisions were adopted by the Commission, the Commission rejected that portion of the MOU which would have settled the Writ Petition.

26. Evidentiary hearings were held on June 24, 2002 through July 2, 2002, and the matter was submitted on August 7, 2002.

27. SDG&E filed Advice Letter 1405-E on May 10, 2002 seeking approval to return to AB X1 43 customers the $168 million overcollection in the TCBA as of March 31, 2002, including accrued interest.

28. In response to Advice Letter 1405-E, on November 7, 2002, the Commission issued Resolution E-3781 allocating the $168 million to SDG&E's large commercial customers.

29. On June 14, 2002, SDG&E proposed to the Commissioners that the federal litigation regarding the intermediate term contracts be settled.

30. Comments on the proposed settlement of the federal litigation were solicited in an assigned Commissioner's ruling dated June 18, 2002.

31. The public had an opportunity to comment on the surcharge and the proposed settlement of the federal litigation at two public participation hearings that were held in the San Diego area in August 2002.

32. The ERSA keeps track of the AB 265 undercollection.

33. The applicable portion of the CTC revenues and other overcollections recorded in the TCBA are used to partially offset the AB 265 undercollection in the ERSA.

34. As a result of D.01-01-061, SDG&E's URG costs were included in the PECA.

35. SDG&E's URG costs are currently recovered through the PECA from the residual revenues from the Schedule EECC rates after disbursements are made to DWR for the power it procures for SDG&E's retail customers.

36. In late 1996 and early 1997, SDG&E entered into the intermediate term contracts with Illinova, LG&E, and PacifiCorp.

37. The AB 265 undercollection on March 31, 2002 and May 31, 2002, were $338 million and $324.7 million, respectively.

38. SDG&E forecasts that the AB 265 undercollection, as of December 31, 2002, will be approximately $222 million.

39. If the Commission lacked the authority to order SDG&E to sell the intermediate term contracts at cost to customers from February through December 2001, SDG&E asserts that the forecast of the undercollection would be artificially low.

40. SDG&E's witness provided testimony at the hearings regarding the composition of the $168 million overcollection for AB X1 43 customers.

41. The $168 million overcollection only includes the AB X1 43 customers' 30% share ($23 million) of the $77 million resulting from the adjustment of the intermediate term contract revenues as required by D.01-05-035.

42. SDG&E requests that the surcharge be imposed on all AB 265 customers for a period of two years, and that the CTC rate recovery continue for that period.

43. The offset provision of AB 265 appears in § 332.1(c) and states that the "accounting procedure shall utilize revenues associated with sales of energy from utility-owned or managed generation assets to offset an undercollection, if undercollection occurs."

44. The arguments and the evidence over whether the intermediate term contracts are shareholder assets, or assets dedicated to the use of utility customers, are conflicting.

45. The discussion of SDG&E's taking argument in D.01-05-035 is relevant to SDG&E's arguments in this proceeding.

46. The net revenues generated from the intermediate term contracts for the period from February 1, 2000 through December 31, 2001 have already been accounted for as directed by the Commission.

47. The net revenues from the intermediate term contracts for the period from June 1, 2000 through January 31, 2001 amount to $130 million plus interest.

48. Although AB 265 was signed into law on September 6, 2000, the rate ceiling was made retroactive to June 1, 2000.

49. Since SDG&E's advice letter has been approved, AB X1 43 customers receive a $168 million credit, whereas AB 265 customers face an undercollection of $222 million.

50. Although SDG&E has nominally retained, to date, $197 million in profits from the intermediate term contracts, SDG&E has effectively foregone $100 million of these profits in connection with its settlement with ORA in Commission proceeding A.00-10-008.

51. The settlement in A.00-10-008 was approved by the Commission in D.01-11-029.

52. The Commission's adoption of SDG&E's June 14, 2002 proposed settlement will have the effect of reducing the AB 265 undercollection by an additional $24 million.

53. AB 265 customers should be protected from further rate increases, and the adoption by the Commission of SDG&E's proposed settlement will move us affirmatively toward the achievement of that objective.

54. The AB 265 customers' share of the expected $120 million true-up adjustment by DWR could be applied to reduce the AB 265 undercollection.

55. There are viable options to reduce the AB 265 undercollection through means other than imposing a surcharge on customers' rates that should be pursued.

Conclusions of Law

1. The Commission has the authority to supervise and regulate every public utility, and may do all things that are necessary and convenient in the exercise of such power and jurisdiction.

2. The Commission's ratemaking authority includes determining just and reasonable rates.

3. The Commission, and not the utility, has the authority to determine the appropriate accounting of assets, costs, and revenues for ratemaking purposes.

4. The Commission takes judicial notice that there is pending litigation in both state and federal courts initiated by SDG&E addressing the validity of Commission decisions D.01-01-061 and D.01-05-035 that would be

resolved based on the Commission's adoption of SDG&E's proposed settlement of June 14, 2002.

5. There are persuasive arguments on both sides of the question of whether the intermediate term contracts should properly be treated as ratepayer or shareholder assets.

6. It is the intent of SDG&E that governs whether the intermediate term contracts have been dedicated to public utility use; dedication can never be presumed, there must be unequivocal intention to dedicate.

7. Unequivocal intention to dedicate the intermediate term contracts to public utility use has not been shown in this proceeding.

