

Decision 99-12-020 December 2, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U 902-E) for Authority to Sell Electrical Generation Facilities and Power Contracts.

Application 97-12-039
(Filed December 19, 1997)

OPINION

I. Summary

A. Procedural History

San Diego Gas & Electric Company (SDG&E) requests approval to conduct an auction designed to decrease the costs SDG&E's customers incur as a direct result of power purchase agreements (PPAs) between SDG&E and certain qualifying facilities (QFs), Public Service Company of New Mexico (PNM), and Portland General Electric Company (PGE) (collectively the power sellers).

Protests were filed by the Office of Ratepayer Advocates (ORA), the California Cogeneration Council (CCC), the Independent Energy Producers Association (IEP), and PNM. SDG&E held numerous discussions with ORA, CCC, and PNM regarding SDG&E's PPA auction proposal. Because of the possibility that the California Independent System Operator (ISO) would impose a reliability must-run (RMR) contract on power sellers located in SDG&E's service area, SDG&E revised its PPA auction proposal.

On May 13, 1999, SDG&E and ORA executed a Memorandum of Understanding (MOU).¹ The MOU resolves and disposes of all but two issues

¹ Appendix A.

between ORA and SDG&E concerning SDG&E's proposed PPA auction. SDG&E and ORA agree that:

- (1) The Mirror Agreements do not affect SDG&E's legal obligation under the existing PPAs;²
- (2) SDG&E may suspend the auction if it does not produce substantial net ratepayer benefits for SDG&E's customers;
- (3) SDG&E does not have to impose a minimum bid in the auction and SDG&E agrees to provide ORA with the bid related information necessary to allow ORA to determine whether, in ORA's opinion, the bids selected by SDG&E produce substantial net benefits to SDG&E's customers;
- (4) If necessary, SDG&E and ORA will meet and confer to facilitate the exchange of information regarding SDG&E's bid selection(s);
- (5) ORA will support SDG&E's auction results if the auction produces substantial net ratepayer benefits; and
- (6) Under current tax law, SDG&E does not anticipate that the PPA auction will create a taxable event for SDG&E, but, if it does, SDG&E may reflect any tax expenses in its post-auction compliance filing.

² The Mirror Agreements are the Master Agreement and the Power Sales and Administration Agreement (PSAA). The Mirror Agreements are described below. Drafts of the Master Agreement and PSAA are Attachments A and B to Ex. 4.

The only two issues that remain outstanding between SDG&E and ORA are:

- (1) Whether SDG&E is entitled to receive, as a shareholder incentive, 10% of the savings produced by the PPA auction in connection with the QF PPAs as contemplated by Decisions (D.) 95-12-063, and D.99-02-085; and
- (2) Whether SDG&E's shareholders or customers should bear the costs SDG&E incurs in an effort to comply with the Commission's direction in D.95-12-063 to reduce above-market PPA costs if the PPA auction SDG&E proposes does not produce substantial net benefits.

ORA and SDG&E agreed the two unresolved issues do not require hearings because they involve matters of law and policy that are best resolved by the Commission through briefs by the parties. On May 28, 1999, SDG&E and ORA individually submitted supplemental testimony regarding the MOU. ORA also submitted prepared direct testimony on the two unresolved issues. On June 15, 1999, CCC and PNM submitted prepared direct testimony. SDG&E and ORA individually submitted prepared rebuttal testimony on July 2, 1999.

Evidentiary hearings were scheduled for July 12 and 13, 1999. On July 8, 1999, however, the presiding ALJ issued a telephonic ruling granting an oral stipulation by the parties to forego hearings in the power contracts phase of this proceeding. The ALJ accepted the direct, supplemental, and rebuttal testimony of each party into the record and established a briefing schedule for the power contracts portion of this proceeding. SDG&E, ORA, CCC, and PNM submitted briefs. PNM supports SDG&E's proposal.

On December 3, 1998, the Commission adopted D.98-12-012, which approved a mitigated negative declaration for the project represented by SDG&E's entire divestiture application, and approved a related mitigation, monitoring, and reporting program

B. SDG&E's Proposal To Reduce Uneconomic Costs Associated With 11 PPAs

SDG&E proposes to conduct a two-stage auction, the winner(s) of which will be the bidder(s) that provides the most benefit to SDG&E and its customers (the Counterparty). The Counterparty will execute two agreements – the Master Agreement, which is interim in nature, and the PSAA that will govern the relationship between SDG&E and the Counterparty for a term equal to the term of the underlying PPA.

1. The Master Agreement

The Master Agreement will address the period from the conclusion of the auction until the closing of the transaction with the winning bidder, and will cover such matters as representations and warranties, regulatory approvals, conditions precedent to closing the transaction, closing mechanisms, and other general provisions. The Master Agreement will have a term of up to 180 days. The Master Agreement will include a schedule of payments to be made to the Counterparty under the PSAA. All payment obligations are addressed by the PSAA.

2. The PSAA

Because all of the PPAs have pricing provisions which result in SDG&E currently paying overmarket prices, it is expected that all bids at the auction will be negative. That is, SDG&E will have to pay to get someone to take the capacity and energy provided by the PPA. In general, SDG&E will make payments to the Counterparty equal to the amounts designated in the Counterparty's winning bid.³ In exchange, the Counterparty will make payments

³ Unless exempted from the mandatory sell provisions of the Preferred Policy Decision, during the Initial Period, SDG&E will sell all of the output from the PPA(s) to the PX.

Footnote continued on next page

to SDG&E equal to the full amount due under the PPA for the preceding month. In addition, SDG&E will not take any material actions under the PPA(s) without first receiving approval or direction from the Counterparty.

