BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Adopting Rules To Account For The Consideration Received By Regulated California Electric And Natural Gas Utilities Under A Settlement With El Paso Natural Gas Company, et al.	FILED PUBLIC UTILITIES COMMISSION JULY 10, 2003 SAN FRANCISCO OFFICE RULEMAKING 03-07-008

ORDER INSTITUTING RULEMAKING ADOPTING RULES TO ACCOUNT FOR THE CONSIDERATION RECEIVED BY REGULATED CALIFORNIA ELECTRIC AND NATURAL GAS UTILITIES UNDER A SETTLEMENT WITH EL PASO NATURAL GAS COMPANY, ET AL.

I. Summary

The Governor of the State of California, the California Attorney General (AG), the California Public Utilities Commission (Commission), the California Department of Water Resources (CDWR), Southern California Edison Company (Edison), Pacific Gas & Electric Company (PG&E), the Attorney Generals from Nevada, Washington and Oregon, law firms representing plaintiffs in 15 lawsuits, including class action lawsuits, and others, have reached a settlement with El Paso Natural Gas Company, its parent corporation, and affiliates (El Paso) resolving issues concerning El Paso's alleged involvement in the extremely high natural gas and electric prices in California during the period March 1, 2000 through May 31, 2001, which is the subject of the Commission's complaint proceeding, Docket No. RP00-241-000 at the Federal Energy

Regulatory Commission (FERC), the investigations by the AG and the Attorneys General from Nevada, Washington, and Oregon, and 15 separate plaintiffs' lawsuits in the San Diego Superior Court (hereinafter, this overall settlement will be referred to as the "Settlement"). This Order Instituting Rulemaking (OIR) will adopt the appropriate ratemaking mechanisms to enable the three major investor-owned electric utilities, Edison, San Diego Gas and Electric Company (SDG&E) and PG&E, and the four major investor-owned gas utilities, PG&E, Southern California Gas Company (SoCalGas), SDG&E, and Southwest Gas Company (Southwest) to implement accounting mechanisms for the proceeds they receive from the Settlement**.** Although the Settlement is pending before FERC and the Superior Court in San Diego California,[1] it is the Commission that must determine how to allocate fairly the settlement proceeds the respondent utilities receive from El Paso under the Settlement.

The need for this rulemaking has arisen because of the significant consideration that the California public utilities will receive under the Settlement, and the appropriate deference in the Settlement to the Commission's jurisdiction over the California public utilities' rates.

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[1] The FERC settlement was filed on June 4, 2003, and the Master Settlement Agreement (with an Allocation Agreement as an attachment) (collectively the "Master Settlement Agreement") was filed with the San Diego Superior Court on June 26, 2003. The Master Settlement Agreement contains the provisions with the consideration provided to the California public utilities under the Commission's jurisdiction, and to entities who are not under the Commission's jurisdiction (e.g., California Department of Water Resources (CDWR), non-core gas customers in California, municipalities in California, and the Attorney Generals in Nevada, Washington in Oregon). On the Commission's own motion, the Master Settlement Agreement will be entered into the record in this OIR and provided on the Commission's web site. The Master Settlement Agreement is also available in hard-copy at the Commission's Central Files office.

The Commission will herein solicit comments on its proposals regarding what actions Edison, PG&E, SDG&E, SoCalGas and Southwest should take in their accounting for and rate treatment of the consideration they receive under the Settlement. To the extent that investor-owned California electric public utilities (with much smaller California service territories than Edison, PG&E and SDG&E) receive any consideration under the Settlement, they should track the consideration in a memorandum account upon its receipt and file a proposal in their next appropriate proceeding or as an advice letter as to how to credit or refund the consideration to their ratepayers.[2]

II. Introduction and Background

After years of litigation between El Paso and the Commission, Edison PG&E, and others in the Commission's complaint proceeding at the FERC (FERC Docket Nos. RP00-241-000, et al.), litigation against El Paso in 15 lawsuits, including class action lawsuits, consolidated in the San Diego Superior Court, and investigations which could result in complaints filed by the California AG and the Attorney Generals, from Nevada, Washington, and Oregon, El Paso has chosen to settle these disputes and enter into the Settlement with all of the above-mentioned parties. The Settlement also resolves a dispute between El Paso and the Commission, CDWR and the California Electricity Oversight Board (CEOB) concerning El Paso's long-term wholesale power contracts with CDWR by reducing the electric prices therein by $125 million.

[2] All California utilities including PG&E, Edison, SoCalGas, and Southwest, should always file with the Commission an application or advice letter to address how to refund or credit to their ratepayers any revenues or other consideration that they receive as a result of orders by state or federal court or the FERC.

The Settlement consists of the Master Settlement Agreement, and separate settlement agreements, which were recently filed in the San Diego Superior Court, the FERC settlement providing structural relief to California shippers utilizing the El Paso system, and a Stipulated Judgment, which will be filed in the United States District Court for the Central District of California and will also provide for structural relief to California. Most of the consideration, which El Paso has agreed to pay to resolve these disputes, is provided in the Master Settlement Agreement, and, therefore, this OIR will focus on this aspect of the Settlement.

