Decision 08-02-033 February 28, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking Regarding Whether, or Subject to What Conditions, the Suspension of Direct Access May Be Lifted Consistent with Assembly Bill 1X and Decision 01-09-060.	Rulemaking 07-05-025 (Filed May 24, 2007)

OPINION REGARDING COMMISSION AUTHORITY TO LIFT THE DIRECT ACCESS SUSPENSION

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1. Introduction

Pursuant to Phase I of this rulemaking, we herein determine if the Commission has discretionary authority under applicable statutes to lift the suspension of direct access for retail electric service. The option for retail customers to purchase electricity on a direct access basis is currently suspended.

As explained below, we conclude that under the applicable statutory provisions, the Commission does not have authority to lift the suspension at present. Nonetheless, we remain committed to exploring proactive alternatives whereby the legal conditions allowing for the lifting of the suspension could be satisfied.[1]

We disagree with parties that argue that this proceeding should not proceed forward. This proceeding shall move to Phase II to consider permissible steps to satisfy the statutory requirements for the Commission to lift the suspension of direct access. This rulemaking shall therefore proceed to Phase II as a forum for considering the appropriate conditions and market framework within which any renewed direct access program may ultimately be implemented.

As announced in opening this proceeding, we shall ensure that any program designed to reinstitute retail competition be guided by sound legal principles, carefully safeguarding relevant public policy interests. We will

[1] While we shall explore alternative means to remove any legal constraints on the Commission's authority to lift the suspension, we make no prejudgment in this decision concerning the substantive merits of how any reinstituted direct access market should function consistent with the public interest. Those issues will be addressed in Phase II.

conduct this rulemaking in a sequential, careful, and balanced manner, taking into account any lessons to be learned from previous efforts to bring competition to electric retail markets.

2. Background

As a context for addressing whether, or under what circumstances, the Commission has legal discretion to lift the direct access suspension, we review events leading up to this proceeding. We first implemented direct access in 1998, as an integral part of a restructuring program to bring retail competition to California electric power markets.[2] Through the direct access program, eligible retail customers had the option to purchase electric power from an independent electric service provider (ESP) rather than through an investor-owned utility (IOU).

The electric industry restructuring program was cut short, however, by events of 2000-2001 which led to extraordinary wholesale power costs increases, threatening the solvency of California's major public utilities and the reliability of electric service. On February 1, 2001, Assembly Bill 1 from the First Extraordinary Session (Ch. 4, First Extraordinary Session 2001) (AB1X) was signed into law, implementing various measures to address the energy crisis. Among other measures to ensure the reliability of electric retail service, AB1X required the California Department of Water Resources (DWR) to step in to

[2] *See* Decision (D.) 95-12-063, as modified by D.96-01-009 (1995) 64 Cal. PUC 2d 1, 24 (Preferred Policy Decision).) The Legislature codified the Preferred Policy Decision in AB 1890, Stats. 1996, ch. 854 (AB 1890).

procure electric power supplies sufficient to meet the net short for customers of the IOUs.[3]

Pursuant to AB1X, DWR entered into a series of electric power supply contracts and also issued long-term bonds to support funding for the DWR power procurement program. DWR formally began procuring electric power for customers in the service territories of Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (SCE) on January 17, 2001, and in the service territory of San Diego Gas & Electric (SDG&E) on February 7, 2001. AB1X authorizes DWR to recover its power costs from electric charges established by the Commission (Water Code § 80110). DWR also entered into servicing agreements with the IOUs to collect money on its behalf for power that DWR sells to the IOUs' customers.

To ensure that cost responsibility for the DWR procurement was assigned in a fair manner among retail electric customers and to assure a stable customer base, the Legislature instituted various measures, including the suspension of direct access. Pursuant to the legislative mandate of AB1X, the Commission suspended the right to enter into new contracts for direct access after September 20, 2001.[4] We applied a "standstill approach," permitting no new direct access contracts, but allowing preexisting contracts to continue in effect. Direct access customers who departed bundled IOU service between January 17 , 2001 and September 20, 2001, were assessed a "cost responsibility surcharge" (CRS) for their fair share of DWR costs. We opened Rulemaking

[3] The net short is the difference between customer loads and the power already under contract to the utilities or generated from a utility-owned asset.

[4] *See* D.01-09-060 and Pub. Util. Code §§ 366 or 366.5.

(R.) 02-01-011 to implement the necessary cost recovery mechanisms and billing processes to recover a fair share of DWR costs from direct access load as required by the statute. The suspension has continued in effect up until the present time.

On December 6, 2006, the Alliance for Retail Energy Markets (AReM) filed a Petition (P.06-12-002) pursuant to Pub. Util. Code § 1708.5 for a rulemaking to consider reopening electric retail markets to competition by lifting the direct access suspension. AReM argued that the electricity crisis of 2000-2001 which gave rise to the direct access suspension had run its course, and that the purposes of direct access suspension had been served, addressed through other means, or no longer applied. In response, parties expressed views ranging from strict opposition to full support for a rulemaking to address lifting the direct access suspension.

On May 24, 2007, the Commission granted the AReM Petition and concurrently issued the instant Order Instituting Rulemaking (OIR) to consider whether, when, or how direct access could (or should) be restored. The rulemaking is segmented into three sequential phases, as follows:

I – Commission Legal Authority to Lift the Direct Access Suspension in accordance with AB1X.

II – Public Policy Merits of Lifting the Direct Access Suspension and Applicable Wholesale Market Structure/Regulatory Prerequisites.

III – Rules Governing a Reinstituted Direct Access Market: *e.g.*, Entry/Exit/Switching; Default Arrangements, and Cost Recovery Issues.

This decision resolves Phase I issues as to whether, or subject to what conditions, the Commission has (or may acquire) legal authority to lift the suspension on direct access. We also address whether, or to what extent DWR

contract assignment or novation, would be sufficient to satisfy the legal conditions under AB1X to lift the direct access suspension.

Pursuant to the schedule in the OIR, comments on Phase I issues were filed on July 24, 2007. Comments were filed by AReM, California Alliance for Creative Energy Solutions (CACES), and Constellation NewEnergy, Inc (Constellation). PG&E, SDG&E, and SCE were the IOUs filing comments. Comments were filed jointly by The Utility Reform Network, the Division of Ratepayer Advocates, the Coalition of California Utility Employees, Consumer Federation of California, and the Natural Resources Defense Council (collectively "TURN"). DWR also filed comments in the form of a memorandum to the Commission.

As a basis for the instant decision, we have considered the comments filed in this OIR, as well as the pertinent comments that were previously filed by parties in reference to the AReM Petition for Rulemaking. No evidentiary hearings are necessary to decide Phase I issues.