SDG&E will continue to administer the PPA and to pay the power seller the full amounts due under the PPA, regardless of whether SDG&E receives payment first from the Counterparty. Thus, SDG&E believes the power seller will see no change in its relationship with SDG&E under the PPA. SDG&E will remain the point of contact for administration and will be the source of payment for deliveries made under the PPA. SDG&E remains liable to the power seller for SDG&E's duties and obligations under the PPA. Additionally, the PSAA contemplates that:

- a. For substantive matters (other than PPA default and a QF's compliance with the Federal Energy Regulatory Commission (FERC) QF operating and efficiency regulations), SDG&E will consult with the Counterparty and will take direction from the Counterparty.
- b. The Counterparty will indemnify SDG&E with respect to the Counterparty's directives to SDG&E.
- c. SDG&E will not take directives from the Counterparty regarding defaults under the PPA or QF operating and efficiency monitoring. SDG&E will maintain sole discretion in determining the existence of a default.
- d. SDG&E will treat as confidential the operating and efficiency monitoring information it receives from a QF. Accordingly, SDG&E will not provide this

During Period Two, however, SDG&E will sell to the Counterparty all the capacity, energy and any other benefits SDG&E receives under the PPA. ORA supports SDG&E's request for relief from any requirement to sell the PPA power to the PX once the auction is completed and the PSAA becomes effective.

information to the Counterparty without the QF's consent.

- e. If SDG&E notifies the power seller that the power seller is in default under the PPA, SDG&E's payments to the Counterparty will cease on at least an interim basis. SDG&E and the Counterparty will reinstate their respective payment and performance obligations under the PSAA only if SDG&E withdraws its notice of default or a Court determines no default occurred. Otherwise, the PSAA terminates concurrently with the PPA. This provision eliminates the Counterparty's incentive to force the power seller into a default under the PPA.

3. The Auction

SDG&E proposes a two-stage auction, similar to the fossil generation auctions held by SDG&E, Pacific Gas & Electric Company (PG&E), and Southern California Edison Company (Edison). SDG&E's investment bankers will contact potential bidders, inform them of the auction process and expected schedule, and invite them to participate in the auction.

SDG&E will require parties expressing an interest in the auction to sign a confidentiality agreement. Parties signing this agreement will receive an offering memorandum containing a significant amount of information regarding the relevant PPAs. As in the fossil auctions, SDG&E will establish a document repository for auction participants that execute the confidentiality agreement. This repository will contain numerous documents relevant to a due diligence examination of the PPAs. SDG&E will not make available to auction participants confidential information it holds regarding the QF and utility power sellers, unless SDG&E first receives consent from the QF or utility.

The first round of the auction will require non-binding preliminary bids approximately three weeks after SDG&E distributes its offering memorandum. Bidders must participate in the first round to be eligible to bid in

the second round. SDG&E will allow bidders to submit bids on an individual or bundled basis. Though SDG&E will not impose a minimum bid, ORA has agreed to endorse only those bids that provide substantial net benefits to ratepayers. Additionally, SDG&E will not accept bids in which the annual payments to the winning bidder will cause the cumulative expected benefits to be less than zero. This means SDG&E will not accept bids that would require it to pay the Counterparty more money than the savings accumulated up to that time on an annualized basis. Parties submitting preliminary bids will also be required to execute an auction protocols agreement that will govern the conduct of the auction.

SDG&E will evaluate first round bids and determine which entities SDG&E will allow to participate in the second round. Specifically, SDG&E will evaluate each bidder's financial and operational qualifications and indicated non-binding bid amount. Based on the results of that evaluation, SDG&E will identify bidders for each PPA for a final, binding bid process. Authorized second-round bidders will have approximately six weeks to conduct further due diligence examinations of the PPAs. In addition, second-round bidders could propose changes to the relevant transactional documents, including the Master Agreement and the PSAA. SDG&E would consider the proposed changes, and issue a final set of transactional documents before final bids are due. Subject to SDG&E's reservation of the right to reject all bids in the event of irregularities in the auction process or if the auction fails to produce substantial net ratepayer benefits, and subject to the Commission's final review and approval to determine whether the auction had been conducted in accordance with the approved procedure, SDG&E would enter into definitive agreements with the winning bidder(s).

The auction and PSAA will allow power sellers to participate in the auction for their PPA(s) one of two ways: (1) the power seller may submit a bid that offers a buy-out proposal which if accepted as the winning bid would trigger the novation provisions of the PSAA; and (2) the PSAA allows the Counterparty and the power seller to enter into a post-auction buy-out of the underlying PPA and, if possible, to explore and structure a post-auction assignment that relieves SDG&E of its obligations under the relevant PPA.⁴ Bidders will compete not only with bids for the PSAA, but also with entities proposing buy-outs. As such, SDG&E believes bidders will incorporate any possible future savings from post-auction buy-outs or assignments into their auction bids to SDG&E.

SDG&E will execute the Master Agreement with the winning bidders, and SDG&E will then submit a compliance filing to obtain final Commission approval of the proposed PSAAs. Final closing of the transactions will take place when all closing conditions in the Master Agreement are satisfied. SDG&E expects this closing process will take several weeks, or months.