In the Settlement, El Paso has agreed to provide more than $1.5 billion (nominal value) in consideration for resolving all of this litigation:

- $900 million in cash at $45 million per year for 20 years (15 years if El Paso achieves an investment grade credit rating) with a prepayment option for El Paso
- $125 million reduction in El Paso's long-term contracts with CDWR
- $352 million in up front cash
- Proceeds from the sale of more than 26 million shares of El Paso stock.

Under the Allocation Agreement attached to the Master Settlement Agreement, the parties have agreed to hundreds of millions of dollars in consideration to persons or entities beyond the ratemaking jurisdiction of the Commission, such as the Attorney Generals of Nevada, Oregon and Washington; certain litigants (*e.g.*, the City of Long Beach) in private lawsuits against El Paso; municipalities, which can establish in a claims process in the court that they were harmed by high natural gas prices at the California border during the time in question; non-core natural gas customers, which will also go through a claims process in the court; and CDWR, which will receive the $125 million reduction in its

long-term contracts with El Paso, as well as more than $300 million (nominal value).

The parties have also agreed that more than $600 million (nominal value) of the consideration will be allocated to the California natural gas and electric investor-owned utilities under the Commission's jurisdiction. When considering the lower revenue requirements of CDWR, which will result from the consideration under the Settlement, and the consideration allocated to the California public utilities, we estimate that more than $1 billion (nominal value) of the consideration will ultimately benefit the California public utilities and their ratepayers.

There is an Allocation Agreement between the Settling Parties that controls the specific allocation of the consideration under the Master Settlement Agreement. In addition, El Paso has provided consideration to parties in separate Settlement Agreements and a $125 million reduction in price in the long-term contracts with CDWR. The Master Settlement Agreement provides for "up-front" consideration that includes both cash ($78,590,070) and the proceeds of the sale of El Paso common stock (26,371,308 shares), whose value can only be estimated at this time. There is additional Master Settlement Agreement consideration ($875,626,072) that is "deferred" in forty equal semi-annual payments over twenty years. The total of all of the Settlement consideration is likely more than $1.5 billion in nominal dollars. The total consideration's net present value exceeds $1 billion, which is less than its nominal value due to the deferred payments.

The more than $1.5 billion in the consideration amount includes the consideration under the separate settlement agreements as well as predetermined amounts for certain settling parties under the Master Settlement Agreement. In addition, there is an iterative process involving the municipalities' claims and the payment of attorneys' fees, which makes the precise residual amount of consideration for the public utilities' ratepayers unknown at this time.

The following estimate for the Commission's jurisdictional allocations is intended only to provide a context for the application of the proposed ratemaking and accounting procedures proposed in this proceeding:

Consideration Affecting the Rates of Commission Jurisdictional Customer Groups	**Estimated Allocation ($Nominal Million)**
Electric	
Reduction of CDWR Revenue Requirements	$425.0
PG&E Electric Customers	$210.0
Edison Electric Customers	$195.0
SDG&E Electric Customers	$60.0
Gas	
PG&E Core Gas Customers	$75.0
SoCalGas Core Gas Customers	$36.0
SDG&E Core Gas Customers	$29.0
Southwest Core Gas Customers	$5.0

III. Preliminary Scoping Memo

A. Principal Issues to Resolve

This rulemaking will be conducted in accordance with Article 2.5 of the Commission's Rules of Practice and Procedure. As required by Rule 6(c)(2), this order includes a preliminary scoping memo as set forth below.

The issues to be considered in this proceeding are:

- Do the ratemaking and accounting mechanisms that the Commission proposes to adopt, enable Edison, SDG&E, PG&E, SoCalGas and Southwest to account equitably for the consideration they receive under the Settlement?
- Are there better alternatives for the Commission to adopt governing how the California natural gas and electric public utilities should account for the consideration they receive under the Settlement?
- Specifically excluded from this proceeding are issues concerning the substantive merits of the Settlement, which are issues for the San Diego Superior Court to resolve. This OIR will only consider the proposed ratemaking and accounting mechanisms.

B. Overview of the Objectives of the Rulemaking

We believe that while the Superior Court would have to approve the allocation of the more than $1.5 billion to the various entities, discussed above, the Superior Court would not have jurisdiction over how the California natural gas and electric utilities (under the Commission's jurisdiction) should allocate or distribute the amounts they receive to their various accounts underlying their rates to their customers. Moreover, a substantial amount of the consideration may be provided by El Paso over a 15 to 20 year period, and, therefore, there need to be specific mechanisms for the accounting of the settlement amounts.

