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Decision 97-12-107 December 16, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authorization to Sell Certain Generating Plants and Related Assets Pursuant to Public Utilities Code Section 851. (U 39 E)

ORIGINAL

Application 96-11-020
(Filed November 15, 1996)

INTERIM OPINION

Summary

We approve the application of Pacific Gas and Electric Company (PG&E) for authority, pursuant to Public Utilities (PU) Code Section 851, to sell the Morro Bay, Moss Landing, and Oakland fossil-fuel electric generation plants to affiliates of Duke Energy Power Services, Inc. (Duke EPS), the terms and conditions of the related sales, and the forecast environmental remediation and transaction costs for purposes of accounting and ratemaking adjustments. We refer the request of the Southeast Alliance for Environmental Justice (SAEJ) for a finding of eligibility for compensation to the assigned Commissioners.

Procedural Background

PG&E filed its application on November 15, 1996. Notice appeared in the Daily Calendar on November 19, 1996. We issued our first interim opinion in Decision (D.) 97-09-046 on September 3, 1997, in which we permitted PG&E to commence an auction of the three plants, subject to certain conditions, and approved the accounting and ratemaking treatment described in the application. On October 22, 1997, we adopted D.97-10-022, which approved a mitigated negative declaration for the project represented by the application, and approved a related mitigation, monitoring, and reporting program. On November 5, 1997, we adopted D. 97-11-030, which required PG&E to require as a condition of sale that the successful bidder enter into an operations and maintenance agreement with PG&E as described in the application, and

for the Moss Landing Power Plant and Oakland Power Plant, an agreement with the Independent System Operator (ISO).

On November 11, 1997, an evidentiary hearing was convened concerning PG&E's estimated environmental remediation costs for the plants. At the hearing, it was determined that no disputed issues existed, as a result of the adoption by PG&E of the recommendations of the Office of Ratepayer Advocates (ORA). At the hearing, PG&E disclosed that it anticipated making the results of its auction available on November 20, 1997. The assigned administrative law judge (ALJ) issued a ruling on November 13, 1997 permitting any party to make a responsive pleading to PG&E's filing not later than the sixth business day following. On November 20, 1997, PG&E made a Compliance Filing to certify that it had followed the auction process approved by the Commission, identify Duke EPS as the buyer of the three plants, provide certain estimates, including book values and transaction costs, for accounting and ratemaking adjustments necessary to reflect the sales, and request a final order finding that the sales are in the public interest and approving them. On December 2, 1997, ORA filed its response. On December 5, 1997, PG&E filed a reply to ORA's response. On December 12, 1997, Duke and its affiliates moved that the Commission make certain findings necessary to qualify the owners of the plants as exempt wholesale generators under Section 32(e) of the Public Utilities Holding Company Act (PUHCA). No other party commented on the record.

On April 8, 1997, SAEJ filed a notice of intent to claim compensation, 85 days after the second prehearing conference of January 13, 1997 was held, and after an evidentiary hearing was held on March 31, 1997. On September 29, 1997, the assigned ALJ issued an order finding that SAEJ was not eligible for compensation. On October 28, 1997, SAEJ filed a request for the Commission to make a finding of eligibility for compensation.

Description of the Application

Auction of the Plants

PG&E conducted an auction of three electric generation plants: Morro Bay Power Plant, Moss Landing Power Plant, and Oakland Power Plant. The real and personal property included in the proposed sale are described, in general, in D. 97-09-046, and in detail in PG&E's November 20, 1997 filing.

PG&E's investment banker, Morgan Stanley & Co. Incorporated (Morgan Stanley) sent letters to more than 175 domestic and international utilities, power marketers, independent power producers and other potential purchasers. PG&E ran advertisements in *The Wall Street Journal* and the *Financial Times*, and publicized the auction on its Internet web site. Following issuance of D.97-09-046, Morgan Stanley sent a confidential information memorandum containing detailed information about the proposed auction to 46 potential bidders, each of which was also permitted to inspect documents at PG&E related to the plants and general information concerning electric restructuring in California. On October 10, 1997, bidders submitted statements of interest and qualification, including a non-binding initial bid. Based on an evaluation of the financial and operational background of the bidders and the amounts of the initial bids, PG&E selected bidders to participate in the second stage of the auction.