3. Legal Basis for Commission Authority to Reinstitute Direct Access

3.1. Analytical Framework for Reviewing Legal Basis for Suspension Under Water Code § 80110

3.1.1. Relevant Provisions of AB1X

As a basis for determining whether, as a matter of law, the Commission has authority to lift the suspension and reinstitute direct access, we examine the governing requirements set forth in AB1X. The direct access suspension must continue until DWR "no longer supplies power" under the provisions of AB1X as codified in Water Code § 80110. The precise language prescribing this condition reads as follows:

> "After the passage of such period of time after the effective date of this section as shall be determined by the commission, the right of retail end use customers pursuant to Article 6 (commencing with Section 360) of Chapter 2.3 of Part 1 of Division 1 of the Public Utilities Code to acquire service from other providers shall be suspended until the department [the Department of Water Resources] no longer supplies power hereunder."

3.1.2. Parties' Position

Parties disagree over the analytical framework that the Commission should apply in determining whether the Commission has statutory authority to lift the direct access suspension. AReM and CACES argue that language in AB1X regarding the duration of the direct access suspension is ambiguous, and requires the Commission to exercise discretion to interpret its intended meaning. As possible meanings, CACES suggests that the phrase "no longer supplies power" could refer to the time (1) when DWR no longer contracts to supply power, (2) when DWR no longer operates or administers power supply contracts, or (3) when DWR no longer has financial responsibility for any power contracts to supply electric retail customers.

CACES argues that the Commission has broad discretion to interpret statutes by applying principles of statutory construction, and by considering extrinsic aids, including: the objectives that the Legislature sought to achieve, the evils sought to be remedied, the legislative history, public policy contemporaneous administrative construction of the statute, and the broader statutory scheme of which the relevant statutory provision is a part.[5]

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[5] AREM Comments at 7, citing *Golden State Homebuilding Ass'n v. City of Modesto*, (1999) 26 Cal. App. 4th 601, 608.

CACES argues that AB1X was enacted on an emergency basis to deal with the power crisis of 2000-2001, but that such emergency no longer exists. AReM similarly argues that the direct access suspension was intended by the Legislature to be temporary, and that the condition precedent for lifting the direct access suspension has occurred. AReM believes that the status quo that existed prior to the crisis conditions of 2000-2001 has been restored, and that continued suspension of direct access is merely an historical "anachronism."

CACES argues that the Commission has discretion to interpret the suspension on direct access as no longer applicable in the light of changed circumstances since AB1X was enacted. AReM believes that there is no statutory impediment to the Commission's authority to reopen direct access.

The IOUs and TURN dispute the claim that AB1X is ambiguous, but believe that the phrase "until DWR no longer supplies power" is clear on its face. TURN argues that there is no need to look past the "plain language of the statute" to determine whether DWR still supplies power.

3.1.3. Discussion

We first address whether ambiguity exists in the statute's use of the term "no longer supplies power," particularly in view of how DWR's role has changed since the statute was enacted. In order to address the power crisis of 2000-2001, AB1X was passed into law, which required DWR to enter into contracts to purchase electric power on behalf of California's retail end-use customers. AB1X further provided that DWR was not to enter into new power purchase agreements after January 1, 2003. The specific functions performed by DWR under the statutory provisions of AB1X have changed since 2001. Given the novel and unconventional circumstances surrounding DWR's role in

resolving the energy crisis of 2000-2001, and the evolving nature of its role under AB1X since then, certain parties claim that DWR is no longer supplying power.

We consider the merits of parties' legal theories underlying their interpretations of AB1X, as a basis to determine whether DWR continues to supply power under the statute. The California Supreme Court has acknowledged this Commission's authority to interpret statutes and has affirmed the Commission's reasonable interpretation of statutes as long as such interpretation bears "a reasonable relation to statutory purposes and language."[6] Moreover, the Commission has exercised its authority to interpret statutes on a number of occasions. We have specifically held that § 80110 "requires interpretation" at least in the context of applying switching exemptions.[7]

Thus, while the Commission has authority to interpret AB1X, the interpretation must be within the bounds of the governing statutory language. The Commission's authority to interpret a statute does not permit disregarding statutory language or making an interpretation that bears no reasonable relation to statutory purposes and language.

Certain parties argue that we should look to the underlying intent behind the direct access suspension, and whether the purposes for which direct access was suspended have been satisfied. A reading of the language of AB1X, however, reveals that the suspension is expressly linked to DWR supplying power. The Legislature imposed this specific condition as a prerequisite for lifting the suspension, but did not authorize the Commission to

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[6] *See e.g., Greyhound Lines, Inc. v. Public Utilities Commission*, 68 Cal. 2d 406, 410 (1968).

[7] D.03-06-035, *mimeo.*, pp. 4-5.

decide to lift the suspension based upon whether the presumed Legislative intent behind the suspension had been satisfied.

Therefore, we reject the argument that to determine whether the statutory conditions for lifting the direct access suspension have been met, we need merely confirm that the underlying purposes for the suspension have been satisfied. In this regard, CACES identifies the following as purposes cited by the Commission for suspending direct access:[8]

- Assuring a stable customer base from which DWR could recover its bond-related costs, thereby facilitating the bonds being issued at investment-grade ratings;
- Assuring a stable customer base from which DWR could recover its ongoing procurement-related costs of power, and
- Preventing DWR procurement costs from being shifted from direct access to bundled IOU customers

CACES also points to language in a subsequent Legislative committee bill analysis which cited these factors as reasons for suspending direct access.[9] In any event, CACES argues that because the original purposes for the direct access suspension have now been addressed, the Commission has discretion to interpret the requirement for suspension as being no longer applicable.

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[8] *See* D.01-09-060, pp. 4, 5, and 8.

[9] CACES cites to Senate Energy Committee Analysis of AB 428, dated July 8, 2003. However, AB 428 was from a subsequent legislative session and was never enacted into law. Thus the citation to this legislative history has limited value for purposes of interpreting AB 1X requirements.

We acknowledge that the underlying concerns previously identified by the Commission as reasons for the suspension of direct access have been addressed in other proceedings. For example, DWR bonds were issued at investment grade, and the Commission established non-bypassable charges for recovery of DWR bond costs. The Commission has also established cost recovery mechanisms for DWR to be reimbursed for its power costs from both bundled and direct access customers. California energy markets have become more stable and the Commission has adopted various policy reforms to eliminate the conditions that prompted the energy crisis of 2000-2001.

