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Decision 02-02-051 February 21, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 3338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs.	Application 00-11-038 (Filed November 16, 2000)
Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E)	Application 00-11-056 (Filed November 22, 2000)
Petition of THE UTILITY REFORM NETWORK for Modification of Resolution E-3527.	Application 00-10-028 (Filed October 17, 2000)

OPINION ADOPTING A RATE AGREEMENT BETWEEN THE COMMISSION AND THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

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I. Summary

This decision adopts a Rate Agreement between the Commission and the California Department of Water Resources (DWR) pursuant to Water Code §§ 80110 and 80130.[1] The purpose of the Rate Agreement is to facilitate DWR's issuance of the bonds authorized by Water Code § 80130.[2] DWR will use the bond proceeds to repay more than $ 10 billion of debt that DWR incurred to finance power purchases during the electricity crisis, including more than $6 billion owed to the State's General Fund. The Rate Agreement terminates when the bonds and associated financial obligations have been paid or otherwise provided for. The adopted Rate Agreement is attached hereto as Appendix C.

This decision adopts the Rate Agreement because it is in the public interest, in part because it will allow the General Fund to be repaid. The adopted Rate Agreement establishes a framework for discharging DWR's and the Commission's statutory obligations set forth in AB 1X, as amended by SB 31X (referred to hereafter as "the Act"). Under the Act, the Commission has an obligation to impose charges on electric customers that are sufficient to compensate DWR for its costs under the Act, including procuring and delivering power, and paying bond principal and interest.

The adopted Rate Agreement establishes two streams of revenues. One stream of revenues will come from Bond Charges imposed on electric customers, and is designed to pay for bond-related costs. The second stream of revenues will come from Power Charges imposed on electric customers who buy power

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[1] These provisions of the Water Code were enacted by Assembly Bill No. 1 from the 2001-2002 First Extraordinary Session (AB 1X).

[2] DWR is authorized to issue bonds by AB 1X, as amended by Senate Bill No. 31 from the 2001-2002 First Extraordinary Session (SB 31X).

from DWR, and is designed to pay for the costs that DWR incurs to procure and deliver power. Both streams of revenue are necessary for DWR to issue bonds with investment-grade ratings.

The Commission is not required to enter into the Rate Agreement, but does so pursuant to its discretion under the Act.[3] The many reasons for adopting the proposed Rate Agreement are discussed below. Once executed, Sections 5.1(a) and 5.1(b)[4] of the Rate Agreement will have the force and effect of an irrevocable financing order issued by the Commission pursuant to Pub. Util. Code § 840 et seq., and these sections may not be amended once the bonds have been issued.

II. Background

Beginning in the summer of 2000, the price for wholesale electricity in California skyrocketed to exorbitant levels. The inflated prices caused financial distress for Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (SCE), and resulted in legislation to protect the ratepayers of San Diego Gas & Electric Company (SDG&E) from excessive prices. Despite emergency action by the Commission to raise electric rates, the situation became a crisis when wholesalers refused to sell electricity to the utilities that they themselves had crippled, thereby endangering the supply of power for millions of Californians.

To avert a collapse of the electric system, Governor Davis proclaimed a state of emergency on January 17, 2001, and ordered DWR to immediately purchase and sell electric power, as necessary, to mitigate the effects of the

[3] Water Code § 80110 and § 80134.

[4] Section 5.1(a) requires the Commission to establish rates that are sufficient to timely pay bond principal, interest, and other bond-related costs. Section 5.1(b) states that the rates established by the Commission to pay for bond-related costs shall be the property of DWR for all purposes under California Law.

emergency.[5] The Legislature subsequently granted DWR temporary, then long-term authority to purchase and sell power by passing SB 7X and AB 1X. DWR ultimately spent billions of dollars borrowed from the State's General Fund to procure power, which has not yet been repaid. To date DWR has borrowed approximately $6.1 billion from the State's General Fund, and approximately $4.3 billion from a group of lenders led by Morgan Guaranty Trust Company. DWR's ability to repay the General Fund is now critical.

A. The Statutory Scheme

On January 19, 2001, Governor Davis signed SB 7X,[6] which directed DWR to buy electricity and sell the power to retail customers for a period not to exceed 12 days from the effective date of the legislation.[7] On February 1, 2001, Governor Davis signed AB 1X.[8] This statute provides DWR with longer-term authority to procure electric power and to sell the power directly to the retail customers served by electrical corporations[9] (i.e., the retail customers of PG&E, SCE, and SDG&E).[10] AB 1X appropriated $496 million from the State's General Fund for

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[5] The Governor's proclamation is appended hereto as Appendix B.

[6] Statutes of 2001-02 First Extraordinary Session, Chapter 3.

[7] SB 7X appropriated $ 400 million from the State's General Fund for this purpose. SB 7X also directed the Commission to implement emergency regulations governing (1) the utilities' collection of customer payments for power sold to the customers by DWR, and (2) the remittance of the moneys so collected to DWR. The Commission implemented SB 7X in Decision (D.) 01-01-061.