On October 12, 1997, PG&E provided the remaining bidders with proposed forms of agreement for the sale and operation of each plant. During the following five weeks, each bidder visited the plants for which it was bidding, received a management presentation on the plants and associated contractual and regulatory issues, had follow-up meetings and telephone conference calls with PG&E staff to answer specific questions, and continued review of documents related to the plants. On October 27, 1997, all the bidders submitted contract markups and comments to PG&E, which reviewed the proposed changes, and returned revised, final contract documents to all bidders on November 3, 1997.

On November 14, 1997, final, price-only, binding bids were received. Duke EPS submitted the highest bid, $501 million for the three plants as a package. No

other single bid or combination of bids yielded proceeds as high as the bid of Duke EPS. On November 18, 1997, PG&E's board of directors met and approved the sale, PG&E and Duke EPS signed purchase and sale agreements for the plant, and Duke EPS provided a $6.9 million irrevocable standby letter of credit to secure its performance of the agreements. Copies of those purchase and sale agreements, an Operation and Maintenance Agreement, and a Switchyard and Retained Properties Agreement for each plant were included in PG&E's November 20, 1997 filing. In addition, a Special Facilities Agreement for the Oakland Plant was included.

Duke EPS is a Colorado corporation, and a unit of Duke Energy Corporation, one of the country's largest energy services companies. Duke EPS will make the acquisition of the three plants through three special-purpose Delaware limited liability companies: Duke Energy Morro Bay LLC, Duke Energy Moss Landing LLC, and Duke Energy Oakland LLC. A subsidiary of Duke Energy Corporation, Duke Capital Corporation will guarantee the obligations of the three limited liability companies under the agreements. Duke Capital Corporation has a Standard & Poor's corporate rating of "A."

Neither Duke EPS nor its parent or affiliates owns or controls any other generation assets in California.

No party raised any claim that the auction was conducted contrary to the approved procedures.

We have considered the mitigated negative declaration that we adopted in D.97-10-022 and the adequacy of the measures approved there to avoid the possibility of indirect physical changes to the environment or to reduce the effect of such changes to non-significant levels. We will conclude that the sale and transfer of the plants is in the public interest, subject to the adoption of those measures (which are independent of the identity of the buyer) and to our analysis of the factors in PU Code Section 362.

Market Power

In proceedings pursuant to Section 851, we must ensure that "facilities needed to maintain the reliability of the electric supply remain available and

operational, consistent with maintaining open competition and avoiding an overconcentration of market power." (PU Code § 362.) In D.97-11-030, we determined that making two of the three plants subject to an agreement with the ISO was consistent with maintaining open competition, but we reserved determining whether it would be consistent with "avoiding an overconcentration of market power." Now that we know the results of the auction, we are in a position to determine whether the outcome raises any overconcentration issue or other market power issue. None appears, because the buyer represents a new entrant to the California market, and no party has raised any claim that the buyer will possess sufficient capacity to have market power.

Request for Exempt Wholesale Generator Finding

Under the federal Energy Policy Act of 1992 (the Act), it is possible for Duke's limited liability company affiliates to qualify as "exempt wholesale generators" (EWGs) under the Act, which avoids federal regulation as a public utility holding company under PUHCA. Duke's affiliates must apply to the Federal Energy Regulatory Commission for EWG status and, in the case of facilities that were formerly in a utility's ratebase, such as the three plants PG&E has agreed to sell, a finding is necessary that allowing such a facility to be an EWG "(1) will benefit consumers, (2) is in the public interest, and (3) does not violate State law." (15 U.S.C. § 79z-5a(c).) Since that determination must be made by this Commission, as the applicable state utility commission, Duke EPS requests that we include that determination in this decision.