II. Contested Issues

A. ORA

The MOU resolves all but two issues between SDG&E and ORA – (1) whether SDG&E is entitled to receive a 10% shareholder incentive for ratepayer savings resulting from SDG&E's proposed PPA auction, and

⁴ Any additional post-auction savings will flow to the Counterparty or power seller, not SDG&E or SDG&E's customers. SDG&E will continue to make payments to the Counterparty after a novation or assignment. As explained in SDG&E's Rebuttal Testimony (Ex. 6), if the California Independent System Operator (ISO) imposes a regulatory must-run (RMR) contract on the generating facility subject to the buy-out, and SDG&E is required to make transmission owner payment's under the RMR, SDG&E will reduce its payments to the Counterparty on a dollar-for-dollar basis.

(2) whether to allow SDG&E to recover from customers the costs of an auction that does not produce substantial net ratepayer benefits. Except for these two policy issues, ORA supports an interim Commission decision approving SDG&E's PPA auction.

B. CCC

CCC opposes the PPA auction and recommends Commission rejection of SDG&E's entire proposal. Alternatively, CCC argues that SDG&E's auction proposal contain serious flaws that threaten to interfere with the rights of the power sellers under the PPAs, and will frustrate SDG&E's ability to reduce its costs associated with the PPAs and achieve a fair market valuation of the PPAs. To remedy these flaws, CCC proposes the following:

1. The Commission should not make any finding regarding whether SDG&E's Mirror Agreements will result in an assignment of any affected PPA or require the consent of any affected power seller under its PPA.
2. The broad price reopener included in Sections 4.2(b) and 4.4 of the PSAA should be eliminated for the following reasons:
 - a) The broad price reopener in the PSAA diminishes the auction's potential to produce savings for SDG&E and its ratepayers under the PPAs. SDG&E's inclusion of the price reopener destroys (or, at least, significantly reduces) the value associated with possible future savings related to post-auction buy-outs because the reopener exposes the winning Counterparty to an unknown price adjustment when it attempts to consummate such a buy-out.
 - b) The price reopener should be eliminated to require SDG&E to structure its auction proposal in a way that precipitates a competitive auction that ultimately results in a low fixed payment to the Counterparty and substantial ratepayer benefits.
3. SDG&E's proposal to revise the PSAA in response to the comments of potential bidders should not be approved unless interested parties are given the opportunity to review those changes before SDG&E concludes the auction.

4. SDG&E's proposal should be modified to give each power seller a right of first refusal to buy-out its PPA at the winning bid price, provided that the power seller reimburses the winning Counterparty for the direct costs of its participation in the auction.
5. Any bidder that bids on more than one PPA must be required to specify a separate value for each individual PPA. SDG&E may experience difficulty in enforcing its rights to terminate fixed payments with respect to any PPA if a separate bid value is not specified for the PPA at the outset.
6. The Commission should reject SDG&E's request to recover the ten percent shareholder incentive unless a PPA negotiated termination or novation is effectuated with respect to the affected PPA.
7. The Commission should reject SDG&E's request to place all financial responsibility for this experiment on ratepayers. Instead, SDG&E's shareholders should be solely responsible for the costs of a failed auction.

III. Discussion

A. The 10% Shareholder Benefit

SDG&E requests authority to retain 10% of the estimated savings resulting from the auction. SDG&E argues that in the Preferred Policy Decision, the Commission determined to allow shareholders to retain 10% of the net ratepayer benefits resulting from renegotiation of QF contracts. ORA opposes SDG&E's proposal. It is ORA's position that the Commission should allow a shareholder incentive only if the auction results in a novation of the PPA contract.

ORA points out that to date the Commission has provided a shareholder incentive only in the case of the buy-out or buy-down of QF contracts. Such buy-outs and buy-downs permanently eliminate or reduce a utility's future obligations under the QF contract. In contrast, SDG&E's proposed auction would neither eliminate nor guarantee a permanent reduction in SDG&E's obligation under the QF contract because ratepayers would assume any

contingent liability in the event that the Counterparty defaults. Given ratepayers' continuing contingent liability and the utility's continuing role in the administration of these PPA contracts, ORA submits that the auction of PPAs will not result in a permanent reduction in ratepayer obligation, a key feature of a buy-out or a buy-down of the power contracts. Rather, SDG&E's proposed auction is simply an alternative means of administering the same purchased power contract. Therefore, ORA recommends that unless an individual auction results in the buy-out of the PPA, the Commission reject the 10% sharing of ratepayer benefits. CCC agrees.

SDG&E states that it is entitled to receive 10% of the forecasted savings whether or not the savings result from a buy-out, novation, or an auction. It argues that ORA's and CCC's recommendations stem from a literal interpretation that the Preferred Policy Decision and D.99-02-085 authorized retention of the 10% incentive only if the savings stem from a PPA buy-out or restructuring. SDG&E believes that ORA's and CCC's interpretations are too narrow and ignore the policy set forth in D.95-12-063 to expeditiously transition California's electric industry to a competitive marketplace while minimizing the transition costs associated with that transition. The Preferred Policy Decision states:

When a QF contract is renegotiated, shareholders should retain 10% of the resulting ratepayer benefits, which will be reflected by an adjustment to the CTC if the modification is approved by the Commission. (D.95-12063, Conclusion of Law 74.)

The Commission, in D.99-02-085, again articulated its direction to the utilities:

We do not believe this is the time to relax the utility's accountability to manage these (QF) costs in a reasonable manner and to do their best to reduce them whenever

possible, especially when ratepayers are faced with large QF payments over the coming years. (D.99-02-085, at 24.)

SDG&E says that just because it proposes cost reduction measures not contemplated at the time of the Preferred Policy Decision is no basis for denying the 10% sharing in this instance. The spirit and intent of the 10% mechanism is to provide an incentive for utilities to find ways to reduce QF costs. SDG&E's proposal is intended to do just that and if successful, SDG&E should receive 10% of the customer savings.