In light of the fact that the proceeds are not a single payment, that there may be numerous transactions over a protracted period, we propose to adopt a minimalist approach and initially use, for the most part, the utilities' existing accounting mechanisms to the fullest extent possible. The rationale is that the refund may be so protracted that it is not feasible to consider prior customers or prior consumption during the period that led to the Settlement as a basis for refunds. Moreover, the non-core gas customers and the municipalities, which were directly harmed during the time in question, will have the opportunity in the court's claims process under the Settlement to establish their harm and receive a fair share of the consideration. Thus, we believe that California Public Utilities Code § 453.5 is satisfied in view of the claims process in the court, the impracticability of tracking the customers harmed during the energy crisis over the next 15 to 20 years that the consideration may be received, and the explicit authorization for the Commission under § 453.5[3] to authorize refunds on a current usage basis, and we will therefore focus on the equitable aspect of the mechanism that we adopt.

[3] Section 453.5 provides:"Whenever the commission orders rate refunds to be distributed, the commission shall require public utilities to pay refunds to all current utility customers, and, when practicable, to prior customers, on an equitable pro rata basis without regard as to whether or not the customer is classifiable as a residential or commercial tenant, landlord, homeowner, business, industrial, educational, governmental, nonprofit, agricultural, or any other type of entity. For the purposes of this section, "equitable pro rata basis" shall mean in proportion to the amount originally paid for the utility service involved, or in proportion to the amount of such utility service actually received. Nothing in this section shall prevent the commission from authorizing refunds to residential and other small customers to be based on current usage."

C. Affected Parties

The mechanisms proposed herein must provide for a fair recovery by ratepayers of the Settlement proceeds. We believe that there are generally three customer groups to be adequately addressed: 1) electric full-service customers, those customers who purchase all of their electric service needs including the energy commodity from the utilities; 2) direct access customers who purchase a portion of their electric service needs, excluding the energy commodity, from the utilities; and 3) core gas customers who purchase all of their gas service needs including the natural gas commodity from the utilities. Non-core gas customers are those customers who self-procure gas and who do not purchase the commodity from the utility. They are excluded from receiving the benefits of the Settlement that are the subject of this Rulemaking, because non-core customers are able under the Settlement to pursue a claims process before the Superior Court. The one exception is for core subscription and core elect customers, who will be addressed in the ratemaking and accounting treatment proposed below.

We believe that the Rulemaking must also provide for the allocation of the reduced revenue requirements of CDWR, as a result of the consideration it receives under the Settlement. Although CDWR determines its own revenue requirement for electric energy procured for retail customers, and follows its own administrative procedures to ensure due process, it is this Commission that decides the allocation of CDWR's revenue requirements in the California public utilities' retail rates.

IV. Proposed Ratemaking & Accounting

The Commission routinely decides on an individual company basis the electric and natural gas procurement costs, the retail rate recovery of those costs, and other ratemaking issues to ensure that ratepayers pay the lowest reasonable

rates. As a part of routine regulatory processes, the Commission equitably allocates costs among customer classes. The reasonable and prudent commodity costs of the utilities acquired for retail sale to customers are recovered in rates established by the Commission in standard, recurring formal proceedings. The proposal here is, for the most part, to rely initially upon the mechanisms established in these routine proceedings for credits or offsets to the costs as a way of benefiting the public utilities' natural gas and electric ratepayers with the consideration provided to them under the Settlement.

For Direct Access (DA) electric customers, there is an established mechanism, the Cost Responsibility Tracking Account (DACRTA), used to recover certain specific costs from DA customers. We believe that the portion of the proceeds from the settlement, allocable to these customers, can be equitably and reasonably recovered using the DACRTA mechanism, as discussed further, below.

A. CDWR Revenue Requirement

The Commission has an adopted process for the recovery of CDWR's revenue requirement for long-term energy contracts and other related costs.[4] There is an explicit and detailed Rate Agreement between the CDWR and the Commission. We expect that to the extent CDWR receives consideration under the Settlement, that the benefit will be passed through to retail customers as an adjustment to CDWR's revenue requirement, which, under the terms of the Rate Agreement, will result in an adjustment in retail rates. The Allocation Agreement explicitly provides in paragraph 4(c)(ii), that all consideration

[4] Decision (D.) 02-02-051.

received by CDWR "shall be used solely to reduce amounts which contribute to CDWR's revenue requirements." Therefore, the Commission proposes that all electric ratepayers of the California public utilities, including the DA customers, will benefit from the consideration that CDWR receives under the Settlement, to the same extent that they bear a share of CDWR's revenue requirements in the rates the utilities charge to them. This benefit to the electric ratepayers will be an automatic result from the lower CDWR revenue requirements resulting from the El Paso consideration under the Settlement (compared to what the revenue requirements otherwise would have been).