The transition of electrical generation from a regulated monopoly to a competitive marketplace is the policy of the State of California. (*See, e.g.*, PU Code § 330(d).) That policy is expressly intended to benefit consumers. (*Id.*) Subjecting the affiliates of Duke to regulation under PUHCA would not advance that policy and is not required to prevent any violation of California law regulating utilities.

Accounting and Ratemaking Adjustments

PG&E proposes to remove the net book value of the plants from rate base upon sale. Because the sales proceeds exceed the net book value, the difference between the book value of the plants and sales proceeds, net of transaction costs and tax effect,

will be credited to the Transition Cost Balancing Account (TCBA). This is expected to amount to approximately $60 million.

PG&E estimates its transaction costs will total approximately $9.9 million. It estimates net taxes will amount to $41 million. PG&E calculates the net book value of the plants at $390.2 million, including inventories. The buyer will assume responsibility for non-environmental decommissioning costs, and PG&E will be responsible for the environmental remediation portion of such costs. As a result, PG&E proposes to remove from its non-nuclear decommissioning liability the net amounts accrued for environmental remediation and non-environmental decommissioning, resulting in a surplus of $23,128,445, which will be applied *pro rata* across remaining generation plants, with the effect of reducing rate base. ORA does not dispute, or finds reasonable, each of these proposals.

ORA does dispute PG&E's position that the rate of return applicable to the three plants should be the authorized rate of return from July 28, 1997 (pursuant to D.97-07-059), rather than the reduced rate of return required by D.97-11-074. In addition, ORA does not agree that a 10-basis point increase in return on equity for each 10% of fossil plant divested, as contemplated by D.97-07-059, should be effective before the closing of the sale or that the increase may be applied in increments of less than 10%, as PG&E as PG&E contemplates in its November 20, 1997 filing. PG&E clarifies, however, in its December 5, 1997 filing that it is not seeking adoption of its suggestions in this proceeding. Therefore, the resolution of these differences should not delay the transfer of the plants. PG&E may advance its suggestions in other proceedings, as appropriate, consistent with the procedural schedules adopted in such proceedings.

SAEJ's Request

PU Code Section 1804(a)(1) provides as follows: "A customer who intends to seek an award under this article shall, within 30 days after the prehearing conference is held, file and serve on all parties to the proceeding a notice of intent to claim compensation." The duty of the Commission to award compensation set forth in PU

Code Section 1803 is expressly conditioned upon compliance with Section 1804, and does not provide for any exception.

PU Code Section 1804(a)(1) recognizes that there may be cases where filing a notice of intent within 30 days of the prehearing conference is not possible, because the schedule would not reasonably allow parties to identify issues within that time. That was the basis for our award in D.95-03-007, permitting another intervenor to obtain compensation even though it had filed out of time. In that case, we had issued a previous decision that was necessary to clarify the issues in that case.

In this case, not one but two prehearing conferences (PHCs) were held, on December 19, 1996 and January 13, 1997. SAEJ was represented by counsel at each. Many of the issues litigated in this proceeding were identified at the first PHC. In particular, the applicability of the California Environmental Quality Act and the appropriate point at which a decision qualifies as the approval of a discretionary project was specifically identified as an issue. (Tr. at 25.) That was an issue to which SAEJ devoted much attention subsequently. Counsel for another party identified as issues "the particular regulatory and programmatic environment of Hunter's Point, the reliability within the Hunter's point, local reliability, the availability of alternatives and alternative programs within the Hunter's Point proposal, including shutting it down." (Tr. at 37.) These are issues that SAEJ has also participated in developing since the date of the first PHC.