As a modification to its original 10% proposal, SDG&E offers that if a Counterparty defaults and SDG&E has to assume full financial responsibility for the PPA without any further contribution by the Counterparty (i.e., SDG&E is unable to obtain a letter of credit, collateral, or cash sufficient to ensure customers receive contributions for the remainder of the PPA term), SDG&E will refund to customers a pro rata portion of the 10% incentive payment representing the savings not realized for the remaining term of the PPA. SDG&E would agree to make this refund to customers using the same forecast as that on which the 10% incentive payment was calculated and collected.

We agree with SDG&E that the spirit of the 10% mechanism is to provide an incentive for utilities to find ways to reduce QF costs. SDG&E's proposal, if successful, will reduce QF costs. We will adopt its modified proposal. We are confident that pursuant to the MOU, ORA will monitor the auction results and will factor this 10% shareholder incentive into the benefits to ratepayers.

B. Auction Costs

SDG&E proposes that ratepayers pay the costs of the auction,⁵ regardless of whether the auction results in ratepayer benefits. ORA argues that ratepayers should not have to bear the costs of the auction if it results in no ratepayer savings.

SDG&E claims that transaction costs are a reasonable and necessary element of SDG&E's efforts to reduce its transition costs, and are consistent with the Commission's treatment of PG&E's and Edison's generation divestitures. SDG&E would track its auction costs in its generation divestiture transaction costs memorandum account (GDTCMA) similar to PG&E and Edison.

SDG&E believes the ratepayers should pay the costs of the auction regardless of outcome. SDG&E points out that SDG&E's shareholders bear no financial risk under the existing contracts other than the reasonableness of contract administration. Thus, SDG&E could maintain the status quo and continue passing these uneconomic PPA costs through to customers. However, to the extent that SDG&E can reasonably reduce costs for its customers, it wishes to do so. It declares that requiring SDG&E's shareholders to bear the costs associated with a failed auction sends a clear signal to SDG&E and other utilities: prudently administer existing PPAs, but do not attempt to reduce customer costs through innovative methods unless you are prepared to take on additional risk if substantial customer benefits cannot be guaranteed.

⁵ These costs include developing, conducting, and completing the power contract auction. More specifically, auction costs will include fees and expenses from the investment bankers, outside counsel, outside accounting and tax analysis, document and data gathering for regulatory discovery and buyer due diligence, advertising, and other auction-related expenditures.

SDG&E asserts that the expenses of conducting this auction are associated with valuable external expert advice from investment bankers and others whose efforts and input will only increase the likelihood of a successful auction. SDG&E maintains that it would be unreasonable to place SDG&E's shareholders at risk for an undertaking that is intended to produce significant customer benefits. SDG&E contends that even if the auction fails to produce acceptable bids, the cost of the existing contracts will not increase. At most, there would be a small, additional transition cost expense associated with putting on the auction; SDG&E maintains that these costs would not, in and of themselves, increase the existing contract costs.

ORA contend that the expenses of holding the auction are part of the overall transaction costs and must be internalized in all analyses of whether bids yield ratepayer benefits and the extent of such benefits. The addition of these costs may make a bid unacceptable. However, SDG&E has not proposed to include the auction expenses in evaluation of the bids. ORA recommends 1) that the Commission direct SDG&E to identify and include in the bid evaluation any expenses associated with the PPA's auction and 2) that SDG&E bear the costs of the auction.

This issue may be much ado about very little. Surprisingly, there is no estimate of costs in the record. SDG&E says that the costs are expected to be small. Under the circumstances, and especially because of the highly speculative nature of this auction process, we will place the burden of an unsuccessful auction on SDG&E. This requirement will enhance SDG&E's motivation to achieve a successful outcome with significant ratepayer savings. It also aligns SDG&E's incentives with potential Counterparties, who would incur significant costs to participate in this process. Accordingly, SDG&E shareholders alone should bear cost responsibility if the auction fails to produce successful results.

We will not require SDG&E to include pre-bid auction expenses in evaluating the bids. Auction expenses are sunk costs, the bids are incremental revenue.

C. CCC's Concerns

We agree with CCC that this Commission should not make any findings regarding whether SDG&E's Mirror Agreements will result in an assignment of any affected PPA or require the consent of any affected power seller under its PPA. Neither SDG&E nor any power seller has requested an interpretation of any PPA; we have no reason to review the PPA. CCC's position regarding SDG&E's request to recover a 10% shareholder incentive and to place all financial responsibility for this auction on the ratepayers was discussed above.

We find no merit in CCC's assertions that the broad price reopener included in Sections 4.2(b) and 4.4 of the PSAA should be eliminated; that interested parties be given the opportunity to review changes in the PSAA; that each power seller should be given a right of first refusal to buy-out its PPA at the winning bid price; and that bidders who bid on more than one PPA must be required to specify a separate value for each individual PPA.