Nonetheless, the disposition of such underlying factors is not determinative of whether the suspension can be lifted. Pursuant to the statutory language, the suspension must continue until DWR is no longer supplying power under AB1X, irrespective of whether other conditions arising out of the 2000-2001 energy crisis may have been resolved. We cannot ignore the statutory language even if the reasons that led to the inclusion of that language in the statute no longer exist.

The California Supreme Court has held that "if the statutory language is clear and unambiguous, there is no need for construction, nor is it necessary to resort to indicia of the intent of the Legislature."[10] Regarding the extent of inquiry required to ascertain the meaning of statutory language, "if the language is unambiguous, then the language controls and the inquiry is over."[11]

Given the range of divergent views concerning how to interpret the meaning of the condition that DWR "no longer supplies power," we

[10] *Lungren v. Deukmejian,* (1988) 45 Cal. 3d 727, 735.

acknowledge the need to render an interpretation of whether DWR continues to supply power under AB1X, and if so, what conditions would be sufficient to relieve DWR of the responsibility to supply power. Accordingly, in the following section, we render a statutory interpretation of whether, under current conditions, DWR still supplies power under AB1X. In doing so, we must look to the statutory language to discern whether or when AB1X no longer requires suspension of direct access.

3.2. Interpretation of the Term: "No Longer Supplies Power" Under AB1X[1]. Parties' Positions

Parties disagree as to the interpretation of what is meant by the term "no longer supplies power" under AB1X. Based upon these differing interpretations, parties disagree as to whether DWR is still supplying power under AB1X. As long as DWR is supplying power, the statute requires that the suspension continue in effect. Once DWR "no longer supplies power" under AB1X, however, the Commission will then have the legal discretion to lift the suspension.

AReM and CACES argue that the phrase "supplies power" should be interpreted to refer to DWR's role in *contracting* to supply power. DWR's authority to contract for the procurement of power supplies under AB1X ended on January 1, 2003. In this regard, Water Code § 80260 provides that:

> On and after January 1, 2003, the department shall not contract under this division for the purchase of electrical power. This section does not affect the authority of the department to administer contracts entered into prior to that date or the department's authority to sell electricity.

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[11] *See* D.04-04-029 on p. 4.

AReM argues that the legislative history relating to AB1X supports the interpretation that the suspension of direct access was linked to DWR's authority *to contract for t*he *procurement* of power. AReM points to the Enrolled Bill Report signed by then-Commissioner Loretta Lynch, which construed AB1X to "suspend the ability of retail customers from selecting alternative providers of electricity until such time as DWR ceases *procuring* power for retail customers."[12]

While DWR's authority to enter into new contracts for power expired on January 1, 2003, power continues to be sold to retail customers under DWR contracts executed prior to that date (Water Code § 80260). DWR retains legal title to the power sold under such DWR contracts and is financially responsible for paying all contract-related bills. (Water Code, § 80110.)

Constellation argues, however, that DWR is not supplying the power that continues to be sold to IOU retail customers under existing DWR contracts. Constellation argues that since the responsibility for scheduling, dispatching and delivering power under such contracts was transferred from DWR to the IOUs after January 2003, DWR no longer supplies such power.

Up until January 1, 2003, a two-tiered system had existed whereby DWR and the IOUs each separately dispatched power. This process was described in D.02-09-053:

> ". . . under the [then-]existing two-tiered procurement system in California, the utilities dispatch their own generating assets and contracts first to determine their net short position, and DWR dispatches its contracts and procures additional resources as necessary to meet

[12] AReM Petition at 24 (emphasis added).

> the combined net short of all three utilities.
> (D.02-09-053 at 37.)

However, this two-tiered procurement system ended as the utilities resumed control of all dispatch functions effective January 1, 2003. At that time, the DWR contracts were placed within the IOUs' resource portfolios, under procedures adopted in D.02-09-053. Although DWR continued to hold legal title to the electricity sold under existing DWR contracts, responsibility for dispatching such power was assigned to the IOUs beginning in January 2003. D.02-09-053 directed the three major IOUs to integrate the DWR contracts into their respective generation resource portfolios, using a least-cost dispatch for the integrated portfolio, and to assume all operational, dispatch, and administrative functions for the DWR Contracts. As stated in D.02-09-053:

> "The utilities can now move forward with their procurement planning knowing exactly what DWR contracts they will need to integrate into their resource portfolios. Today's decision eliminates the current two-tier procurement system in California that was put in place on a temporary basis, and only under emergency circumstances, until the utilities could resume their procurement role. As described in this decision, the utilities will now perform all of the day-to-day scheduling, dispatch and administrative functions for the DWR contracts allocated to their portfolios, just as they will perform those functions for their existing resources and new procurements. Legal title, financial reporting and responsibility for the payment of contract-related bills will remain with DWR." (D.02-09-053 at 5.)

Constellation argues that while DWR still sells power in that it holds legal title to power dispatched under existing contracts, DWR is not supplying such power given the termination of its responsibilities for day-to-day scheduling, dispatch, and administrative functions for the power sold under

DWR contracts. Constellation argues that the "common understanding" of the terms "supplying" and "selling" are different, and that if the Legislature wished to have direct access suspended while DWR was "selling" power, it could have easily said so. Constellation argues that the Legislature used the terms "delivery," "transmits," or "sells," when describing DWR's retail sales functions. Constellation claims that there is no basis to equate the term "supplies" with DWR's retail sales function. Accordingly, AReM, CACES, and Constellation believe that there is no statutory impediment to the Commission's authority to reopen direct access.

Opposing parties argue, however, that DWR is currently supplying power, by virtue of having an ownership interest in the power sold under the DWR power contracts. TURN argues that the Commission has repeatedly characterized DWR as supplying power, as the owner and seller of the power that is delivered to retail customers under DWR contracts.[13] TURN argues that even though the utilities assumed responsibility for DWR contract administration after January 1, 2003, the Commission still referred to "energy supplied by DWR to the utility" in describing how the DWR energy payment was to be allocated after January 1, 2003.[14] TURN thus argues that DWR continued to supply power after January 1, 2003, based upon how the Commission has applied that terminology.

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[13] *See* D.02-12-069, which refers to DWR supplying power by providing electricity for delivery to retail customers, even though the IOUs would be scheduling and dispatching power.

[14] D.02-12-069, Appendix C, pp. 6-7.

TURN further argues that DWR, itself, has characterized its function as that of supplying power in its own published annual "Revenue Requirements Determinations." For 2007, DWR identified the level of energy "projected to be supplied on behalf of the retail electric customers of the IOUs through [DWR's] long term power contracts." DWR also stated that if one or more of DWR's contracts are terminated, energy "no longer supplied by DWR" would need to be replaced.[15] TURN points to such statements as further confirmation that DWR still supplies power to retail customers under AB1X. TURN thus argues that direct access suspension must continue as long as DWR has an ownership interest in *any* DWR power contract.