[8] Statutes of 2001-02 First Extraordinary Session, Chapter 4. AB 1X adds Division 27 (commencing with § 80000) to the Water Code, and adds and amends certain provisions of the Public Utilities Code.

[9] Water Code §§ 80002.5, 80012, 80102(a), 80102(b), 80102(c), and 80116. The Act requires DWR to sell power to retail customers at not more than DWR's acquisition costs, including transmission, scheduling, and other related costs. (Water Code § 80116.)

[10] The Act does not reduce or modify any utility's obligation to serve. (Water Code § 80002.)

this purpose,[11] and requires DWR to repay the General Fund as soon as practicable.[12]

The Act provides DWR with authority to purchase electric power "on such terms and for such periods as the department determines, and at such prices as the department deems appropriate[,]" taking into account certain enumerated factors.[13] In addition, "any just and reasonable review" of the revenue requirements designated to pay for DWR's power purchases "shall be conducted and determined by the department.[14]" DWR's authority under the Act to enter into new contracts for electric power expires on January 1, 2003. However, AB 1X does not prevent DWR from administering contracts executed prior to January 1, 2003.[15]

Any money that the electrical corporations collect for power sold by DWR must be segregated by the electrical corporations on terms and conditions established by DWR, and held in trust for the benefit of DWR.[16] The Act allows DWR to enter into contracts with electrical corporations (Servicing Agreements) for the collection of money owed to DWR for power that DWR sells to the electrical corporations' customers. The Act also provides that, at the request of DWR, the Commission shall order the electrical corporations to undertake such

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[11] AB 1X, Section 5.

[12] Water Code § 80200(b)(4). All statutory references in this section of the decision refer to the Water Code unless otherwise indicated.

[13] § 80100.

[14] § 80110.

[15] § 80260.

[16] § 80112.

activities.[17] Certain changes to the existing Servicing Agreements and Servicing Orders may be necessary or desirable to implement the Rate Agreement.[18]

DWR's costs and revenues are tracked in the Department of Water Resources Electric Power Fund (the Electric Power Fund) held in the State Treasury. All revenues payable to DWR pursuant to AB 1X must be deposited into the Fund. These revenues include bond proceeds and revenues from the sale of electric power. Amounts held in the Electric Power Fund may be spent only on the items specified in AB 1X, which include power purchases, debt service, and repayment of the General Fund.[19]

To provide DWR with money to procure power and to repay the General Fund, AB 1X authorizes DWR to (1) issue bonds, and (2) recover its power costs and bond-related costs from electric charges established by the Commission.[20] AB 1X requires DWR to determine annually, if not more frequently, a revenue requirement. The statute defines "revenue requirement" as the amount that is sufficient, together with any moneys in the Electric Power Fund, to provide all of the following: (1) the amounts necessary to timely pay the principal, interest, and other costs associated with the bonds issued by DWR; (2) the amounts necessary to pay for power purchased by DWR, including costs for transmission, scheduling, and other related expenses, or to make payments under any other

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[17] § 80106.

[18] DWR suggests several general modifications that need to be made to the Servicing Agreements and requests that the Commission order the investor-owned utilities to make these modifications promptly. (DWR's Comments on the Draft Decision, pp. 9-10.) We decline to address DWR's proposed changes to the Servicing Agreements in this order, but we encourage utilities to work with DWR to submit appropriate amendments to the Servicing Agreements to the Commission for approval.

[19] § 80200.

[20] § 80110 and § 80130.

contracts, agreements or obligations entered into under AB 1X; (3) reserves in such amount as DWR deems necessary or desirable; (4) repayment of advances from the General Fund; (5) interest on moneys advanced by the General Fund; and (6) the costs incurred by DWR to administer AB 1X.[21]

DWR is entitled by AB 1X to recover its revenue requirement from electric charges established by the Commission. However, AB 1X limits the rates paid by certain residential customers for this purpose. In particular, AB 1X states that until DWR has recovered its costs for power procured under the statute, the Commission shall not increase rates that were in effect at the time AB 1X was enacted for residential usage up to 130% of baseline quantities.[22]

On May 10, 2001, Governor Davis signed SB 31X.[23] Among other things, SB 31X amended AB 1X to provide DWR with authority to issue bonds in the maximum aggregate amount of $13.423 billion.[24]

B. The Bonds

DWR is authorized by the Act to issue bonds for the purposes specified in AB 1X. These purposes include (1) paying for the cost of electric power procured by DWR pursuant to the Act and the Governor's Emergency Proclamation dated January 17, 2001; (2) reimbursing the General Fund for advances; and (3) establishing and maintaining reserves in connection with the bonds.[25] The price, terms, conditions, and manner of offering the bonds will be determined by DWR and approved by the Director of Finance and the State Treasurer. At the

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[21] § 80134.

[22] § 80110.