CCC's recommendation to remove what it calls "fatal flaws" in the auction process rings hollow when juxtaposed with CCC's principal position that the Commission reject the entire auction proposal. If the auction is fatally flawed as CCC asserts, there will be no bidders and the auction will fail of its own weight. SDG&E and its ratepayers are faced with purchasing electricity over long periods of time at over market prices. SDG&E believes that its auction proposal is a method which may result in lower prices to SDG&E and its ratepayers. We will not stand in the way of any proposal that will reduce the price of electricity; nor will we second-guess SDG&E's proposal. It may well be that the proposal is as flawed as CCC asserts, but that is SDG&E's problem. Why CCC would offer suggestions to improve the auction process and remove what it

considers a fatal flaw, while at the same time asking us to reject the entire proposal escapes our understanding. In what appears to be another contradictory position to the "fatal flaw," CCC request the right of first refusal. Apparently CCC, in order to cover all the bases, wants to be sure that if a third party finds value in these PPAs, that CCC will be able to co-opt that value. This certainly would dampen the enthusiasm of third parties to bid. SDG&E points out that none of the existing PPAs provides the power sellers with a right of first refusal. CCC, therefore, is proposing to create a new substantial valuable right that power sellers do not have today. CCC's requirement that all bids be unbundled could interfere with the market price. The bidders will decide how they wish to bid, not CCC.

IV. Statutory Provisions

Pub. Util. Code § 851 provides that no public utility may transfer property that is necessary or useful in the performance of its duties to the public without first having secured the Commission's authorization. The PPAs are presently useful in the performance of SDG&E's duties as a public utility and Pub. Util Code § 851 applies.

Pursuant to Pub. Util. Code § 362, the Commission must ensure that facilities needed to maintain the reliability of the electric supply remain available and operational. SDG&E seeks authority to auction 11 long-term PPAs with the power suppliers. Eight of the PPAs involve QFs directly interconnected to SDG&E's system. The QFs have been designated as regulatory must-take generation. After SDG&E executes the PSAA, SDG&E will continue to schedule these resources through the PX on a must-take basis.

Pub. Util. Code § 377 provides that the Commission "shall continue to regulate the nonnuclear generation assets owned by any public utility prior to January 1, 1997, that are subject to [C]ommission regulation until those assets

have been subject to market valuation in accordance with procedures established by the [C]ommission." SDG&E believes that its PPA auction proposal is consistent with this requirement.

V. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure.

This decision was issued as a Draft Decision to which the parties commented. The parties merely reargued their original positions; no substantive changes are needed. We have clarified the decision to reflect that SDG&E is only liable for the costs of an unsuccessful auction and that the post auction procedures contained in the MOU are explicitly recognized.

Goal Line, L.P. (Goal Line), moves to enter a special appearance or, in the alternative, to intervene for the limited purpose of advising the Commission of Goal Line's position that the Commission does not have jurisdiction over issues of contract interpretation and that Goal Line will suffer economic harm if the Commission adopts the Draft Decision as filed in this proceeding. Goal Line argues that granting its motion is warranted because the proposed auction of the Power Purchase Agreement (PPA) between Goal Line and SDG&E will cause unintended, adverse economic consequences to Goal Line's cogeneration project.

Goal Line asserts the proposed auction of its PPA, if successful, would unilaterally change Goal Line's relationship with SDG&E and cause Goal Line's tax-exempt bonds⁶ to become taxable and subject to mandatory redemption.

⁶ The Goal Line project was financed primarily by tax-exempt revenue bonds issued by the California Alternative Energy Source Financing Authority.

Unless the Commission remedies the factual and legal errors contained in the DD, Goal Line will suffer unintended, adverse economic consequences.

Having become aware of the DD and its Finding of Fact No. 12⁷ purporting to decide the question of assignment and consent with regard to the Goal Line PPA, Goal Line now moves to protect its rights and interest in the PPA which fall within the scope of the auction approved by the DD.

Goal Line says the proposed auction is the same as a QF contract restructuring because SDG&E achieves ratepayer savings by changing the economic costs of the contractual relationship between SDG&E and Goal Line. In Goal Line's opinion, the proposed auction clearly has an impact on the SDG&E-Goal Line relationship that is not voluntary. A third party will achieve control over the destination of Goal Line's power sold under the PPA, forcing Goal Line to lose a large part of its expected benefit of the bargain.

Goal Line's motion to intervene is granted. The relief it seeks: to delete Finding of Fact No. 12; to reject portions of the MOU; and to exempt Goal Line from the auction is denied. Goal Line misconceives the effect of this decision. We are not interpreting any PPA contract. We are merely authorizing an auction and implementing ratepayer protection as described in the MOU. Should SDG&E go through with the auction and thereby breach any QF contract (or any contract), that determination may be made in other forums where SDG&E could be held responsible for its actions. Any breach of contract by SDG&E would be without recourse to its ratepayers.

CCC and Goal Line object to paragraph 3 of the MOU and argue that it should not be approved as being "consistent with law." Paragraph 3 states:

⁷ Finding of Fact No. 12: SDG&E is not proposing to assign any of its PPAs in its PAA auction.

"3. The Parties agree that the proposed Mirror Agreements will not affect or reduce SDG&E's legal obligations under the existing PPAs, do not involve an assignment of SDG&E's interests in the underlying PPAs, and do not require the consent of the QF or utility power seller."

CCC and Goal Line objections are rejected. We are approving a MOU between two parties; we are not adopting the MOU as an order of the Commission. The MOU "resolves all issues between ORA and SDG&E...", it does not bind third parties and we are not imposing it on third parties. This decision authorizes an auction pursuant to the terms of the MOU. It does not interpret any PPA, nor does it rule on the legality of paragraph 3.

Findings of Fact

1. On December 3, 1998, the Commission adopted D.98-12-012 which approved a mitigated negative declaration for the project represented by SDG&E's entire divestiture application, and approved a related mitigation, monitoring and reporting program.
2. In the absence of significant irregularity in the auction process, the fair market value for the PPAs will be determined by the auction process.
3. The PSAA is designed to preserve the economic benefits of the auction and protect customer savings against a Counterparty's default.
4. Providing power sellers a right of first refusal is not in the public interest.
5. Requiring bidders to submit bids on a contract-by-contract or bundled, but itemized basis will diminish the value SDG&E's customers may derive from the PPA auction.
6. CCC and other entities will have an adequate opportunity to review and comment on the final terms and conditions of the Mirror Agreements during the compliance filing phase of this proceeding.