3.2.1. Discussion

As a basis to discern whether the statutory requirement that DWR "no longer supplies power" under AB 1X has been satisfied, we consider the alternative interpretations offered by parties of the statutory language. As described above, parties have presented essentially three possible interpretations of AB 1X. Briefly, these interpretations equate DWR's supplying of power with one of the following:

1) DWR authority to enter into new power contracts.
2) DWR responsibility for the scheduling and dispatch of power supplies.
3) DWR ownership and sale of power to retail customers.

We reject the interpretation that presumes that DWR no longer supplied power once its authority to enter into new power contracts ended on

[15] TURN Brief, page 10, citing DWR 2007 Revenue Requirements Determination, pp. 21 and 24.

January 1, 2003. The loss of authority to enter into new contracts to procure power is distinctly different from the supplying of power by sales to retail customers. Execution of contracts for the procurement of power was merely a means for DWR to secure contractual rights to sources of power supply to provide for ultimate sale to retail customers. Power is supplied, however, when it is sold to the retail end user. Even though DWR ceased to contract for new sources of power supply after January 1, 2003, power has continued to be supplied through the scheduling, dispatch and delivery of power sold to retail customers under existing DWR contracts executed prior to 2003.

The term "power" in this regard is defined as "electric power and energy, including but not limited to, capacity and output or any of them." (Water Code § 80010(f).) Based on its legal rights under existing contracts, DWR still owns the power supplies that continue to be delivered to retail customers from existing contracts.

We disagree with Constellation's contention that the selling of power does not constitute the supplying of power. Power clearly continues to be dispatched and sold to retail customers under DWR contracts that have continued in effect since January 1, 2003. From the retail customer's perspective, it makes no difference that the power being supplied to them is dispatched and sold pursuant to DWR contracts that were executed prior to 2003. These contracts are still in effect. Power is still being supplied to retail customers pursuant to DWR contracts.

The statutory language does not permit the direct access suspension to be lifted merely because DWR no longer has authority to enter into new contracts. If the Legislature had intended to lift the direct access suspension once DWR no longer had authority to enter into new contracts, the Legislature could

have simply specified the date of January 1, 2003 for the lifting of the suspension, or it could have referred to the time when DWR was no longer entering into new contracts. As the Legislature failed to use such language, we reject this first proffered interpretation of the language "no longer supplies power."

We likewise find no support for the second proposed interpretation that statutory requirement was satisfied once the responsibility for day-to-day dispatch and scheduling functions for power sold under DWR contracts was transferred to the IOUs. Certainly, the IOU is now responsible for scheduling and dispatch of the DWR power, and in that capacity is instrumental in delivering the DWR power to retail customers. DWR is no longer performing operational functions associated with the day-to-day scheduling, dispatch and delivery of DWR power to retail customers as it previously performed prior to 2003.

Nonetheless, the transfer of such operational functions from DWR to the IOUs on January 1, 2003 did not terminate DWR's role as supplier of power under AB1X. Such operational functions were not identified in the statutory language that requires that direct access remain suspended until DWR "no longer supplies power." Just because the responsibility for these operational functions was transferred from DWR to the IOUs, DWR did not thereby cease to supply power under AB1X.

Indeed, if we look at the reasons for the suspension of direct access mentioned above, we find that this interpretation of the term "supplies power" would not bear "a reasonable relation to statutory purposes." The purposes for requiring a suspension of direct access previously mentioned include: assuring a stable customer base for the recovery of bond and power costs, facilitating the bonds being issued at investment-grade ratings; and preventing cost shifting.

The transfer of operational functions to the IOUs did not particularly assure a stable customer base for paying DWR costs, assure that the bonds would be issued at investment-grade ratings, or prevent cost shifting. These concerns have been addressed by other mechanisms, including the imposition of the "Cost Responsibility Surcharge." The transfer of operational functions to the IOUs did not obviate the concerns that apparently led to the direct access suspension. Therefore, it would be inconsistent with the statutory purposes to conclude that the legislature meant – when it said that the suspension of direct access could be lifted when DWR "no longer supplies power" – that the suspension could be lifted just because the IOUs had taken over the dispatch and scheduling functions for DWR power.

We conclude that the third possible condition identified above as a basis for interpreting the point where DWR no longer supplies power is the correct one, namely, where DWR no longer has any ownership interest in the power that is sold to retail customers. This interpretation is the only one that bears a reasonable relation to the statutory purposes and language. Consistent with this interpretation, the DWR power continues to be "supplied" by the entity that legally "owns" and "sells" the power. That entity is DWR.

The legal responsibilities that still apply to DWR in supplying power are described in D.02-09-053, as follows:

> Legal title to the contracts resides with DWR. Financial reporting responsibilities, including those associated with the DWR revenue requirements proceeding and Trust indenture reporting requirements, will also remain with DWR. In addition, DWR will be financially responsible for paying all contract-related bills. ….
>
> As financial obligor under the allocated contracts, DWR will also need to monitor performance of the generators

> under the contracts to enable DWR as the contract counter party to make decisions related to actions to be taken in the event of performance issues with generators, contract disputes, defaults, or to defend DWR in the event of counterparty claims against DWR. In undertaking these actions, DWR should work in concert with the utilities through provisions to be incorporated into the operating agreements. (D.02-09-053 at 46.)

Although the IOU performs the operational functions associated with DWR power supplies, DWR retains the role of owner and seller of the power to retail customers. Water Code § 80002.5 states that "[i]t is the intent of the Legislature that power acquired under this division shall be sold to all retail end use customers served by electrical corporations, …."

Water Code § 80104 explains that "[u]pon the delivery of power to them, the retail end use customers shall be deemed to have purchased that power from [DWR]. Payment for any sale shall be a direct obligation of the retail end use customer to the department." Customers are supplied with power at the point of purchase. In turn, the purchase occurs "upon the delivery of power" pursuant to Water Code § 80104. Therefore, DWR "supplies power" under the statute upon the sale of the DWR power to retail end use customers. In this regard, Water Code § 80110 provides in relevant part:

> [DWR] shall retain title to all power sold by it to the retail end use customers. [DWR] shall be entitled to recover, as a revenue requirement, amounts and at the times necessary to enable it to comply with Section 80134, and shall advise the commission as the department determines to be appropriate.

