Decision **ALTERNATE PAGES OF COMMISSIONER LYNCH**
(Mailed 5/25/00)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority to Establish Post-Transition Period Electric Ratemaking Mechanisms. (U 39-E)	Application 99-01-016 (Filed January 15, 1999)
Application of San Diego Gas & Electric Company for Authority to Implement Post Rate Freeze Ratemaking Mechanics (U 902-E) to Review and Recovery Transition Cost Balancing Account Entries from January 1, 1998 through June 30, 1998 and Various Generation-Related Memorandum Account Entries.	Application 99-01-019 (Filed January 15, 1999)
Application of Southern California Edison Company (U 338-E) to: (1) Propose a method to Determine and Implement the end of the Rate Freeze; and (2) Propose Ratemaking Mechanisms which would be in place after the end of the Rate Freeze Period.	Application 99-01-034 (Filed January 15, 1999)
Application of SAN DIEGO GAS & ELECTRIC COMPANY: (1) informing the Commission of the Probable Timing of the End of its Electric Rate Freeze, (2) for Authorization to Change Electric Rates Through Implementation of Interim Ratemaking Mechanisms Concurrent with Termination of the Electric Rate Freeze, and (3) for Authorization to Change Electric Rates by Adding New, and Revising or Terminating Existing, Rate and Revenue Mechanisms and Rate Designs. (U 902-E)	Application 99-02-029 (Filed February 19, 1999)

(See Decision 99-10-057 for Appearances.)

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be expanded to street lighting customers, rather, we see this as an opportunity for the marketplace to offer solutions.

We make several findings related to cost allocation after the rate freeze ends for each utility. We find that ongoing transition costs, restructuring implementation costs, and nuclear decommissioning costs should be allocated according to a cents-per-kilowatt methodology. Public purpose program costs related to energy efficiency should continue to be allocated according to a system average percent change (SAPC) methodology.

We also address issues related to SDG&E's rate reduction bonds. The unrealized savings resulting from the excess rate reduction bond proceeds must be refunded to ratepayers at SDG&E's authorized pre-tax rate of return immediately as a bill credit, refund, or both. Finally, we address other issues related to our post-rate freeze policies in the body of this decision.

II. Background and Procedural History

As required by D.97-10-057, PG&E, Edison, and SDG&E filed applications in order to establish the ratemaking mechanisms for the period following the rate freeze and to establish procurement and ratemaking policies for the post-transition period. As we discussed in D.99-10-057, Pub. Util. Code § 368(a)[1] established that electric rates would remain fixed at the June 10, 1996 levels, except that rates for residential and small commercial customers were reduced by 10% from those levels. This "rate freeze" was put into place in order to allow PG&E, Edison, and SDG&E to recover uneconomic investments in generation facilities. Section 367 defined these uneconomic costs, or transition costs, and established that such costs must be recovered by December 31, 2001, with certain

[1] All statutory references are to the Pub. Util. Code, unless otherwise noted.

demonstrates. Edison's residential customers are currently allocated approximately 39% for transition cost obligations under EPMC. Under the cents-per-kWh approach, these customers are allocated approximately 31.2% of these costs. Similarly, customers on Edison's large power schedules are allocated approximately 4.2% to 8.8% of these costs.[16] Under the cents-per-kWh methodology, larger power customers are allocated approximately 8.3% to 10.9% of the continuing transition cost obligation. The same types of shifts occurs for PG&E and SDG&E.

We therefore conclude that the cents-per-kWh methodology maintains the obligation of each customer class to pay these costs in substantially the same proportion, particularly when considering the impact of distribution and transmission cost allocation. We recognize that large users maintain they will be disadvantaged by this approach, but agree with TURN that rate caps and floors should be explored in utility-specific rate design proceedings. Therefore, once the rate freeze ends, on a utility-specific basis, ongoing transition costs shall be allocated using a cents-per-kilowatt-hour, usage-based methodology as proposed by TURN and ORA. The allocation method should be applied on a system wide basis pursuant to the Farm Bureau's recommendation. This approach can be easily implemented and will remain appropriate until the last QF and power purchase contracts expire decades from now.