7. SDG&E should be authorized to conduct the PPA auction it has proposed, and to permit bids on any combination of its PPAs.

8. Once the Commission approves an executed Mirror Agreement, all payments that SDG&E makes in accordance with the Mirror Agreement should be deemed reasonable and prudent and should not be subject to further Commission review.

9. Once the Commission approves an executed Mirror Agreement, post-auction administration of the related PPA by SDG&E should not be subject to further Commission review for purposes of determining the reasonableness of any PPA payments, unless the Counterparty defaults and not until after the cost reducing-benefits provided by the Counterparty cease.

10. Any post-auction modifications of SDG&E's PPAs which are the subject of approved Mirror Agreements, including, but not limited to restructurings, amendments, or buy-outs, should become effective without any further Commission review and approval; provided, however, if any such post-auction PPA modifications result in an increase in SDG&E's payment obligations under the PPA and such obligation was incurred without prior Commission approval, the difference between the payments under the PPA and the payments under the new obligations shall be subject to reasonableness review.

11. SDG&E should receive as a shareholder incentive, 10% of any savings produced by the PPA auction.

12. The MOU states that SDG&E is not proposing to assign any of its PPAs in its PPA auction.

13. SDG&E should be allowed to recover the reasonable costs of its PPA auction from its customers if the auction results in net benefits to customers. SDG&E's shareholders alone shall bear the costs of an unsuccessful auction.

14. If SDG&E enters into any Mirror Agreement which is approved by the Commission, SDG&E should be authorized to apply the accounting and ratemaking treatment described in its application.

15. The procedure described in the SDG&E/ORR MOU will allow ORR a reasonable opportunity to assess whether winning bids would be likely to result in substantial savings and so advise the Commission prior to final approval of the bids with minimal delay in the case and maximum protection for confidential data and the fairness of the auction process.

16. SDG&E agrees that it will not select a bid in which the annual payments to the winning bidder under the Mirror Agreement will cause the cumulative expected benefits to be less than zero.

Conclusions of Law

1. SDG&E's PPA auction complies with Pub. Util. Code Sections 851, 362, and 377, and should be authorized.

2. The provisions of Commission Decision 95-12-063 as amended by D.96-01-009 (Ordering Paragraph 5) requiring a utility to bid all its generation into the Power Exchange should not apply to generation associated with the SDG&E PPAs that are subject to an approved Mirror Agreement, because these agreements are akin to QF buy-outs.

3. Based on the current tax laws of the United States and the State of California, it does not appear that the PPA auction or execution of the Mirror Agreements will create a taxable event for SDG&E. The utility does not anticipate a need to net any tax expense against the benefits of the PPA auction. However, should circumstances change prior to the completion of these transactions, SDG&E will reflect a tax expense in its compliance filing following the PPA auction and ORR would have the opportunity to review the

circumstances of this action and to challenge these expenses in SDG&E's next Annual Transition Cost Proceeding after the booking of these expenses.

4. The Commission should not make any findings regarding whether SDG&E's Mirror Agreements will result in an assignment of any affected PPA or require the consent of any affected power seller under its PPA.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company (SDG&E) may conduct the Power Purchase Agreement (PPA) auction it has proposed. SDG&E shall permit bids on any combination of its PPAs.

2. Once the Commission approves an executed Mirror Agreement, all payments that SDG&E makes in accordance with the Mirror Agreement shall be deemed reasonable and prudent and shall not be subject to further Commission review.

3. After the final bids have been received:

- a. At the earliest feasible date, SDG&E shall meet and confer with ORA to discuss the bid results and, if SDG&E contends the bids will produce adequate ratepayer benefits, SDG&E's rationale for this claim;
- b. At least seven days prior to the date on which SDG&E submits the Mirror Agreement(s) to the Commission for approval (the Compliance Filing Date), SDG&E shall provide ORA with information supporting SDG&E's bid selection(s), including, if requested, the bids SDG&E received (subject to confidential treatment under California Public Utilities Code § 583 and Commission General Order 66-C);
- c. No later than 14 days after SDG&E makes its Compliance Filing, ORA and other parties may file written comments on the Compliance Filing; and

- d. No later than 21 days after SDG&E makes its Compliance Filing Date, ORA may submit testimony in opposition to SDG&E's request for approval of the Mirror Agreement(s), if ORA concludes that one or more of the bids offers less than substantial net benefits or is the product of bidding practices ORA reasonably believes constitute a bidding irregularity.
- e. SDG&E shall have the opportunity to file comments and, if desired, testimony within 28 days after the Compliance Filing Date in response to any comments, testimony or both filed by ORA or any other entity. SDG&E shall file these comments, testimony or both.

4. At the time it makes its post-auction compliance filing, SDG&E shall provide ORA all workpapers and supporting documents reasonably necessary to quantify and describe any additional ratepayer costs including, but not limited to auction expenses. At the time of any response by ORA to SDG&E's post-auction compliance filing, ORA shall provide SDG&E all workpapers and supporting documents reasonably necessary to quantify and describe its position that the additional ratepayer costs including, but not limited to auction expenses identified by SDG&E are different than claimed by SDG&E.

5. Once the Commission approves an executed Mirror Agreement, post-auction administration of the related PPA by SDG&E shall not be subject to further Commission review for purposes of determining the reasonableness of any PPA payments, unless the Counterparty defaults and not until after the cost reducing-benefits provided by the Counterparty cease.

6. Any post-auction modifications of SDG&E's PPAs which are the subject of approved Mirror Agreements, including, but not limited to restructurings, amendments, or buy-outs, shall become effective without any Commission review and approval; provided, however, if any such post-auction PPA modifications result in an increase in SDG&E's payment obligations under the PPA and such obligation was incurred without prior Commission approval, the

difference between the payments under the PPA and the payments under the new obligations shall be subject to reasonableness review.

7. The provisions of Commission D.95-12-063 as amended by D.96-01-009 (Ordering Paragraph 5) that a utility must bid all its generation into the Power Exchange shall not apply to generation associated with the SDG&E PPAs that are subject to an approved Mirror Agreement.

8. SDG&E shall receive as a shareholder incentive 10% of any savings produced by the PPA auction.

9. SDG&E may recover the reasonable costs of its PPA auction from its customers if the auction results in net benefits to customers; SDG&E's shareholders alone shall bear the costs of an unsuccessful auction.

10. If SDG&E enters into any Mirror Agreement which is approved by the Commission, SDG&E may apply the accounting and ratemaking treatment described in its application, except as modified by this decision.

11. This proceeding remains open to deal with further disposition of SDG&E's generation assets.

This order is effective today.

Dated December 2, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
CARL W. WOOD
Commissioners

APPENDIX A

MEMORANDUM OF UNDERSTANDING
BETWEEN OFFICE OF RATEPAYER ADVOCATES AND
SAN DIEGO GAS & ELECTRIC COMPANY

A.97-12-039

This Memorandum of Understanding ("MOU") is entered into by the Office of Ratepayer Advocates ("ORA") and San Diego Gas & Electric Company ("SDG&E") (collectively the "Parties"). Except as set forth herein, this MOU resolves all issues between ORA and SDG&E concerning SDG&E's proposed cost-saving measures related to Qualifying Facilities ("QF") and utility purchase power contracts. This MOU excludes issues related to SDG&E's proposed divestiture auctions for San Onofre Generating Station and SDG&E's fossil generating facilities.

1. In its application (A.97-12-039), SDG&E requests authorization from the Commission ("Commission") to execute a Master Agreement and a Power Sales & Administration Agreement ("PSAA") (collectively a "Mirror Agreement") with each bidder SDG&E selects as the winning bidder in an auction for SDG&E's Qualifying Facilities ("QF") and utility purchase power contracts (the QF and utility purchase power contracts are collectively referred to as "PPAs").
2. SDG&E and ORA have been engaged in meetings and negotiations for several months to resolve their differences on the auction associated with SDG&E's PPA obligations.
3. The Parties agree that the proposed Mirror Agreements will not affect or reduce SDG&E's legal obligations under the existing PPAs, do not involve an assignment of SDG&E's interests in the underlying PPAs, and do not require the consent of the QF or utility power seller.
4. The Parties agree that SDG&E may suspend or cancel the auction for the PPA(s) if the auction would not yield *substantial net benefits* for ratepayers.
5. SDG&E does not intend to impose a "minimum bid" in the auction. SDG&E has reviewed and understands the bid evaluation criteria ORA will use to evaluate SDG&E's post-auction compliance filings. If necessary, SDG&E agrees to submit to the Commission after the auction, on a confidential basis, the information SDG&E and ORA agree represents the expected above-market costs of these contracts that would allow the Commission to evaluate whether these bids individually would result in substantial net benefits to ratepayers.

6. SDG&E agrees:
 - a) to meet and confer with ORA at the earliest feasible date after bids have been received to discuss the rationale for SDG&E's claim that the Mirror Agreement(s) would produce adequate ratepayer benefits;
 - b) to provide ORA, seven (7) days prior to the date on which SDG&E submits the Mirror Agreement(s) to the Commission for approval (the "Compliance Filing Date"), with information supporting SDG&E's bid selection(s), including, if requested and subject to confidential treatment under California Public Utilities Code Section 583 and Commission General Order 66-C, the bids SDG&E received;
 - c) that it has recommended and will support a Commission order allowing ORA to submit comments on the Compliance Filing within 14 days after the Compliance Filing Date; and
 - d) that it has recommended and will support a Commission order allowing ORA to submit, within 21 days after the Compliance Filing Date, testimony in opposition to SDG&E's request for approval of a Mirror Agreement(s), if after the above meetings, ORA concludes that one or more of the bids offers less than substantial net benefits or is the product of bidding practices ORA reasonably believes constitute a bidding irregularity.
7. The Parties agree that SDG&E shall have the opportunity to file comments and, if desired, testimony in response to any comments, testimony or both filed by ORA in accordance with sections 6 (c) and (d) hereof and filed by any other individual or entity. SDG&E shall file these comments, testimony or both within 28 days after the Compliance Filing Date.
8. If the auction produces substantial net benefits to ratepayers, then ORA will make filings with the Commission supporting SDG&E's acceptance of these bids and advocating for approval of the Mirror Agreement(s) by the Commission. If an entity or organization challenges, in a non-Commission forum, including a state or federal court in California, SDG&E's actions implementing the Commission's decision approving SDG&E's auction results and Mirror Agreement(s), ORA agrees to recommend to the Commission that the Commission seek intervention in the proceeding for the purpose of supporting SDG&E's actions and defending the Commission's decision(s).
9. At the time of and as part of SDG&E's post-auction compliance filing, SDG&E agrees to provide ORA all workpapers and supporting documents reasonably necessary to quantify and describe any additional ratepayer costs including, but not limited to auction expenses. Similarly, at the time of and as part of any response by ORA to SDG&E's post-auction compliance filing, ORA agrees to provide SDG&E all workpapers and supporting documents reasonably necessary to quantify and describe its position that the additional ratepayer costs including,

but not limited to auction expenses identified by SDG&E are different than claimed by SDG&E.