Although the IOU performs billing and collection functions associated with DWR power sales, the revenues associated with the sale of the power belong to DWR.[16] We therefore conclude that under AB1X, DWR continues to supply power since it (a) owns the power that is produced under existing DWR contracts, and (b) sells such power to retail customers upon delivery to them. This conclusion is consistent with the use of the term supplying power in the prior Commission decisions in the context of AB1X. In D.01-03-081, for example, we began to develop a method for remitting funds to DWR for energy delivered to retail customers pursuant to DWR contracts. In that decision, we stated that remittances to DWR should occur "no later than 45 days after *DWR supplies power* to the utilities' retail end-use customers." (Emphasis added.)[17] This reference to supplying power necessarily means the actual delivery and sale of the power to retail customer marks is the time when power is supplied.

In summary, although DWR ceased to contract for new supplies of contract power after January 1, 2003, DWR continues to "sell" power to retail customers under contracts executed prior to January 1, 2003. By virtue of holding legal title to the power and selling it to retail customers, DWR—not the IOUs -- supplies the power under AB1X. Therefore, the Commission cannot lift the direct access suspension at this time because the suspension can only be lifted

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[16] *See* D.02-12-069 and D.02-02-051 which adopted the "Rate Agreement." The central feature of the Rate Agreement was the irrevocable commitment by the Commission under Pub. Util. Code § 840 *et seq.*, to set charges for electricity sold by DWR that would recover DWR's power-related and bond-related costs.

[17] D.01-03-081, Conclusion of Law 9.

when DWR "no longer supplies power." (Water Code § 80110.) Such is not the case at present time.

One way to satisfy the statutory condition that DWR no longer supplies power, however, is through the expiration of existing DWR contracts. After the contracts have expired, DWR will no longer supply power under AB1X since it will no longer have any ownership interest in power that is sold to retail customers. As explained in Section 4, however, we will consider the merits of possible alternative approaches to satisfy the statutory condition so as to allow the suspension to be lifted on a more expedited basis.

3.2.2. Can Direct Access Suspension Be Lifted in Stages as Individual DWR Contracts Expire?

As part of Phase I, we also consider whether AB1X can be interpreted to permit the suspension of direct access to be phased out in stages as individual DWR contracts expire.[18] We solicited parties' legal arguments in Phase I as to whether such an interpretation is legally supportable under the provisions of AB1X, whereby the statutory restriction that DWR no longer supply power would be construed on a contract-by-contract basis.

3.3. Parties' Positions

Certain parties suggest that even if the statute is interpreted to refer to power supplied under existing DWR contracts, direct access could still be reinstituted on a partial basis prior to 2017, as contracts expire. The DWR contracts do not expire simultaneously, but expire in gradual increments over a period of years. Some DWR contract quantities are exclusively subject to must-

[18] 2017 is the year the last DWR contract is scheduled to expire.

take clauses, some quantities are dispatchable on a least-cost basis, and others include a combination of both must-take and dispatchable purchases.

According to a DWR report issued in March 2006,[19] the number of active DWR contracts as of that date had been reduced from 59 to 33, with the cost of the portfolio reduced from $42.5 billion to $24.8 billion. By 2010, the cost of the remaining portfolio is expected to be $6.1 billion, or about one-seventh of the original liability. In 2001, DWR contracts covered 35% of the IOU's peak demand and energy requirements. By 2010, the remaining long-term contracts will cover only 15% of the IOU requirements.[20] The vast majority of DWR contracts are scheduled to expire by 2011.[21]

AReM denies that the term "supplies power" requires direct access suspension until the very last DWR contract expires. AReM argues that such an interpretation is unreasonably extreme and would preclude resumption of direct access even if just one contract remained for one Megawatt (MW).

CACES likewise argues that if the suspension were deemed legally binding until the very last DWR contract has expired, then the Commission's Constitutional authority could be undercut by private parties that could extend their DWR contracts for any time period. CACES argues that such an action would constitute a usurping of the Commission's decision-making authority. CACES argues, however, that California courts have held that the Commission's

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[19] *See* CACES Comments at 18, citing web site reference at http://wwwcers.water.ca.gov/energy_contracts.cfm.

[20] *Id.* at 18.

[21] *See* the DWR Revenue Requirement Determination for 2007, submitted to the Commission on August 2, 2006, pursuant to Sec. 80110 and 80134 of the Water Code, pp. 22-24, TABLE D-5 LONG-TERM POWER CONTRACT LISTING.

constitutional and regulatory authority cannot be limited by private contracts, especially where potential discriminatory results may occur. CACES argues that continued suspension of direct access based upon such action by private parties would unduly prolong the current restrictions on customer choice, which CACES characterizes as discriminatory.

Specifically, parties suggest that additional capacity might be opened up to direct access corresponding to the capacity in each respective DWR contract as it expires. CACES suggests that while the specific mechanics of a gradual lifting of the suspension between 2010 and 2015 could be addressed in Phase II of the proceeding, the Commission can confirm in Phase I that a partial lifting would be consistent with Water Code § 80110 and within the Commission's jurisdiction.

AREM and CACES thus argue that even if the Commission decides that a full lifting of the suspension is statutorily precluded at this time, then a partial lifting of the suspension should be considered to be legally permissible as individual DWR contracts expire. In the event that the Commission elected to lift the suspension based on such a legal interpretation, AREM proposes that an initial increment of direct access be authorized up to the amount of MW capacity of terminated or expired DWR contracts as of the time of the order, with additional increases in allowable direct access transactions each year thereafter based on the amount of additional DWR contract amounts that expired or terminated in the preceding year. CACES believes that the specific mechanics of how such increased allowances would be allocated could addressed in Phase III of this proceeding.

TURN disagrees with the claim that there is any legal basis for a partial lifting of the suspension. TURN argues that there is no reference in the

statute linking or relating the duration of the direct access suspension to the magnitude of annual quantities of power supplied by DWR. TURN argues that the notion that the suspension could be partially lifted based on annual fluctuations in DWR-delivered energy is at odds with the plain language of AB1X as well as the reasonable expectations held by legislators at the time. TURN believes that the Commission has no legal authority to lift the direct access suspension until the last DWR contract expires, currently due to occur in 2017.

TURN attached, as Appendix B of its comments, a copy of a letter dated May 23, 2007, authored by four members of the California Legislature to Commissioner Michael R. Peevey. In the letter, the authors stated the following in reference to AB1X:

> "There is nothing in this language to suggest that the legislature intended to allow the suspension to be lifted as individual DWR contracts expire. When AB1X was enacted, the legislature could not have known the quantity or duration of the contracts that DWR would execute. Accordingly the statute provides no indication that the length of the suspension could be linked to the duration of a subset of the DWR contracts. The suspension can only be lifted once DWR no longer supplies any power at all."

TURN thus argues that this letter from legislators supports the view that AB1X requires that the direct access suspension continue until DWR no longer supplies any power at all, which would only occur when the last DWR power contract expires.