We would also like to briefly address the proposed alternate by Commissioners Neeper and Bilas. The proposed alternate attempts to resurrect an early TURN allocation methodology which corresponds to customer class demand in the top 100 hours of the year. We note that the alternate's allocation

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[16] These percentages are without the interruptible credit.

methodology was abandoned earlier on in the proceeding. Because that proposal lacks support in the record, the Neeper/Bilas alternate would defer resolution of on-going transition cost allocation to a future proceeding or advice letter. We believe that opening this matter for further litigation does not contribute to resolution of the matter and imposes additional burdens on parties. In addition, it is overly bureaucratic to revisit this issue when it can and should be resolved immediately.

B. Allocation of Restructuring Implementation Costs

Restructuring implementation costs are costs resulting from the implementation of direct access, the PX, and the ISO. Treatment of these costs is addressed in Pub. Util. Code § 376[17]. We discussed the eligibility of such costs for § 376 treatment in D.99-05-031, D.99-09-064, and D.99-12-032. In D.99-06-058, we determined that these costs should be allocated using a SAPC methodology during the rate freeze. Again, the question before us now is whether the allocation methodology can and should be changed after the rate freeze.

As with ongoing transition costs, SCE, SDG&E, FEA, and Large Users propose to continue to use a SAPC method for restructuring implementation cost allocation. These parties believe that maintaining the SAPC methodology is most consistent with the cost-shifting principles of § 367(e)(1).

They point out that implementation costs are not recoverable after the rate freeze, only the displaced transition costs. Therefore, the displaced

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[17] Section 376 states that the utilities may recover restructuring implementation costs found reasonable by the Commission, and, to the extent that such recovery reduces the opportunity to recover the uneconomic costs of generation during the rate freeze, the utility may recover the displaced uneconomic costs after December 31, 2001.

We have explained that, during the rate freeze, § 367(e)(1) requires that transition cost be allocated in substantially the same proportion as similar costs were allocated in June of 1996. However, we do not believe that the language "in substantially the same proportion" is necessarily in conflict with the § 371(a) provisions mandating that transition cost allocation reflect changes in usage profiles. We agree with FEA, Large Users, and Edison that the statute mandates that the allocation of transition costs be adjusted for changes in usage patterns. Therefore, during the rate freeze, while transition costs continue to be allocated using an EPMC or SAPC methodology, allocators shall be updated to reflect changes in class usage profiles occurring in the normal course of business.

Regarding reconciliation of RGTCOMA balances, D.99-10-057 is explicit that costs cannot be carried over after the rate freeze period. In that decision, we also established refund accounts and mandated that over-collections must be returned to ratepayers using the allocation method used in the collection of those costs. (*Id.*, mimeo. at p. 16). In addition, it established that the rate freeze will end at the same time for all customers.

We reiterate that the rate freeze should end for all customers at the same time notwithstanding the class transition cost obligations in the RGTCOMA. Rate groups that have not met their transition cost obligation cannot continue to pay CTC post rate freeze as it would constitute a carry over of costs to the post rate freeze period. Such a carryover is unlawful pursuant to §§ 367(a) and 368(a). The RGTCOMA should be eliminated for each utility.

D.99-10-057 provides for the difference between the amount of CTC authorized and the actual amount collected to be returned to ratepayers at the utilities authorized rate of return. The utilities shall propose a method to return the funds in the first ATCP following the end of the rate freeze.

V. Rate Reduction Bond Issues

Pursuant to § 841 *et seq.* and D.97-09-057 (Financing Order) SDG&E issued $658 million in rate reduction bonds in December of 1997 in order to finance a 10% rate reduction for eligible customers over the anticipated four-and-a-half year rate freeze period. According to the terms outlined in the Financing Order, the bonds will be fully repaid by 2007 and a charge to repay the bonds appears on the customer bill until that time. The Financing Order also required SDG&E to establish a Rate Reduction Bond Memorandum Account (RRBMA). When SDG&E ended its rate freeze early on July 1, 1999, the mandated 10% rate reduction for residential and small commercial customers also ended, leaving these ratepayers with unrealized savings. The Financing Order requires that any excess RRB proceeds be returned to ratepayers. SDG&E states that currently there is $423 million in excess RRB proceeds.

In this proceeding, SDG&E has made two proposals concerning the unrealized savings. The first is to return the money to ratepayers at the interest rate of 9.52% (reduced pre-tax rate of return on transition cost assets) rather than the 12.6% (SDG&E's authorized pre-tax rate of return) mandated by the Financing Order.[20] The second proposal is to return the money to customers over a shorter period than the life of the bonds.