B. Electric Utility Accounting

The utilities currently have fairly recent accounting mechanisms embedded in their tariffs, as approved by the Commission, to record the costs and revenues associated with the ongoing provision of retail electric service to customers. The Commission has implemented the necessary ratemaking for CDWR to recover its revenue requirement for retail electricity sold to the customers of PG&E and Edison; and it has established cost of service ratemaking for utility retained generation (URG)[5], by establishing a rate base and allowing the utilities an opportunity to recover their operating costs. There is also an extensive program as a result of AB 57,[6] and the Commission's own initiative, to allow the utilities to procure wholesale energy beyond their URG resources with an allocation of pre-2003 CDWR long-term contracts integrated into their procurement portfolios.

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[5] D.02-04-016 dated April 4, 2002.

[6] Stats. 2002, Ch. 835. Effective September 24, 2002.

For certain utilities, the use of these existing accounting mechanisms is the most efficient means to implement the recovery of the Settlement proceeds over time. The Commission proposes to require the respondent utilities to file advice letters with amendments to their tariffs adding a specific provision for the El Paso Settlement revenues to be used as a credit to the accounts summarized below.

We are also concerned that the Settlement should not affect the determination of any regulatory reward or penalty incentive mechanisms in place for electric or gas utilities and so we will explicitly order that all incentive determinations are to be exclusive of the effects of the Settlement revenues.

V. The Energy Resource Recovery Account (ERRA)

For Edison and SDG&E (the electric utility), the Commission proposes that the Settlement revenues should be credited to their ERRA accounts in order to expeditiously reflect the value of the Settlement as a reduction to electricity procurement costs. Each of these two electric utilities has an ERRA account, as described below. Since their electric ratepayers would pay for these electricity procurement costs in their future rates, the crediting by these utilities for the El Paso consideration they receive under the Settlement will inure to the benefit of their electric ratepayers.

A. Edison

Edison's ERRA was established pursuant to D.02-10-062. The purpose of the ERRA is to record its: (1) URG fuel costs, and (2) purchased power-related expenses.

B. SDG&E

SDG&E's ERRA, adopted by D.02-10-062 and D.02-12-074, provides full recovery of the Utility's energy procurement costs associated with fuel and

purchased power, URG, ISO related costs and costs associated with its residual net short procurement requirements to serve its bundled service customers.

C. PG&E

In the Commission's plan of reorganization in PG&E's pending bankruptcy proceeding[7], the Commission has proposed that a regulatory asset be added to PG&E's rate base as a means to recover in rates PG&E's previously unrecovered costs. In addition, the rate stabilization proceeding is pending before the Commission after the Commission's D.02-01-001 granted limited rehearing of D.01-03-082. In D.02-01-001, p.25, the Commission stated, " we must also determine the extent and disposition of stranded costs left unrecovered, and will address this in proceedings subsequent to our determinations regarding the rate freeze." Without regard to the likelihood of the outcome of either the bankruptcy proceeding or rate stabilization proceeding, we recognize that PG&E's ratepayers will have to pay for a certain amount of PG&E's unrecovered costs, which were previously known as PG&E's "stranded costs," in order for PG&E to emerge from bankruptcy as a financially healthy company.

At this point in time, we do not know the amount of unrecovered costs or the means under which the costs will be recovered in retail rates. We therefore propose to require PG&E to place the proceeds of the El Paso settlement attributed to PG&E's electric customers into an interest bearing memorandum account until these cases are resolved. We do this because it is our belief that the consideration for electric customers received by PG&E from the El Paso

[7] PG&E filed for bankruptcy reorganization pursuant to Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court for the Northern District of California, Case No. 01-30928-DM ("the Bankruptcy Proceeding").

settlement should be used as a credit or offset to previously unrecovered costs that would ultimately be borne by ratepayers. PG&E's electric ratepayers should be the beneficiaries of the El Paso consideration allocated to PG&E for its electric damages to the extent that PG&E's ratepayers must ultimately pay for any of PG&E's previously unrecovered costs that resulted from the extremely high prices for electricity and natural gas during the energy crisis. Therefore, we propose to require PG&E to place the consideration it receives from El Paso, which is allocated to PG&E for electric damages, into a memorandum account until we determine the extent to which PG&E's electric customers' retail rates

will recover PG&E's previously unrecovered costs, which could then be partially offset by the settlement proceeds.

D. DA Customers

The Settlement addresses the damages to ratepayers from extremely high natural gas prices, which were also a contributing cause of extremely high electric prices, for the period from March 1, 2000 through May 31, 2001. During this period there were a number of customers (and a portion of the utilities' system load) who did not purchase electricity from the utilities but were instead served by several alternative energy service providers. These customers were called DA customers, and they received a credit on their bill for the "savings" by the utility in its wholesale procurement program. These savings were the avoided costs of the utility (avoided because the utility did not purchase power to serve them) and the savings were therefore subtracted from the bill that was otherwise applicable under the utilities' tariffs for full-service customers.

For Edison, the purpose of the Direct Access Cost Responsibility Surcharge (DACRS) described in its tariffs is to track the difference between: (1) recorded DACRS Revenues, and (2) authorized DACRS Obligations, pursuant to D.02-11-022 and D.02-12-045. Pursuant to D.02-11-022, the authorized DA CRS-related Obligations include the CDWR Bond Charge, the CDWR Power Charge, ongoing Competition Transition Charges (CTC), and its Historical Procurement Charge (HPC). Edison's account is the DACRS Tracking Account.