At the second PHC on January 13, 1997, the ALJ reviewed the positions of the parties reflected in the filings. (Tr. 62-69.) This review included the choice of plants for divestiture, market power, identification of the relevant market, mitigation measures for market power, reliability, alternatives for reliability services, the factual basis for reliability, the difference between must-run and non-must-run plants for scheduling purposes, the relationship of the auction process to the competitive transition charge, the role of bidder qualification and what role, if any, non-price factors should play in bid evaluation, the effect of divestiture on air quality management planning assumptions, the significance of different operational strategies from PG&E's for the

plants, the necessity for knowing the identity of the successful bidder, and the uncertainty of the role of the ISO.

PU Code Section 1804(a)(1) is intended, in the circumstances in which a prehearing conference has been held that identifies issues in a proceeding, to be ministerial, which is why the Legislature delegated the eligibility determination to the ALJ. Because the threshold eligibility determination is intended to be a ministerial application of bright-line tests of whether the notice was timely filed and contained the statement and estimate required by PU Code Section 1804(2)(A), the ALJ lacks authority to excuse the time of filing requirement in the absence of a showing that the parties could not have reasonably identified issues within 30 days of the PHC.

Whether our first interim decision so changed the issues in this proceeding such that SAEJ could not reasonably be expected to be able to identify issues is a question we refer to the assigned Commissioners, who may, in the exercise of their sound discretion, grant or deny SAEJ's request for a finding of eligibility for compensation.

Findings of Fact

1. No party disputes that PG&E has conducted an auction process without significant irregularity.

2. The measures described in the mitigated negative declaration adopted in D.97-10-058 are sufficient to avoid or mitigate the reasonably foreseeable adverse environmental effects of the project.

3. The market value of the Morro Bay Power Plant, Moss Landing Power Plant, and Oakland Power Plant is $501 million.

4. It is undisputed that neither the buyer of the plants, it parent, nor affiliates owns any other electrical generation in California.

5. It is undisputed that PG&E's transaction costs will total approximately $9.9 million, net taxes will amount to $41 million, the net book value of the plants is $390.2 million, including inventories, buyer will assume responsibility for non-environmental decommissioning costs, and PG&E will be responsible for the environmental remediation portion of such costs, or that the net amounts accrued for

environmental remediation and non-environmental decommissioning as a result of the transaction will experience a surplus of $23,128,445, which will be applied *pro rata* across remaining generation plants, with the effect of reducing rate base.

6. PHCs were held on December 19, 1996 and January 13, 1997, which reasonably allowed parties to identify issues in this matter prior to February 13, 1997.

7. SAEJ filed its notice of intent to claim compensation on April 8, 1997.

Conclusions of Law

1. The sale of the Moss Landing and Oakland Plants subject to the agreement with the ISO is consistent with avoiding an overconcentration of market power.

2. The sale of the plants to Duke EPS is in the public interest and should be approved, subject to the measures adopted in D.97-10-058 to avoid or mitigate the reasonably foreseeable adverse environmental effects of the project.

3. Except for determining the means by which a rate of return on the plants should be calculated, the accounting and ratemaking adjustments described in PG&E's November 20, 1997 filing should be approved.

4. Allowing the three plants to be exempt wholesale generators within the meaning of the Act would benefit consumers, be in the public interest, and would not violate California law.

I N T E R I M O R D E R

THEREFORE, IT IS ORDERED that:

1. Subject to the measures described in the mitigated negative declaration approved in Decision (D.) 97-10-058 to avoid or mitigate the reasonably foreseeable adverse environmental effects of the project, Pacific Gas and Electric Company (PG&E) may transfer and sell its Morro Bay, Moss Landing, and Oakland Power Plants to affiliates of Duke Energy Power Services, Inc. in accordance with the transaction documents filed by PG&E on November 20, 1997.

2. Except with respect to PG&E's description of the means by which a rate of return on the plants should be calculated, the accounting and ratemaking adjustments described in PG&E's November 20, 1997 filing are approved.

3. The request for the Southeast Alliance for Environmental Justice for a finding of eligibility for intervenor compensation is referred to the assigned Commissioners.

This order is effective today.

Dated December 16, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners