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Decision No. 89067 JUL 11 1978

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of  
SAN DIEGO GAS & ELECTRIC COMPANY  
for Authority to Lease Certain  
Electric Generating Equipment and  
Related Facilities Known as Encina 5  
and for Approval of a Facilities  
Agreement in Connection Therewith  
Pursuant to Sections 246 and 851 of  
the Public Utilities Code of the State  
of California.

Application No. 58148  
(Filed June 19, 1978)

O P I N I O N

On June 19, 1978, San Diego Gas & Electric Company (SDG&E), filed an application seeking an ex parte order from the Commission, pursuant to Sections 246 and 851 of the Public Utilities Code not later than July 14, 1978 approving the terms of and authorizing the execution of a Lease Agreement and a Facilities Agreement in connection with the sale and leaseback of SDG&E's Encina 5 generating unit.

The Commission has, on numerous occasions, encouraged SDG&E to explore creative alternative financing vehicles. Leveraged leasing and sale and leaseback transactions are examples of such vehicles.

The California Legislature recently amended the Public Utilities Code by adding Section 246, which authorizes the Commission to approve the terms of a lease between a lessor of an electric utility plant and a public utility and further providing a lessor is exempt from Section 216 of the Public Utilities Code.

The implicit cost of money to SDG&E on this transaction is currently estimated at 5.74% which is substantially below the 9.67% cost of capital adopted by the Commission in

SDG&E's latest rate case.<sup>1/</sup>

The Encina Power Plant has four generating units in commercial operation. Encina 5 is an additional unit which is currently under construction. It is proposed that, pursuant to the Financing Agreement (Attachment C to the Application), SDG&E will sell all of its right, title and interest in Encina 5 to Lloyds Bank California, as Owner Trustee, on behalf of the equity investor, BameriLease, Inc. as Owner Participant. Various Loan Participants will advance funds secured by a security agreement and mortgage on the facility. SDG&E will, pursuant to the Lease Agreement (Attachment D to the Application), lease Encina 5 back from the Owner Trustee for a period of twenty-five years, with certain renewal options.

SDG&E will also grant to the Owner Trustee, pursuant to the Lease Agreement and the Facilities Agreement (Attachments D and E to the Application), rights in and easements on existing properties and facilities which are necessary for use in connection with Encina 5. SDG&E's Application seeks approval of this Lease Agreement and the Facilities Agreement pursuant to Section 851 of the Public Utilities Code, insofar as they grant rights in an easement on utility property which is necessary or useful in the performance of its duties to the public.

SDG&E will not issue any stock or other evidence of interest or ownership in connection with this transaction, nor will these Agreements be regarded as a bond, note or other evidence of indebtedness. SDG&E will not, through its lease payments, acquire any ownership, equity or reversionary interest in the Encina 5 facility.

SDG&E filed this application on June 19, 1978 requesting expeditious approval so that the sale and leaseback transaction may be consummated before that degree of testing which results in production of electricity is undertaken. It

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<sup>1/</sup> Decision No. 88697, dated April 11, 1978.

is expected that this will occur on or before July 14, 1978. This is necessary to insure that the purchaser become the first user of the equipment to utilize the Investment Tax Credit.

The point at which equipment is placed in service is unclear under Internal Revenue Service regulations.

SDG&E requested 15 rulings on April 26, 1978 relative to the sale and leaseback transaction, including one that "the facility will first be 'placed in service' within the meaning of Sections 1.46-3(d) and 1.167(a)-11(e)(1)(1) of the Regulations upon successful completion of the testing procedures".

On June 14, 1978 SDG&E requested a separate ruling from IRS on this one issue and on June 19, 1978 presented Application No. 58148 to this Commission requesting approval as soon as possible.

There are income tax considerations in this transaction which make it advantageous to the Owner Trustee, SDG&E and the Company's ratepayers. Qualification for such tax advantages is a function of the timing of the transaction and it appears that the operative date may occur in the very near future. Consequently, SDG&E has requested that an order approving this transaction be effective immediately.

SDG&E proposes that the specific ratemaking treatment for this transaction be explored in SDG&E's current rate Application No. 58067.

The Staff has reviewed Application No. 58148 and recommends that the requested approval under Section 246 be granted and SDG&E be authorized to enter into the agreements in substantially the same form as presented in the application.

The Commission has considered this matter and finds that:

1. The transaction described in the Application and Attachments will be to the ratepayer's benefit due to its cost of capital and financing advantages.

2. The appropriate rate treatment for the transaction should be determined in Application No. 58067, SDG&E's general rate case.
3. The Lease Agreement constitutes a true lease and SDG&E is not a guarantor or issuer of indebtedness under Sections 816, 817, 818, 830 or 851 of the Public Utilities Code.
4. The terms of the Lease Agreement should be approved as contemplated in Section 246 of the Public Utilities Code.
5. The terms and conditions of the Lease Agreement, insofar as they grant rights in existing utility property which is useful or necessary in performing SDG&E's duties to the public, are necessary and reasonable, and, therefore, SDG&E should be authorized, pursuant to Section 851 of the Public Utilities Code, to enter into such Agreement in substantially the same form as presented herein.
6. The terms and conditions of the Facilities Agreement, insofar as they grant rights in an easement on existing utility property which is useful or necessary in performing SDG&E's duties to the public, are necessary and reasonable, and, therefore, SDG&E should be authorized, pursuant to Section 851 of the Public Utilities Code, to enter into such Agreement in substantially the same form as presented herein.
7. Preservation of the tax advantages of this transaction is dependent upon its consummation as soon as possible, and, therefore, this matter requires expedited treatment. A public hearing is not necessary.

On the basis of the foregoing findings we conclude that the application should be granted and this Order should be effective immediately.

#### O R D E R

IT IS ORDERED that:

1. The terms of the Lease Agreement are approved and San Diego Gas & Electric Company is hereby authorized to enter into such Lease Agreement in substantially the same form as set forth in Attachment D to the Application, for purposes of qualification under Section 246 of the Public Utilities Code.
2. San Diego Gas & Electric Company is hereby authorized, pursuant to Section 851 of the Public Utilities Code, to enter into such Lease Agreement in substantially the same form as set

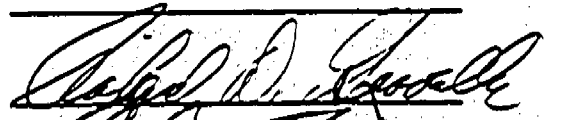

forth in Attachment D to the Application, insofar as it provides for the granting of rights and interests in existing utility property which is necessary or useful in the performance of the Company's duties to the public.

3. San Diego Gas & Electric Company is hereby authorized, pursuant to Section 851 of the Public Utilities Code, to enter into such Facilities Agreement in substantially the same form as set forth in Attachment E to the Application, insofar as it provides for the granting of rights in and easements on existing utility property which is necessary or useful in the performance of the Company's duties to the public.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 11th day of F JULY, 1978.

  
President

  
  
Commissioners

Commissioner William Symons, Jr., being necessarily absent, did not participate in the disposition of this proceeding.

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.