8. The state and federal constitutions prohibit the Commission from forcing a utility to dedicate private property to public use without just compensation.

9. The Commission has the duty to interpret AB 265 in a manner that is consistent with state and federal constitutional proscriptions and which bears a reasonable relation to the statutory purpose.

10. The adoption by the Commission of the proposed settlement of the federal litigation that SDG&E offered on June 14, 2002 provides a just and reasonable basis for us to resolve the issues surrounding the intermediate term contracts.

11. The record evidence in this proceeding supports a conclusion that the terms of the June 14, 2002 proposed settlement agreement are reasonable, prudent and in the public interest.

12. The adoption by the Commission of the June 14, 2002 proposed settlement is consistent with state law, including P.U. Code §§ 332.1 and 454.

13. Because SDG&E has already booked a substantial portion of the profits from the intermediate term contracts to offset the AB 265 undercollection and has booked another significant portion of said profits to credit the TCBA for large commercial and industrial customers, it would work a substantial hardship on all SDG&E customers if SDG&E were to prevail on the merits in the federal litigation.

14. The costs and risk of further litigation in the federal lawsuit are not in the public interest and a settlement of the dispute surrounding the intermediate term contracts and their impact on the AB 265 undercollection is in the mutual interests of the Commission and SDG&E, in the interest of SDG&E's ratepayers, and in the public interest.

15. The allocation to ratepayers of the $175 million that SDG&E has already booked to the benefit of ratepayers pursuant to Commission Decisions D.01-01-061 and D.01-05-035, plus the additional $24 million that SDG&E will book to the benefit of ratepayers pursuant to the proposed settlement, and the allocation to SDG&E's shareholders of the $173 million in profits from the contracts that SDG&E has nominally retained, represent a fair and reasonable apportionment of the litigation risk that the Commission and SDG&E respectively bear in the federal litigation.

16. This decision does not revisit the decisions that the Commission made in D.01-01-061 and D.01-05-061 with respect to the intermediate term contracts.

17. Because the June 14, 2002 proposed settlement was offered to settle existing litigation between SDG&E and the Commission, it is not necessary for the Commission to observe the procedural requirements of Rule 51 of the Commission's Rules of Practice and Procedure in order to approve this settlement.

18. Notwithstanding the foregoing, the parties to this proceeding were provided several opportunities to comment on the proposed settlement agreement: in written comments, via direct testimony during the hearings in this proceedings, via cross-examination of SDG&E witnesses, in two public participation hearings, and in their closing briefs.

19. There is accordingly no basis for the parties to claim that the Commission's adoption of the June 14, 2002 proposed settlement agreement would in any way violate their due process rights.

20. The recommendation of ORA regarding the offset period and the offset revenue amount should not be adopted.

21. The recommendation of the Farm Bureau and FEA that the allocation of revenues from the intermediate term contracts should reflect the allocation of URG to all customer classes should not be adopted.

22. The assigned Commissioner assigned to this proceeding should coordinate with the Energy Division staff assigned to the other proceedings in which the $120 million true-up adjustment of DWR is being discussed, to determine whether $84 million of it can be used to reduce the AB 265 undercollection.

23. SDG&E's request for a surcharge of 0.00349 cents/kWh for a period of two years on its AB 265 customers should be denied.

24. SDG&E should be required to file a quarterly report on the AB 265 undercollection and all offsetting adjustments.

25. SDG&E should be required to file an advice letter identifying the viable options whereby the AB 265 undercollection will be eliminated without imposing a surcharge on customers' rates by no later than December 31, 2005.

26. The AB 265 rate ceiling should be allowed to expire on December 31, 2002.

ORDER

IT IS ORDERED that:

1. The June 14, 2002 settlement agreement (Attachment 1) proposed by San Diego Gas & Electric Company (SDG&E) to resolve the federal litigation is approved.

2. The Commission's General Counsel is hereby authorized to execute that settlement agreement on behalf of the Commission.

3. On the effective date of that settlement agreement, SDG&E shall reduce the undercollection balance in its Energy Revenue Shortfall Account created by the rate ceiling imposed by Assembly Bill (AB) 265 by $24 million and shall so notify the Commission by letter addressed to the Commission's General Counsel.

4. SDG&E's request for authorization to impose a surcharge of $0.00349 per kilowatt hour on AB 265 customers for a period of two years is denied.

5. SDG&E shall file a quarterly report in this docket, or in another docket as may be directed in a ruling, detailing the amount of the AB 265 undercollection and all offsetting adjustments to the undercollection.

6. The first quarterly report shall be filed on the first business day in January 2003, and shall continue on the first business day of each succeeding quarter until the AB 265 undercollection is eliminated.

7. Within 30 days of the effective date of this decision, SDG&E shall file an advice letter outlining a process whereby the AB 265 undercollection

will be eliminated, without the necessity to impose a rate surcharge, by no later than December 31, 2005.

8. SDG&E shall transfer the AB 265 portion of the balance (70%) in its PECA as of December 31, 2002 to the TCBA, and apply that balance to the AB 265 undercollection.

This order is effective today.

Dated December 19, 2002, at San Francisco, California.

HENRY M. DUQUE
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

I will file a dissent.

/s/ LORETTA M. LYNCH
President

I will file a dissent.

/s/ CARL W. WOOD
Commissioner