3.3.1. Discussion

We decline to make a finding on this question at present. As discussed below, we choose for both policy and legal reasons to proceed with

Phase II of this proceeding in which we will consider the merits of possible alternative approaches to satisfy the statutory condition so as to allow the suspension to be lifted on a more expedited basis. Because a partial lifting of the ban on direct access would not entirely remove DWR from its role as a power supplier, we decline to consider this approach.

4. Next Steps: Proceeding to Phase II of this Rulemaking

While we conclude that the Commission cannot currently lift the suspension of direct access, there is still merit in proceeding forward expeditiously with Phase II of this rulemaking Consistent with the scope of issues previously designated for this phase of the rulemaking, we address herein the legal considerations relating to possible measures to facilitate removal of DWR from its role as supplier of power under AB1X.[22] Even though conditions in effect today require that the suspension continue in effect, we will move ahead to consider permissible steps whereby DWR could be removed from its role as power supplier under AB1X on an expedited basis. Exploring a plan to accelerate the timeframe to remove DWR from supplying power under AB1X is consistent with the policy that we previously articulated as noted below in D.02-12-069.

> Under ABX1-1, DWR's authority is not perpetual. Water Code Section 80260 provides that DWR's authority to contract for such purchases expired on January 1, 2003. Water Code § 80000 and 80003 further demonstrate that DWR's authority was an emergency measure designed to stabilize a crisis. Both

[22] We previously outlined in broad fashion the scope of issues to be addressed in each of the phases of this proceeding in the OIR issued on May 24, 2007, as further clarified by the Assigned Commissioner's Ruling dated July 19, 2007.

> the Commission and the Legislature have expressed their intent to eliminate the need for DWR to continue procuring power for the utilities after January 1, 2003, consistent with the utilities' statutory obligation to serve their customers.
>
> Consistent with the intent of ABIX, one of this Commission's fundamental short-term goals is to transition full responsibility for energy market related activities back to the utilities as soon as possible. We should therefore make every effort to relieve DWR from the responsibility to perform any functions that should be performed in the long term by regular market participants. We note that this direction is consistent with the fact that the utility, and not DWR, continues to have a statutory responsibility to serve its customers. The utilities' obligation to serve their customers is mandated by state law and is part and parcel of the entire regulatory scheme under which the utilities received a franchise and under which the Commission regulates utilities under the Public Utilities Act. (*See, e.g.,* Pub. Util. Code §§ 451, 761, 762, 768, and 770.) [Footnote omitted] (D.02-12-069 at 7-8.)

Consistent with D.02-12-069, alternative approaches should therefore be considered to remove DWR from the role of supplying power to retail customers under AB1X on an expedited basis. We will consider in Phase II the most appropriate process and timing considerations to examine alternative approaches, and whether such approaches would be in the public interest.

CACES offers two possible approaches for accelerating the timeframe in which DWR no longer supplies power under AB1X. One approach would be through the novation and assignment of existing DWR contracts, as suggested in the OIR, whereby DWR would be taken out of the power supply chain entirely. Alternatives may be available whereby DWR could terminate its ownership interests earlier than the current contract expiration dates. If its ownership interests were to be terminated, the condition that DWR no longer "supplied

power" would be satisfied. The Commission would then be legally permitted to lift the suspension on direct access subject to further findings in Phases II and III concerning the public policy merits and manner of doing so. Another possible approach suggested by CACES is to alter the flow of power from the DWR contracts whereby title to the power would move to a third party before any possible resale to retail customers. As a strategy to accomplish such a goal, CACES points to the approach applied in D.06-07-029, where the utilities secure resources for system need rather than for bundled retail customers.

Under such an approach, DWR would no longer sell power directly to retail customers, but would make the power available to the wholesale power market. CACES argues that the following advantages could be realized through this approach:

(1) DWR would no longer directly provide power to retail customers because the IOUs could assume the contracts;

(2) The IOUs would not need to operate as "limited agents" of DWR under the Rate Agreement and Operating Agreements;

(3) An energy auction could open up access to the DWR contract power to all load serving entities and the regional markets in a way that would negate the need for new or more complex non-bypassable charges, and

(4) The utilization of power under the DWR contracts could be better optimized as the contracts were secured for statewide loads rather than any specific IOU residual net short that existed at the time the contract was executed.

According to CACES, DWR would continue to own the power delivered under the contracts, but the flow of power could be altered in a way that would keep DWR whole while having legal title to the power move to a third party before any possible sale to retail customers. By treating DWR contracts in the

same manner as other resources procured for system needs, CACES argues, the revenue stream to pay for the DWR contracts would be protected, and the IOUs would be indifferent to load migration that could occur with the reopening of direct access. CACES contends that the IOUs could make the DWR power available to the system by simply bidding the power into the California Independent System Operator integrated forward market based on each contract's underlying economics, rather than self-scheduling it without economic bids.

Through this approach, CACES argues, there would be no need for multiple contract negotiations with DWR suppliers as would be the case with assignment and novation, because there is no change in the underlying existing commercial arrangements. CACES argues that this approach offers an additional tool should the IOUs decline to pick up the DWR contracts through assignment/novation, either because they do not fit well into the IOUs resource portfolios, or due to financial implications, such as debt equivalency.

CACES notes that Water Code § 80116 specifically permits DWR to direct the output of its contracts to entities other than retail customers when there is a sufficiency of resources, stating:

> However, to the extent that any acquired power that is not required for use within the state, *if it is otherwise advantageous and necessary, the power may be sold, transferred, or otherwise disposed of, or an option may be granted with respect to the power, to any person or public or private entity*." (Sec. 80116, emphasis added by CACES.)

CACES argues that this provision allows for the assignment of the contracts to the IOUs through novation, or by treating the power in the same manner as other IOU-procured system resources. Alternatively, CACES argues,

DWR could auction off the rights to the contract output in a manner similar to that contemplated for the IOUs.

In its comments on the Proposed Decision, TURN contends that any arrangement to redirect the flow of DWR power to the wholesale market, as suggested by CACES, such as through an energy auction, would likely be unlawful because it would violate the purposes for which DWR was directed to enter into the electricity market in the first instance. SCE likewise argues in its comments on the Proposed Decision, that there is nothing in the record to indicate how such an energy auction would be implemented and whether its implementation would meet the legal requirements for ending the Direct Access suspension.