SDG&E argues that the bonds were issued under the assumption that the rate freeze would last until March 31, 2002. In essence, SDG&E contends that

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[20] SDG&E has also filed a petition to modify the Financing Order. ALJ Minkin asked SDG&E to specify which proceeding should address each issue. SDG&E indicated that the interest rate issue should be addressed in the decision regarding the petition to modify, but proceeded to brief the topic here. We will also address this issue in our decision regarding the petition to modify the Financing Order.

imposing a 12.6% rate of return on excess bond proceeds penalizes SDG&E shareholders for their efforts in ending the rate freeze early. Further, SDG&E argues that pursuant to newly-enacted § 846.2 (Senate Bill (SB) 418 Stats. 1999, Ch. 683), this Commission has the discretion to change the interest rate by deeming it "fair and reasonable." SDG&E maintains that residential and small commercial customers are better off under this proposal. The Financing Order assumed that benefits to ratepayers equaled $126 million in net present value (NPV). Under this proposal, SDG&E states that customers will receive $398 million in NPV benefits. At the time the Financing Order was issued, no party contemplated that the rate freeze would end early; therefore, SDG&E maintains that it was reasonable to assign a higher interest rate to the surplus proceeds.

SDG&E argues that the RRBs are complex, asset-backed securities rather than the usual 30-year utility bonds. SDG&E claims that issuing these assets in numerous rounds would have increased the analytical complexity and transaction costs, as well as the back-end accounting and regulatory burdens. SDG&E also contends that the $658 million flotation was quite small for the asset-backed securities market. The utility argues that had it broken up the issuance of the rate reduction bonds into smaller series, the interest rate would have been higher, resulting in larger debt-service payments by the ratepayers.

If the Commission does not alter the interest rate, SDG&E wishes to amortize the funds more quickly, e.g., in a lump-sum. However, if the interest rate is reduced, SDG&E will amortize the funds over a two-year period. SDG&E contends that this would synchronize the use of the remaining RRB funds with the originally intended term and use. SDG&E argues that the second proposal provides ratepayers with the highest net present value of all the proposals on the table

TURN, UCAN, Edison, FEA, and ORA object to both of SDG&E's proposals and argue that excess RRB proceeds should be refunded to ratepayers at SDG&E's authorized pre-tax rate of return throughout the life of the bonds. TURN, ORA, and UCAN argue that SDG&E was not required to issue bonds to fund the 10% rate reduction, but it chose to do so. They also argue that SDG&E was not required to take the riskier approach of issuing all the bonds at once, but rather could have issued them when necessary as the rate freeze progressed. Finally, TURN and UCAN state that the Financing Order was explicit regarding the terms and conditions of the bonds, including the risk if too many bonds were issued. SDG&E understood the risks fully. Parties argue that not only were the conditions completely understood, but the Legislature gave the UDCs veto power over the terms of the financing order in § 841(b):

> A financing order…shall become effective in accordance with its terms only after the electrical corporation files with the commission the electrical corporation's written consent to all terms and conditions of the financing order.

ORA, TURN, and UCAN argue that SDG&E had full discretion to use the bond revenue in any manner it chose to. These parties contend that the only issue of importance is that SDG&E understood the risks of over-issuance of the bonds and accepted those terms. Thus, SDG&E had the opportunity to mitigate that risk and chose not to do so. The consumer advocates argue that SDG&E should comply with the terms that it agreed to.

UCAN refutes SDG&E's argument that it could not have known that the rate freeze would end early and that its fossil plants would sell higher than book value. UCAN maintains that SDG&E either ignored the impact of the generation sale on the length of the rate freeze or assumed a market value of zero. SDG&E states in response to UCAN's data request that "the estimated market value of

the generating assets played no role either directly or indirectly in the revenue reduction bond calculations." (Ex. 82.) TURN and UCAN argue that if SDG&E had made reasonable estimates of generation asset values, it would likely have issued fewer rate reduction bonds.

TURN, UCAN, FEA, and ORA oppose the shorter amortization of the bond refunds because they contend that this approach would enable the UDC to skirt its interest obligations under the Financing Order. More importantly a shorter amortization period would be inequitable to future ratepayers that will continue to pay for the costs of the bonds but will not receive an offsetting credit. Current ratepayers would receive a windfall profit in the present but would continue to pay for the bonds. New SDG&E customers would be paying the bond cost without the offsetting credit.