10. SDG&E agrees that it will not select a bid in which the annual payments to the winning bidder under the Mirror Agreement will cause the cumulative expected benefits to be less than zero.
11. Based on the current tax laws of the United States and the State of California, SDG&E does not anticipate that the PPA auction or execution of the Mirror Agreements will create a taxable event for SDG&E. Therefore, SDG&E does not anticipate a need to net any tax expense against the benefits of the PPA auction. However, should circumstances change prior to the completion of these transactions, SDG&E will reflect a tax expense in its compliance filing following the PPA auction and ORA would have the opportunity to review the circumstances of this action and to challenge these expenses in SDG&E's next Annual Transition Cost Proceeding after the booking of these expenses.
12. There may arise other issues between now and the time of hearings, for example, in other intervenors' testimony, and the Parties reserve the right to present independent separate testimony on those consistent with any ALJ rulings; provided, however, the Parties agree that they shall take no action with respect to the issues covered by this MOU if such action (i) is inconsistent with the terms or intent of this MOU or (ii) reasonably would be expected to have an adverse impact on the other Party or the prospects for obtaining Commission approval.
13. The Parties agree that the auction is intended to produce a reasonable market valuation of the PPAs and to reduce SDG&E's and its ratepayers' responsibility for the above market costs associated with these PPAs.
14. Except as otherwise provided in this MOU, ORA agrees to submit testimony on May 20, 1999 stating that if SDG&E's application is approved subject to the conditions described in this MOU, ORA does not oppose SDG&E's proposal for auctioning the PPAs and executing Mirror Agreements as set forth in SDG&E's April 20, 1999 Second Supplemental and Restated Direct Testimony in A.97-12-039 ("Supplemental Testimony").
15. ORA and SDG&E have not reached resolution regarding two issues: (1) Whether SDG&E is entitled to receive a 10% shareholder incentive based on the PPA auction benefits, and (2) Whether SDG&E's shareholders or customers should bear the costs associated with a PPA auction that does not produce substantial net benefits. ORA and SDG&E agree these issues do not require hearings since they involve matters of law and policy that are best resolved by the Commission through briefs by the parties.

16. The Parties agree to support a Commission decision finding that: (1) all payments SDG&E makes in accordance with the approved Mirror Agreement(s) are reasonable and prudent and not subject to further Commission review; (2) except as provided in Section 17 hereof, post-auction administration of the PPAs by SDG&E is not subject to Commission review for purposes of determining the reasonableness of any PPA payments; (3) any post-auction PPA modifications including, but not limited to restructurings, amendments, or buyouts may become effective without any Commission review and approval; provided, however, if any such post-auction PPA modifications including, but not limited to restructurings, amendments, or buyouts result in an increase in SDG&E's payment obligations under the PPA and such obligation was incurred without prior Commission approval, the difference between the payments under the PPA and the payments under the new obligations shall be subject to reasonableness review; and (4) the provision of Commission Decision 95-12-063 as amended by D.96-01-009 (Ordering Paragraph 5) that a utility must bid all its generation into the Power Exchange does not apply to generation associated with the PPAs subject to an approved Mirror Agreement(s).
17. PSAA Section 3.6 requires the counterparty to provide SDG&E with certain types of credit support if an Event of Default or Credit Event occurs. The Parties agree that if the Commission approves a PSAA with counterparty credit requirements at least as protective of ratepayer interests as PSAA Section 3.6, then the Commission should allow SDG&E to recover the full amount of any PPA payments throughout the remaining term of the PPA if the winning bidder defaults under the Mirror Agreement and SDG&E is required to make all the payments required by the PPA without the benefit of a contribution by the winning bidder or some other third-party; provided, however, commencing with the first PPA payment made by SDG&E after the default and after the termination of any further contributions by the winning bidder or some other third-party (the "Default Contributions"), the Commission may review the reasonableness of SDG&E's contract administration on a prospective basis. The Commission's reasonableness review may not consider actions taken by SDG&E nor disallow recovery of the Mirror Agreement payments SDG&E made prior to the end of the Default Contributions.
18. ORA agrees hearings are not necessary prior to an interim decision approving the PPA auction and the conduct of the auction. ORA agrees to defer any outstanding request for hearings in this proceeding until after the Compliance Filing Date.
19. The Parties acknowledge and agree that the PPA auction proposed by SDG&E is only one of several possible means by which an entity may attempt to reduce the above market costs associated with PPAs. The Parties focused their discussions on the specific circumstances surrounding the few PPAs subject to this application and made no attempt to create a solution for reducing the costs of QF and utility power purchase agreements other than the specific contracts at issue here. Much

of ORA's support for this settlement is tied to the small, experimental nature of SDG&E's proposed auction. Neither Party recommends that the Commission adopt the terms of this MOU as precedent for authorizing a means by which other utilities may attempt to reduce the above market costs associated with its PPA(s).

20. This MOU may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

Executed by the authorized representative of the Parties.

Office of Ratepayer Advocates

By: [Signature]

Title: Staff Counsel

Date: 5/13/99

San Diego Gas & Electric Company

By: [Signature]

Title: Manager Regulatory Case Management

Date: 5/13/99

(END OF APPENDIX A)