In Phase II, we shall consider the merits of possible approaches to facilitating the removal of DWR from its role of supplying power under AB1X, including whether the CACES concept of redirecting the flow of DWR power to the wholesale market has merit from a legal as well as an operational perspective. Concurrently we also shall explore whether, in order to satisfy legal requirements, it may be appropriate for DWR to terminate its ownership interests in its existing contracts and transfer them to one or more of the IOUs, or other credit-worthy third parties through novation or assignment. Such possible approaches are not necessarily mutually exclusive, but may also be explored as complementary options.

If we deem an option to have potential merit, we shall further consider how implementing such an option could affect various interests. In addition to the contracting parties, other relevant interests include those of bundled and direct access customers, the IOUs, and the DWR bondholders. We shall provide

parties an opportunity to address such impacts on the relevant affected interests in Phase II of this proceeding.

We would need to consider whether or to what extent, power costs charged to retail electric customers, or service reliability, would be affected as a result of assignments of DWR contracts. We also would consider whether, or to what extent, the IOU assumption of additional financial obligations of the DWR Contracts could adversely affect their debt equivalence, credit ratings, or costs of capital. The potential effects on utility procurement planning would also be considered.

We also recognize the necessity to protect the interests of DWR Bondholders as required by the "Rate Agreement" adopted in D.02-02-051. Water Code § 80110 expressly entitles DWR to recover in electricity charges amounts sufficient to enable it to comply with Water Code § 80134, which provides for the revenues necessary, inter alia, to support the bonds that DWR was authorized to issue pursuant to Water Code § 80130. Bond proceeds were used to repay the debt that DWR incurred to finance power purchases during the electricity crisis, including amounts owed to the State of California General Fund. D.02-02-051 prescribed the terms and conditions for the recovery of DWR's revenue requirements including the sums necessary, to pay the DWR bonds, as set forth in the "Rate Agreement" adopted therein. The provisions of the "Rate Agreement" do not terminate until the bonds and associated financial obligations have been paid or otherwise funded.[23]

[23] Sections 5.1(a) and 5.1(b) of the Rate Agreement have the force and effect of an irrevocable financing order issued by the Commission pursuant to Pub. Util. Code § 840 *et seq*., and these sections may not be amended after the bonds have been issued.

As explained in D.02-02-051, the DWR receives two revenue streams: (a) a revenue stream from Bond Charges imposed on electric customers, designed to pay for bond-related costs, and (b) a second revenue stream from DWR Power Charges imposed on electric customers, designed to pay the commodity costs of DWR power. Both streams of revenue provided necessary support for DWR to issue bonds with investment-grade ratings.

According to DWR, the DWR bonds were marketed and sold based in part on representations regarding the suspension of direct access and the reserves that DWR would maintain for operating expenses and debt service. DWR states that if, or to the extent, that lifting the direct access suspension could create a material shift in the sources of DWR's revenue streams, it could require changes in the amount of DWR reserves. Such changes could be required to protect against the risk of significant load migration from bundled service to direct access, as well as any other relevant risks. Any possible contract assignment would need to consider the effects on the DWR bonds and bondholders, including reserve requirements, bond ratings, interest charges, and any other relevant concerns.

As noted in its 2007 Revenue Requirement Determination,[24] DWR has renegotiated 19 of the original contracts from 2001 that currently remain in effect, and has terminated five additional contracts for cause. DWR has continued efforts to renegotiate additional contracts, and regularly monitors its contracts to determine if there are opportunities for bilateral negotiation which could lead to more favorable terms and costs.

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[24] *See* the DWR Revenue Requirement Determination for 2007, submitted to the Commission on August 2, 2006, pursuant to §§ 80110 and 80134 of the Water Code.

A number of the renegotiated DWR contracts contain novation clauses which may be exercised at the discretion of DWR. Under a novation clause, upon a written request by DWR, the counterparty to a contract must enter into a replacement agreement with one or more qualified electric suppliers.[25] The execution of such a replacement agreement would thereby constitute a novation that would relieve DWR of any liability or obligation arising under the new agreement.

For DWR contracts that do not contain novation clauses, the contracting parties may still negotiate contract assignment, but DWR may not unilaterally require the counterparty to enter into a replacement agreement. As a vehicle for relieving DWR of all ownership obligations under the power contracts so that the direct access suspension can be lifted, we will consider measures to facilitate contract novation or assignments to a third party.

Assuming that DWR were to proceed with the assignment of DWR Power Contracts, we envision the following steps:

(1) The Commission may request that DWR enter into discussions with qualified entities regarding a process to assign its DWR contract interests.

(2) Upon reaching agreement with one or more qualified entities for the assignment of rights and obligations, DWR provides written request to counterparties to contracts with novation or assignment clauses to enter into a replacement agreement with one or more of the designated entities.

[25] In order to be qualified to take over the rights and obligations of a DWR contract, the supplier's long-term unsecured senior debt must meet specified minimum credit rating standards.

(3) Since DWR may not have unilateral discretion to require counterparties to enter into replacement contracts for contracts without novation clauses, DWR would enter into negotiations with the counterparties for such contracts to adopt amendments to allow the substitution of another credit-worthy entity to assume the rights and obligations of DWR under such contracts, and

(4) Replacement contracts with the applicable entities are executed where novation or assignment clauses apply.

As noted previously, by 2010, the remaining long-term DWR contracts are expected to cover only 15% of the IOU requirements. The vast majority of DWR contracts are scheduled to expire by 2011.[26] Therefore, depending on the time table for the lifting of direct access, the number of remaining power contracts (and associated capacity) that would require reassignment may be substantially less than what exists today. The task of DWR assigning its remaining contract interests may become more manageable as a result.

In its comments on the Proposed Decision, SDG&E agrees that novation or assignment of DWR contracts would constitute one means of meeting the condition that DWR "no longer supply power" under AB1X. SDG&E, however, argues that any novation or assignment of DWR contracts to a party other than DWR should occur only after certain prescribed conditions are met, as enumerated in SDG&E's comments. The question of the time frame within which any DWR contract novation or assignment may occur, and its sequencing relative to other conditions, are issues for Phase II of this proceeding. We make no prejudgment concerning what timing considerations may be involved, or

[26] *See* the DWR Revenue Requirement Determination for 2007, submitted to the Commission on August 2, 2006, pursuant to Sec. 80110 and 80134 of the Water Code, pp. 22-24, TABLE D-5 LONG-TERM POWER CONTRACT LISTING.

what conditions should be met or addressed before steps would be undertaken to implement or facilitate novation or assignment of DWR contracts. Parties will be provided with the opportunity to comment on such issues in Phase II of this proceeding.

Consistent with the directives herein, a scoping memo will provide guidance regarding the development of issues designated for Phase II of this proceeding, as previously outlined in the OIR.