Edison argues that SDG&E's proposal is unlawful. However, SDG&E contends that since SB 418 became law, this Commission has the discretion to alter the Financing Order. SDG&E argues that the opposing parties' position does not meet the "fair and reasonable" provision of Section 846.2, because it is not "fair" to shareholders.

We agree with UCAN, TURN, ORA, SCE, and FEA that the unrealized savings resulting from the excess RRB proceeds must be refunded to ratepayers at SDG&E's authorized pre-tax rate of return; however, we are not convinced that the Financing Order has addressed the period over which these funds must be returned.

The Financing Order reads:

> Balances that are to be credited to rate payers in respect of issuance of rate reduction bonds that subsequently were determined not to be necessary in order to finance a 10% rate reduction for rates in effect on June 10, 1996 should bear interest

at SDG&E's authorized rate of return (D.97-09-057, Conclusion of Law 33, Ordering Paragraph 19).

We recognize that SDG&E understood and agreed to the terms and stated risks embodied in the Financing Order. We agree that SDG&E evaluated the asset-based securities market and issued the $658 million in bonds in order to obtain a relatively low interest rate.

SDG&E states that § 846.2 gives the Commission discretion to alter the interest rate provisions of the Financing Order to make it fair and reasonable to shareholders. Section 846.2 states:

> Notwithstanding subdivision (c) of Section 841, for any electrical corporation that ended its rate freeze period described in subsection (a) of Section 368 prior to July 1, 1999, the Commission may order a fair and reasonable credit to ratepayers of any excess rate reduction bond proceeds.
>
> "Excess rate reduction bond proceeds," as used in this section, means proceeds from the sale of rate reduction bonds authorized by commission financing orders issued pursuant to this article that are subsequently determined by the commission to be in excess of the amounts necessary to provide the 10 percent rate reduction during the period when the rates were frozen pursuant to subdivision (a) of Section 368.

SB 418 clarifies that the Commission has the authority to address the issues raised by SDG&E and order an alternative disposition of the excess bond proceeds, if appropriate. However, SB 418 does not require the Commission to accept SDG&E's preferred solution. We cannot agree that SDG&E's primary proposal for a reduced interest rate, which would result in reduced refunds to ratepayers, is fair or reasonable. SDG&E accepted the terms and conditions of the Financing Order, which provided that ratepayers would receive a specific return if the utility issued an unnecessary amount of bonds. To change the terms of that agreement is not reasonable or fair to the ratepayers that provided

SDG&E with $658 million in bond revenues at the beginning of the transition period. Certainly, SDG&E enjoyed the benefits provided by the lump-sum issuance of the bonds.

However, we do have the discretion to order SDG&E to refund the bonds over a shorter amortization period than the life of the bonds. The Financing Order does not address the time period for refunding the unrealized savings to ratepayers. We believe it is appropriate to give customers their money back as soon as possible; therefore, the interest rate determination is not material to our actions today. Residential and small commercial customers will benefit by receiving either an immediate bill credit, a refund check, or both. This approach is similar to the methodology whereby the utilities benefited from the immediate infusion of cash due to the bond issuance. This is a fair and reasonable outcome of this matter, in compliance with § 846.2, because ratepayers will receive a credit of overpayments as soon as possible.

Therefore, we will order SDG&E to refund to ratepayers the excess rate reduction bond proceeds which bear an interest rate of SDG&E's authorized rate of return. The refund shall occur immediately as a bill credit, refund check, or both. SDG&E shall issue a bill credit, provide a refund check, or both on applicable customers' bills in the next feasible billing cycle, reflecting an immediate amortization of the Rate Reduction Bond Memorandum Account and the unrealized savings resulting from excess rate reduction bond proceeds. Within 15 days of the effective date of this decision, SDG&E shall submit a report informing the Energy Division, ORA, and all parties to this proceeding as to how the credit or refund will be implemented.

We recognize that this will result in certain future customers paying bond costs without the benefit of the offsetting credit. However, AB 1890 recognized that a certain amount of intertemporal inequity would occur by requiring that

43. D.99-10-057 explicitly stated that FERC has jurisdiction of RMR costs and defers to the FERC on all related matters. We will not relitigate these matters.

44. The utilities may continue to offer interruptible or curtailable service only until March 31, 2002 pursuant to Section 743.1.

45. Allocating costs related to rate limiters, costs of interruptible programs, and any rate discounts to transition cost recovery is improper and unlawful and misrepresents the costs, since transition costs are defined specifically in § 367.