For SDG&E, the description in its tariff is slightly different. The purpose of its DACRS Memorandum Account[8] is to track the shortfall in CDWR Power Charge payments and Competition Transition Charges (CTC) resulting from the establishment of the interim 2.7 cents/kilowatts per hour (kWh) DACRS rate cap on applicable Direct Access customers pursuant to Commission D.02-11-022 and D.02-12-045. To the extent DA obligations for the sum of the DWR Bond Charge, DWR Power Charge and CTC are not fully recovered from the 2.7 cents/kWh rate cap, the DACRS Memorandum Account will track the Power Charge and CTC under-collections. Any shortfall resulting from the DWR Bond Charge is recorded in a separate Bond Charge Balancing Account.

To the extent that the DA customers of the utilities must help pay for their previously unrecovered costs, the DA customers, just like the full-service customers, should receive as a credit or offset a fair share of the consideration received by the California electric utilities under the Settlement. Therefore, for Edison and SDG&E, we propose to allocate the proceeds, when they are paid under the Settlement, to the ERRA for full service customers and the DACRTA for DA customers based on the relative percentage of full-service and DA to total kWh system deliveries in the preceding 12 months prior to their first receipt of consideration under the Master Settlement Agreement.

For PG&E, the DA customers should also receive their fair share of the consideration under the Settlement to the extent that the DA customers help pay for PG&E's previously unrecovered costs. As discussed above, PG&E will place

[8] There is essentially no difference between a "Tracking" account title used by Edison and a "Memorandum" account title used by SDG&E.

the El Paso consideration in a memorandum account for the future benefit of PG&E's ratepayers once the Commission determines the extent to which the full-service ratepayers and DA customers will pay for PG&E's previously unrecovered costs.

E. Natural Gas Utility Accounting

The Commission currently has well established accounting mechanisms in place to record the costs and revenues associated with the ongoing provision of retail natural gas service to core customers. The accounting treatment for natural gas procurement embedded in their tariffs, as approved by the Commission, has been stable in recent years and the companies have very consistent accounting and ratemaking mechanisms, as shown below. The Commission proposes to require the natural gas utilities (i.e., PG&E, SoCalGas, SDG&E, and Southwest) to file advice letters with amendments to their tariffs adding provisions for applying the El Paso Settlement revenues as a credit to the accounts summarized below.

F. The Purchased Gas Account (PGA)

The purpose of the PGA is to record the cost associated with gas purchased for the utility's Gas Supply Portfolio (the inventories of gas purchased for resale) and revenues from the sale of that gas. Each of the natural gas utilities has a PGA. The PGA is a long-established account, compared to the new ERRA, and individual company descriptions are not included here. We propose that Settlement revenues attributable to core gas customers shall be credited to this account in order to expeditiously reflect the value of the Settlement as a reduction to core gas procurement costs.

G. Core-Elect and Core-Subscription Customers

During the March 1, 2000 through May 31, 2001 timeframe, some non-core gas customers were served by the utilities' core gas portfolios even though these customers could have otherwise procured their own gas. These non-core customers were called "Core Elect" and "Core-Subscription" customers. To the extent that these customers are still served by the gas utilities' core portfolios, they will receive the benefit of the credit from the El Paso consideration to the gas utilities' PGA. However, during or subsequent to the winter of 2000/2001, some of the non-core customers, who had previously purchased natural gas from the utilities' core portfolios, may have purchased their own natural gas supplies either by choice or because the core subscription option was eliminated before the highest price-spikes were incurred. To the extent that customers in this group are eligible to submit claims under the Settlement to seek consideration in the Superior Court's claims process for non-core customers, we propose that these customers should not receive a share of the California natural gas utilities' consideration under the Settlement. On the other hand, we propose that non-core customers, who were previously core-elect or core subscription customers during the entire above-mentioned time period but are no longer purchasing their gas from the utilities, should be able to submit a request for a refund or credit with the utilities based upon their purchases from the utilities' core portfolios (in therms) during the period at issue, as shown on their bills. The Settlement consideration can be allocated to a fractional-cent per therm for all throughput. This refund rate is discussed below in the core aggregation section.

As discussed elsewhere, we propose to account for the Settlement proceeds allocated to gas customers by initially recording the revenues in the PGA. Any refunds or credits by the utilities to these non-core customers should

then be booked to the PGA as an expense, which has the effect of reducing the settlement revenues attributable to the remaining core customers.

