

Decision **DRAFT DECISION OF ALJ PATRICK** (Mailed 9/13/99)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) to Report on the Valuation Process for Certain Generation-Related Assets Pursuant to D.97-11-074.

Application 98-05-014
(Filed May 1, 1998)

Application of PACIFIC GAS AND ELECTRIC COMPANY to Report Assessments of Inventory Balances and to Address Appraisal of Retained Generation Assets.

Application 98-05-022
(Filed May 1, 1998)

O P I N I O N**Summary**

This decision orders Pacific Gas and Electric Company (PG&E) to file, by November 15, 1999, an application to value remaining generation and generation-related assets pursuant to Sections 216(h) and 377 of the Public Utilities Code. We order PG&E to file the application recognizing that the ultimate disposition of these assets, especially PG&E's hydroelectric assets, will affect the state's economy and the structure of electricity markets, as well as water allocation and the future of some of the state's most precious environmental resources. The primary purpose of the application is to establish market values for remaining assets in order to determine how they may affect ratepayer liability for transition costs and the timing of the end of the existing rate freeze ordered by Assembly Bill (AB) 1890. We also invite PG&E and parties to explore, in the new docket, alternative ownership and operating arrangements.

Discussion

PG&E owns and operates 68 federally licensed hydroelectric facilities in various locations of the state. Its facilities are located in watersheds that provide habitat to complex and vulnerable plant and wildlife communities. PG&E facilities provide approximately 3,000 megawatts (MW) of power to the state's electric grid and supply water to large and small customers. PG&E holds contract rights to an additional 1062 MW of irrigation district power production. Because PG&E's hydroelectric assets make up a substantial portion of the state's ancillary services market, they play a vital role in assuring the reliability of the state's electrical grid. Control of PG&E's hydroelectric facilities may well influence the extent to which the state's electric market is reliable and competitive.

The book value of PG&E's hydroelectric assets is over \$1 billion. Estimates of market value are considerably larger. For example, PG&E recently proposed statutory language that would set the market value at \$3.3 billion. Because the value of PG&E's hydroelectric facilities is so high, their valuation will likely have a substantial impact on the date the rate freeze ends.

PG&E has stated in several forums an interest in transferring its hydroelectric facilities to an unregulated affiliate that would own and operate the plants. The California Legislature has recently considered various proposals to determine the value of the assets and new disposition. Some legislative proposals have also addressed treatment of related environmental resources and the extent of the Commission's authority over the assets. Additionally, although the Legislature is considering the matter in a broader policy context, the Commission must prepare for the contingency that the Legislature will not set a value on the plants. If the Legislature continues to consider new law in this regard, the Commission's review will provide an independent analysis of asset

value through rigorous public review by various experts. To the extent the Office of Ratepayer Advocates (ORA) requires an outside expert to conduct an independent appraisal of the hydroelectric assets, we direct PG&E to pay the costs associated with such contract.

Currently, law requires the Commission to establish procedures for market valuation of generation assets, determine the valuation of those assets, and authorize their disposition. Commission approval pursuant to Pub. Util. Code § 851 is required prior to their transfer to any nonutility entity. Under § 367(b), we are required to value the assets no later than December 31, 2001. The value we establish for the assets is to be used to reduce ratepayers' liability for uneconomic generation assets by way of a credit to the Transition Cost Balancing Account (TCBA). Pursuant to AB 1890 and numerous Commission decisions, the rate freeze ends when the balance in the TCBA is zero or on March 31, 2002, whichever occurs first. The Commission began a preliminary review of methods for establishing market values for the plants in this proceeding.

However, at the request of certain parties, we deferred hearings on the matters at issue. At this point, significant time has passed without the Commission having developed market valuation principles. Because valuation of remaining assets is likely to be controversial, and is crucial to ending the rate freeze according to statutory requirements, we move straight to the valuation process without establishing principles for market valuation in advance.

Our decision today is driven by our interest in a timely review of asset values and their impact on achieving an end of the rate freeze. Indeed, delaying the process of establishing a market value for these assets could artificially extend the rate freeze.

Accordingly, we herein direct PG&E to file an application proposing a method to value remaining generation and generation-related assets and, using

that method, to establish a final valuation pursuant to §§ 216(h) and 377. PG&E may propose any method for valuation but it must identify the value of hydroelectric assets separately and, for those assets, must provide a valuation that, at a minimum:

- Includes a market value for real property associated with generating facilities;
- Assumes existing environmental and licensing conditions;
- Assumes the cost and value of existing water contracts;
- Assumes various future energy and capacity price scenarios;
- Considers the economies of operating clusters of facilities, for example, those located in common or adjacent watersheds; and
- Assumes continued operation of the generation facility at Diablo Canyon.

As part of our review of the application ordered today, PG&E and other parties may propose alternatives to existing ownership and operating arrangements for PG&E's hydroelectric assets. Notwithstanding any proposals made in the valuation application, however, we affirm the finding in the February 1, 1999 scoping memo that under existing law, PG&E may not transfer any generating assets without the express approval of the Commission, pursuant to § 851. If PG&E proposes an asset transfer, we expect PG&E to consult with Energy Division staff in advance regarding environmental issues, including compliance with the California Environmental Quality Act.

Need for Hearing in the Existing Docket

In the February 1, 1999 Scoping Memo, the Assigned Commissioner determined that hearings were required for issues surrounding market valuation principles. Because we have concluded that we should move directly to setting market values in new applications, without establishing principles in advance for

market valuation here, we amend the hearing designation to eliminate the requirement for hearings previously established in Resolution ALJ 176-2993 and the scoping memo. We will address the need for hearings and other procedural matters relevant to the new application at a later date. There being no other matters to consider in Application 98-05-022, we will close that docket.

Comments on Draft Decision

The draft decision of Administrative Law Judge Patrick in this matter was mailed to the parties in accordance with Pub. Util. Code Section 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on ____, and reply comments were filed on _____.

Findings of Fact

1. The timing of the Commission's review of remaining generating assets, especially hydroelectric assets, could affect the ability to end the rate freeze as anticipated by AB 1890.
2. The value of hydroelectric facilities may affect the timing of the end of the rate freeze.
3. The Assigned Commissioner's Scoping Memo has already determined that no utility may transfer its generating assets absent Commission approval under Section 851.

Conclusions of Law

1. The Commission should order PG&E to file an application for valuation of remaining generation and generation-related assets pursuant to §§ 216(h) and 377 as set forth herein.
2. If ORA requires an outside expert to conduct an independent appraisal of PG&E's hydroelectric facilities, the Commission should order PG&E to pay the costs associated with such contract. In order to assure the integrity of the

contract and work performed under it, PG&E should assert no influence over the contracting process or the process of developing the appraisal.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) shall, no later than November 15, 1999, file an application for valuation of remaining generation and generation-related assets consistent with Pub. Util. Code Section 216(h) and Section 377 as set forth herein.
2. To the extent an outside expert is required by the Office of Ratepayer Advocates (ORA) to perform an independent appraisal of the hydroelectric assets, PG&E shall fund such contract, but shall not in any way act to influence the contracting process or the development of the appraisal except to the extent it shall provide requested information to ORA and the contractor.
3. A hearing is not required in Application (A.) 98-05-022.
4. A.98-05-022 is closed.

This order is effective today.

Dated _____, at San Francisco, California.