46. The costs of interruptible discounts, rate limiter adjustments, and power factor adjustment should be included in the distribution in rate component.

47. The RGTCOMA tracks transition costs obligations and payments by rate group. During the rate freeze EPMC or SAPC allocators for transition costs should be adjusted for changes in usage patterns pursuant to § 371.

48. The rate freeze must end for all customers at the same time notwithstanding the class transition cost obligations in the RGTCOMA. Rate groups that have not met their transition cost obligation cannot continue to pay these costs after the rate freeze, because such a carry over of costs into the post-rate freeze period is unlawful pursuant to §§ 367(a) and 368(a).

49. Once the rate freeze ends, any credit balances in the TCBA for each utility, including the difference for the amount of CTC revenues authorized for collection and the amount actually collected, must be refunded to customers. The funds will accrue interest at the 90-day commercial paper interest rate. The utilities must propose a method to return the over- collected amounts to ratepayers in the first ATCP following the end of the rate freeze.

50. Pursuant to § 841 *et seq.* and D.97-09-057, SDG&E issued $658 million in rate reduction bonds in December of 1997 in order to finance a 10% rate reduction for eligible customers over the anticipated four-and-a-half year rate freeze period. According to the terms outlined in the Financing Order, the bonds

impacts should be considered in utility-specific proceedings and may be mitigated through the use of rate caps and floors for particular customer classes.

15. The § 367(e) provision mandating that transition costs be allocated in substantially the same proportion as similar costs on June 10, 1996 is not in conflict with the § 371 provision mandating allocation adjustments for changes in class energy use patterns. Therefore, during the rate freeze EPMC or SAPC allocators for transition costs shall be adjusted for changes in usage pursuant to § 371.

16. If we were to allow reconciliation of RGTCOMA balances post-rate freeze, this would constitute a carryover of transition costs into the post rate freeze period. Such a carryover of costs is unlawful pursuant to §§ 367(a) and 368(a). The RGTCOMA should be eliminated for each utility.

17. SDG&E understood and agreed to the terms and stated risks embodied in the Financing Order.

18. SB 418 clarifies that the Commission has the authority to address issues regarding excess bond revenues and order alternative treatment, if appropriate. However, SB 418 does not require the Commission to accept SDG&E's preferred solution for a lower interest rate.

19. Section 846.2 provides that the Commission may order a credit to ratepayers of excess rate reduction bond proceeds that is fair and reasonable. SDG&E's request for a lower interest rate than that established in the Financing Order, would not be fair or reasonable for ratepayers. However, it is reasonable that residential and small commercial customers benefit from an immediate bill credit, refund check, or both. This approach is consistent with the requirements of § 846.2.

20. The Legislature has called for certain rates and optional service to be in place for a specific amount of time; e.g., § 743.1(b) requires that optional

12. Costs related to rate limiters, costs of interruptible programs, and any rate discounts shall not be recovered as transition costs.

13. The costs of power-factor adjustments, interruptible discounts, and rate limiter adjustments shall be included in the distribution rate component.

14. The rate freeze shall end for all customers at the same time notwithstanding the class transition cost obligations in the Rate Group Transition Cost Obligation Memorandum Accounts (RGTCOMA). During the rate freeze EPMC or SAPC allocators for transition costs shall be adjusted for changes in usage patterns pursuant to § 371. The RGTCOMA shall be eliminated for each utility.

15. Once the rate freeze ends, any credit balances in the Transition Cost Balancing Account (TCBA) for each utility, including the difference for the amount of competition transition charge (CTC) revenues authorized for collection and the amount actually collected, shall be refunded to customers. The funds will accrue interest at the 90-day commercial paper interest rate. The utilities shall propose a method to return the over-collected CTC to ratepayers in the first Annual Transition Cost Proceeding (ATCP) following the end of the rate freeze.

16. SDG&E shall refund to ratepayers the excess rate reduction bond proceeds which bear an interest rate of SDG&E's authorized rate of return. The refund shall occur immediately as a bill credit, refund check, or both. SDG&E shall issue a bill credit, provide a refund check, or both on applicable customers' bills in the next feasible billing cycle, reflecting an immediate amortization of the Rate Reduction Bond Memorandum Account and the unrealized savings resulting from excess rate reduction bond proceeds. Within 15 days of the effective date of this decision, SDG&E shall submit a report informing the Energy Division, ORA,