H. Core Aggregation

Some gas consumers were part of the core aggregation program during the March 1, 2000 through May 31, 2001 timeframe. Those core customers, who had purchased natural gas at that time from core aggregators but who now purchase

natural gas from the gas utilities, will receive the benefit of the El Paso consideration that the utilities credit to their PGA. On the other hand, there are certain core customers, who purchased natural gas from core aggregators between March 1, 2000 and May 31, 2001 and who still purchase natural gas from core aggregators. This latter group would not receive the benefit from the credit in the utilities' PGA. Core aggregation customers pay a core aggregation transportation charge that the gas utilities charge for the transportation of the gas provided by the core aggregators. We propose that each natural gas utility, which has core aggregators transporting natural gas on the utilities' facilities, should book the proportional share of the Settlement consideration attributable to core aggregation customers in a new memorandum account, the El Paso Settlement Memorandum Account (EPSMA), until the appropriate ratemaking proceeding where the memorandum account balance can be used to partially offset the utility's allocated revenue requirement recoverable in the authorized tariff rate for the core aggregation transportation charge. We propose that these customers should receive a proportional share of the California natural gas utility's Settlement consideration based upon their class' share of the utility's total system natural gas throughput, excluding non-core volumes, for the 12 months immediately prior to the time that the utility first receives the consideration. The Settlement consideration can be allocated to a fractional-cent per therm for all deliveries, excluding non-core, to all customers served by the respondents with the core aggregators' share recorded in the EPSMA until it can be credited against the core aggregation transportation charge.

I. Incentive Mechanisms

The Commission has adopted a variety of incentive regulatory mechanisms, for several utilities, intended to act as an incentive to further reduce

costs or improve services beyond the levels expected in either base rate-related proceedings (usually a general rate case (GRC) or a cost of service (COS) proceeding) or for energy procurement proceedings for the acquisition of natural gas or electricity. Fundamentally, the utilities are provided an opportunity to find various efficiencies or to negotiate exceptional prices and thereby benefit in whole or part from the resultant savings. We believe, that with respect to the Settlement, the utilities should not receive an unintended or unearned benefit (or an unearned detriment either). Therefore in adopting a recovery mechanism for the Settlement, the determination of any incentive mechanism should be calculated as if the Settlement payments had not occurred.[9]

J. Income Tax Effects

The refunds from the Settlement should have no tax effect on the utilities. We believe this to be correct because in the prior periods when the over-charges were incurred, the utilities booked the excess costs into their balancing accounts in effect at that time. SDG&E, SoCalGas, PG&E's gas department, and Southwest were not affected by an AB 1890 rate freeze at the time and thus they were able to pass through all of their costs to retail customers. For PG&E's electric department and Edison, they would have booked the costs into the then current Transition Revenue Accounts (TRA) and Transition Cost Balancing Accounts (TCBA) and would have been subject to recovery under the AB 1890 accounting paradigms. Subsequently, Edison has been recovering its costs through its PROACT account and its HPC charge to DA customers. For PG&E, its final cost

[9] To the extent the Settlement payments are money without otherwise affecting procurement costs and retail revenues, this should be a simple adjustment.

recovery should be resolved in its pending bankruptcy proceeding or in the Commission's rate stabilization proceeding.

By crediting the Settlement consideration received by the utilities in their balancing accounts cited above, the Commission's proposed rule will set retail rates so as to avoid over-collection: El Paso Settlement revenues received over time will equal reasonable procurement costs, or in the case of PG&E, the recovery of previously unrecovered costs. For income tax purposes, revenues should equal expense and there should be no tax liability as a result of the Settlement.

Because the Commission is requiring that the El Paso consideration received by the California public utilities inure to the benefit of their ratepayers, we cannot see a basis for the utilities to be taxed for any of the consideration under the Settlement. If, nevertheless, the utilities are taxed for the consideration under the Settlement, even though the utilities' shareholders will not receive the benefits from the consideration under the Settlement, we propose that the utilities should be able to adjust the consideration they receive to the extent they are taxed for it. Therefore, the Commission proposes to allow the utilities to adjust the consideration such that only the net revenues will be a credit to their ratepayers. Alternatively, the utilities should be made whole by being allowed to recover the costs associated with any tax liability for this consideration in the utilities' next ratemaking application before the Commission.

VI. Parties to File Comments on the Ratemaking Proposals

A. Opening Comments

The proposed ratemaking and accounting treatment of the Settlement consideration should be the focus of parties' comments. We require Respondents and interested parties to provide, along with a detailed discussion and

rationale, their best thoughts on the question of the most straightforward and equitable treatment of the expected proceeds that the utilities will receive as a result of the Settlement. Parties should specifically comment on the details of the proposed ratemaking and accounting treatment and are invited to propose any reasonable alternative to address the consideration the utilities will receive under the Settlement. Any such alternative proposals must be included in the Respondents' or interested parties' initial comments, so that others will have an opportunity to respond in their reply comments. This OIR therefore provides notice to all concerned that the Commission may adopt proposals first offered in the initial comments herein.

B. Reply Comments on the Ratemaking and Accounting Proposals

Parties may file reply comments but may only address issues raised in the first round of comments; they may not raise new issues or raise new arguments not already included in the OIR or the first round of comments. Parties may not suggest new proposed rules in their reply comments.