5. Comments on Proposed Decision

The proposed decision of the assigned Commissioner in this matter was mailed to the parties in accordance with § 311 of the Pub. Util. Code and Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on December 31, 2007, and reply comments were filed on January 7, 2008. We have taken the comments into account, as appropriate in finalizing this order.

6. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Thomas R. Pulsifer is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. On December 6, 2006, the Alliance for Retail Energy Markets *et al.* filed a petition pursuant to Pub. Util. Code § 1708.5 requesting that the Commission institute a rulemaking to consider rules for lifting the suspension of direct access.

2. The market and regulatory conditions in effect at the time that direct access was suspended in 2001 have continued to evolve.

3. Although DWR's authority to enter into new power contracts terminated as of January 1, 2003, and the IOUs took over responsibility for the scheduling and dispatch of DWR contract power after that date, DWR's authority to sell

electric power to retail customers pursuant to previously executed DWR contracts continues in effect.

4. Water Code § 80110 provides that DWR shall retain title to all power sold by it to the retail end use customers, and is entitled to recover, as a revenue requirement, amounts necessary to enable it to comply with Section 80134.

5. Financial reporting responsibilities associated with the DWR power supply remain with DWR in both the revenue requirements proceeding and Trust Indenture reporting requirements. DWR is also financially responsible for paying all DWR contract-related bills.

6. DWR performs the functions of holding legal title to the power, and "selling" the power to retail customers. Water Code § 80104 explains that "[u]pon the delivery of power to them, the retail end use customers shall be deemed to have purchased that power from [DWR]."

7. The Commission designated Phase I of this rulemaking for the purpose of determining whether, or subject to what timing of other conditions, legal authority exists for the Commission to lift the suspension of direct access.

8. Phase I was also to address legal issues involved with facilitating the novation or assignment of DWR contracts as a possible vehicle to satisfy the requirement that DWR no long supplies power under AB 1X, whereas the substantive merits and related process and timing issues of such an action were to be deferred to Phase II.

9. In D.02-12-069, the Commission has stated that a fundamental short-term goal is to transition full responsibility for energy market related activities back to the utilities as soon as possible, and to make every effort to relieve DWR from the responsibility to perform any functions that should be performed in the long term by regular market participants.

10. DWR has continued efforts to renegotiate contracts, and regularly monitors its contracts to determine if there are opportunities which could lead to more favorable terms and costs.

11. A number of the renegotiated DWR contracts contain novation clauses which may be exercised at the discretion of DWR, whereby upon a written request by DWR, the counterparty to a contract must enter into a replacement agreement with one or more qualified electric suppliers

12. By 2010, the remaining long-term DWR contracts are expected cover only 15% of the IOU requirements. The vast majority of DWR contracts are scheduled to expire by 2011. The task of DWR assigning its remaining contract interests may become more manageable as additional contracts expire.

Conclusions of Law

1. Although the Commission has broad authority to interpret governing statutes, such authority is to be applied so as to bear a reasonable relation to the statutory purpose and language.

2. The general rule of statutory construction is that if statutory language is clear and unambiguous, there is no need to look beyond the plain language of the statute.

3. The question of whether the Commission has legal authority to lift the suspension of direct access turns on whether DWR continues to supply power under AB1X.

4. Before the direct access suspension may be lifted under existing statutory authority, the Commission must first determine that such action is compliant with the condition in AB1X mandating the suspension continue until DWR "no longer supplies power" pursuant to the statute.

5. Once DWR "no longer supplies power" under AB1X, the Commission then has the legal authority to lift the direct access suspension.

6. The provisions underlying AB1X require interpretation to discern the meaning of the language referencing whether DWR continues to supply power. While the Commission has authority to interpret AB1X, the interpretation must be within the bounds of the governing statutory language. The Commission's authority to interpret a statute does not permit disregarding statutory language or to make an interpretation that bears no reasonable relation to statutory purposes and language.

7. The interpretation that DWR no longer supplied power once its authority to enter into new procurement contracts ended is invalid and does not bear a reasonable relation to statutory purposes and language.

8. The interpretation that DWR no longer supplied power once the day-to-day power scheduling and dispatch functions were transferred to the IOUs is invalid and does not bear a reasonable relation to statutory purposes and language.

9. The interpretation that bears a reasonable relation to the statutory purposes and language of AB1X is that DWR supplies power in its current capacity as legal owner holding title to the power under DWR contracts and selling the power to retail customers.

10. The Commission currently cannot lift the suspension on direct access because DWR supplies power under the provisions of AB1X by virtue of owning the power dispatched under DWR contracts and selling it to retail customers.

11. If DWR were to terminate its ownership interests in the remaining DWR contracts, then DWR would no longer be supplying power under AB1X. The substantive merits of whether termination of DWR's ownership interests in the

contracts, such as through novation or assignment, would be in the public interest, and how such a process might work, are issues to be addressed in Phase II of this proceeding.

12. As part of the inquiry into how the Commission could legally lift the suspension, it is reasonable to proceed in Phase II to consider the merits of alternatives to remove DWR from its role as supplier of power under AB1X. Alternative approaches to be considered include whether or how to terminate DWR's ownership interests under existing contracts, and whether the CACES concept of redirecting the flow of DWR power to the wholesale market has merit from a legal as well as an operational perspective. Alternatives are not necessarily mutually exclusive.

13. The Commission should continue proceedings in this rulemaking in Phase II in accordance with the scope set forth in the OIR, subject to any subsequent rulings.

14. As an element of Phase II, the Commission should consider the merits of possible alternative approaches such as through the novation or assignment of DWR contracts, to satisfy the statutory condition so as to allow the suspension to be lifted on a more expedited basis.

15. Review of any possible DWR contract assignment should take into account the effects on the DWR bonds and bondholders, including reserve requirements, bond ratings, interest charges, and any other relevant concerns.

O R D E R

IT IS ORDERED that:

1. Phase I of this proceeding is hereby resolved by the determination herein that the Commission does not currently have authority to lift the direct access

suspension because California Department of Water Resources (DWR) currently supplies power under Assembly Bill (AB) 1X.

2. Phase II of this proceeding shall move forward consistent with the general scope as defined in the OIR (R.07-05-025) dated May 24, 2007, as modified by Assigned Commissioner's Ruling dated July 19, 2007, and subject to any subsequent rulings.

3. Phase II of this proceeding shall also consider the merits of possible alternative approaches to satisfy the legal conditions s as to allow the suspension to be lifted on a more expedited basis.

4. A scoping memo will be issued prescribing how Phase II issues shall be coordinated and sequenced consistent with the further inquiry relating to termination of DWR's power supply role.

This order is effective today.

Dated February 28, 2008, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners

Commissioner Timothy Alan Simon, being necessarily absent, did not participate.