VII. Category of Proceeding

Pursuant to Rule 6(c)(2), we preliminarily determine the category of this rulemaking proceeding to be “quasi-legislative”, as that term is defined in Rule 5(d). We think that no evidentiary hearing is required in this proceeding, because we will be adopting rules for the California natural gas and electric public utilities’ accounting of and ratemaking treatment for the consideration they receive under the Settlement. These rules involve policy questions rather than factual disputes.

VIII. Schedule

The assigned Commissioner through a ruling may determine any modifications to the timetable for this proceeding. However, for purposes of meeting the preliminary scoping memo requirements and to get this proceeding underway as quickly as possible, we establish the following schedule:

July 10 , 2003	Order Instituting Rulemaking
August 4, 2003	Initial comments on proposed ratemaking and accounting rules
August 14 , 2003	Reply comments
October 16, 2003	Draft decision on Commission agenda

Any respondent or party who objects to the determination that no hearings are needed, or the issues raised in this preliminary scoping memo, shall raise such objection(s) in a pleading to be filed within 10 days of the mailing date of the OIR.

In the event evidentiary hearings are required, the Assigned Commissioner through subsequent rulings, and the assigned Administrative Law Judge (Judge) by ruling with the Assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding. We do not anticipate that this proceeding will require longer than four months to complete.

IX. Parties and Service List

We name the three major investor-owned electric utilities, Edison, SDG&E and PG&E, and the four major investor-owned gas utilities, PG&E, SoCalGas, SDG&E, and Southwest as Respondents to this Rulemaking.

We will serve this OIR on the parties in most recent or current general rate cases for PG&E, SCE, Southwest, and the Cost of Service applications for SDG&E and SoCalGas. These proceedings have large service lists that should include all persons likely to be interested in the procurement issues we are considering here. In addition, our Executive Director should cause the OIR to be served on the Executive Director of the California Energy Commission, on the California Power Authority and on the parties to the Settlement.

Within 10 days from the mailing date of this order, any person or representative of an entity interested in monitoring or participating in this proceeding should send a letter to the Commission's Process Office and to the Public Advisor's Office, both of which are located at 505 Van Ness Avenue, San Francisco, California 94102, requesting that the person or representative's name be placed on the service list. The Process Office will thereafter create a new service list and distribute it to all parties in this proceeding, and the new service list will also be posted on the Commission's web site, www.cpuc.ca.gov, as soon as is practicable. The assigned Commissioner, and the assigned Judge, acting with the assigned Commissioner's concurrence, will have ongoing oversight of the service list and may institute changes to the list or the procedures governing it as necessary.

Any party interested in participating in this rulemaking who is unfamiliar with the Commission's procedures should contact the Public Advisor's Office in Los Angeles at (213) 576-7056, or in San Francisco at (415) 703-2074, (866) 836-7875 (TTY – toll free) or (415) 703-5282 (TTY).

All parties shall abide by the Electronic Service Proposals set forth in Appendix A to this OIR.

X. Ex Parte Communications

This quasi-legislative proceeding is subject to Rule 7, which specifies standards for engaging in *ex parte* communications and the reporting of such communications. Pursuant to Rule 7(d) *ex parte* communications will be permitted without restriction or reporting requirement.

O R D E R

Therefore, **IT IS ORDERED** that:

1. A rulemaking is instituted on the Commission's own motion to examine the adoption of generic ratemaking policy (Rule 5(d)) to account for the consideration received by the California public utilities under the Settlement resolving the issues litigated in Public Utilities Commission of the State of California v. El Paso Natural Gas Company, et al., Federal Energy Regulatory Commission (FERC) Docket Nos. RP00-241-000, et al. (El Paso Complaint) and the consolidated lawsuits against El Paso in the San Diego Superior Court, the investigations by the Attorney Generals of the States of California, Nevada, Washington in Oregon, and related matters against El Paso in pending proceedings before the FERC.

2. Pacific Gas and Electric Company (PG&E), Southern California Edison (Edison), Southern California Gas Company (SoCalGas), San Diego Gas and Electric Company (SDG&E), and Southwest Gas Company (Southwest), are made respondents to this proceeding.

3. The Executive Director shall cause this Order Instituting Rulemaking (OIR) to be served on the respondents, the Executive Director of the California Energy Commission, the California Power Authority, the parties to the Settlement with El Paso, and on the parties to the following Commission proceedings:

1. PG&E's Application (A.) 02-11-017, general rate case (GRC)
2. SDG&E's A.02-12-028, cost of service (COS)
3. Edison's A.02-05-004, GRC
4. SoCalGas's A. 02-12-027, COS
5. Southwest's A.02-02-012, GRC
6. Electric Procurement, Rulemaking (R.) 01-10-024
7. Direct Access Cost Responsibility Surcharge, R.02-01-011

4. Within 10 days from the mailing date of this order, any person or representative of an entity who is interested in monitoring or participating in this rulemaking should send a letter to the Commission's Process Office and to the Public Advisor's Office, both of which are located at 505 Van Ness Avenue, San Francisco, California 94102, asking that the person's or representative's name be placed on the service list for this proceeding.

5. After service of this order and receipt of the letters referred to in Ordering Paragraph 4, the Process Office will develop a new service list for the proceeding. The assigned Commissioner, and the assigned Administrative Law Judge (ALJ) by ruling with the assigned Commissioner's concurrence, shall have ongoing oversight of the service list and may institute changes to the list or the procedures governing it as necessary.

6. The category of this rulemaking is preliminarily determined to be "quasi-legislative" as that term is defined in Rule 5(d) of the Commission's Rules of Practice and Procedure.

7. This proceeding is preliminarily determined not to require evidentiary hearings.

8. The expected timetable for this proceeding is as set forth in the body of this OIR. The assigned Commissioner, and the assigned ALJ by ruling with the assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding. It is not anticipated that this proceeding will require longer than four months to complete.

9. Any respondent or party that objects to the preliminary categorization of this rulemaking, the lack of evidentiary hearings, or the proposed timetable shall raise any such objection in a pleading filed within 10 days of the mailing date of this OIR.

10. All parties shall abide by the Electronic Service Protocols attached as Appendix A hereto.

This order is effective today.

Dated July 10, 2003, in San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

APPENDIX A
Page 1
ELECTRONIC SERVICE PROTOCOLS

Party Status in Commission Proceedings

These electronic service protocols are applicable to all "appearances." In accordance with Commission practice, by entering an appearance at a prehearing conference or by other appropriate means, an interested party or protestant gains "party" status. A party to a Commission proceeding has certain rights that non-parties (those in "state service" and "information only" service categories) do not have. For example, a party has the right to participate in evidentiary hearings, file comments on a proposed decision, and appeal a final decision. A party also has the ability to consent to waive or reduce a comment period, and to challenge the assignment of an Administrative Law Judge (ALJ). Non-parties do not have these rights, even though they are included on the service list for the proceeding and receive copies of some or all documents.

Service of Documents by Electronic Mail

For the purposes of this proceeding, all appearances shall serve documents by electronic mail, and in turn, shall accept service by electronic mail.

Usual Commission practice requires appearances to serve documents not only on all other appearances but also on all non-parties in the state service category of the service list. For the purposes of this proceeding, appearances shall serve the information only category as well since electronic service minimizes the financial burden that broader service might otherwise entail.

Notice of Availability

If a document, including attachments, exceeds 75 pages, parties may serve a Notice of Availability in lieu of all or part of the document, in accordance with Rule 2.3(c) of the Commission's Rules of Practice and Procedure.

Filing of Documents

These electronic service protocols govern service of documents only, and do not change the rules regarding the tendering of documents for filing. Documents for filing must be tendered in paper form, as described in Rule 2, *et seq.*, of the Commission's Rules of Practice and Procedure. Moreover, all filings shall be served in hard copy (as well as e-mail) on the assigned ALJ.

APPENDIX A
Page 2
ELECTRONIC SERVICE PROTOCOLS

Electronic Service Standards

As an aid to review of documents served electronically, appearances should follow these procedures:

Merge into a single electronic file the entire document to be served (*e.g.*, title page, table of contents, text, attachments, service list).

Attach the document file to an electronic note.

In the subject line of the note, identify the proceeding number; the party sending the document; and the abbreviated title of the document.

Within the body of the note, identify the word processing program used to create the document. (Commission experience indicates that most recipients can open readily documents sent in Microsoft Word or PDF formats.)

If the electronic mail is returned to the sender, or the recipient informs the sender of an inability to open the document, the sender shall immediately arrange for alternative service (paper mail shall be the default, unless another means is mutually agreed upon).

Obtaining Up-to-Date Electronic Mail Addresses

The current service lists for active proceedings are available on the Commission's web page, www.cpuc.ca.gov. To obtain an up-to-date service list of e-mail addresses:

Choose "Proceedings" then "Service Lists."

APPENDIX A
Page 3
ELECTRONIC SERVICE PROTOCOLS

- Scroll through the "Index of Service Lists" to the number for this proceeding.
- To view and copy the electronic addresses for a service list, download the comma-delimited file, and copy the column containing the electronic addresses.

The Commission's Process Office periodically updates service lists to correct errors or to make changes at the request of parties and non-parties on the list. Appearances should copy the current service list from the web page (or obtain paper copy from the Process Office) before serving a document.

Pagination Discrepancies in Documents Served Electronically
Differences among word-processing software can cause pagination differences between documents served electronically and print outs of the original. (If documents are served electronically in PDF format, these differences do not occur.) For the purposes of reference and/or citation in cross-examination and briefing, all parties should use the pagination found in the original document.

(END OF APPENDIX A)