[23] Statutes of 2001-02 First Extraordinary Session, Chapter 9.

[24] § 80130.

[25] §§ 80010, 80110, 80130, and 80132(a).

discretion of DWR, the bonds may be secured by a trust agreement between DWR and a trustee.[26]

The Act states that the bonds and other obligations of DWR shall be payable solely from the funds provided for in the Act. Such obligations shall not constitute a debt or liability of the State or any political subdivision of the State. The Act also requires all bonds to contain a statement to the following effect: "Neither the faith and credit nor the taxing power of the State of California is pledged to the payment of the principal of or interest on this bond.[27]" While any obligations incurred by DWR under the Act remain outstanding, the Act provides that the rights, powers, duties, and existence of DWR and the Commission shall not be impaired in a way that adversely affects the interests and rights of the parties to such obligations.[28]

DWR must establish a mechanism to ensure that bonds will be sold at investment-grade ratings and repaid on a timely basis.[29] This mechanism may include an agreement with the Commission (a "Rate Agreement") that provides for the timely recovery of DWR's revenue requirement (including DWR's costs to procure power) in electric rates.[30] Any such agreement may be structured to have the force and effect of a financing order adopted by the Commission pursuant to Pub. Util. Code § 840 et seq., to the extent determined by the Commission.[31]

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[26] § 80132.

[27] §§ 80132(f) and 80200.

[28] § 80200(e).

[29] § 80130.

[30] §§ 80130 and 80110.

[31] Water Code § 80110. Pub. Util. Code § 840 et seq. pertain to rate-reduction bonds issued by electric utilities pursuant to AB 1890. Accordingly, to the extent it explicitly addresses

Footnote continued on next page.

On June 18, 2001, Governor Davis issued an Executive Order that authorized DWR to accept up to $5 billion in loans for the following purposes: (1) to purchase electric power, (2) to purchase natural gas to generate electricity; and (3) to fund capitalized interest and reserves required in connection with the loans. The Executive Order indicates that all provisions in the Act apply to the loans.[32]

On June 26, 2001, DWR exercised its authority under the Governor's Executive Order to obtain a loan that converted to a three-year term loan in the amount of $4.3 billion (the "Interim Loan").[33] Under the terms of the Interim Loan, DWR must repay the must repay the Interim Loan before it repays the General Fund.[34]

C. The Roles of the Commission and DWR

The Commission and DWR each have distinct roles under the Act. The Commission has exclusive authority under the Act to set electric charges to

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AB 1890 bonds, § 840 et seq., is not directly applicable to bonds issued by DWR pursuant to the Act. However, the following provisions in Pub. Util. Code § 841(c) regarding the "force and effect" of Commission financing orders are relevant to bonds issued by DWR under the Act: "Notwithstanding Section 455.5, Section 1708, or any other provision of law . . . the financing orders. . . shall be irrevocable and the commission shall not have authority either by rescinding, altering, or amending the financing order or otherwise, to revalue or revise for ratemaking purposes the transition costs . . . nor shall the amount of revenues arising with respect thereto be subject to reduction, impairment, postponement, or termination." (D.01-05-037, 2001 Cal. PUC LEXIS 374, *17 - *18.) In addition, with respect to the "Fixed Transition Amounts," § 840 provides that (i) the rates and other charges imposed pursuant to the financing order are to be nonbypassable, and (ii) the right created by the financing order to receive such rates and other charges is a property right. These two provisions also appear relevant to the bonds that DWR is authorized to issue by the Act.

[32] Executive Order D-42-01.

[33] The formal title of the Interim Loan is "The Credit and Security Agreement Among the State of California Acting Through the Department of Water Resources, Various Lenders, and Morgan Guaranty Trust Company of New York, as Agent, Dated as of June 26, 2001."

[34] Proposed Rate Agreement, Section 7.6.

recover DWR's costs. The Commission also has sole authority to establish the procedures that it will use set electric charges, and to allocate DWR's revenue requirement among Service Areas and electric customers. DWR has authority to issue bonds and to enter into power contracts. DWR also is entitled to recover in electric rates its bond costs, power procurement costs, and other costs listed in Water Code § 80134. In addition, the Act provides DWR with exclusive authority to conduct any review of the justness and reasonableness of the costs it seeks to recover in electric rates under Pub. Util. Code § 451.[35]

Although the Act specifies the purpose of the Rate Agreement, the legislation provides the Commission and DWR with discretion on whether to enter into such an agreement. The Act also provides each agency with discretion to negotiate the specific details regarding the discharge of each agency's responsibilities under the Act, including the details of each agency's responsibilities regarding the recovery of DWR's revenue requirement.

D. Development of the Proposed Rate Agreement

The Act specifies the purpose of the Rate Agreement, but leaves it to the Commission and DWR to work out the details of the agreement. During the summer of 2001, DWR asked the Commission to enter into a Rate Agreement that had been drafted by DWR ("the summer Rate Agreement"). A central feature of the summer Rate Agreement was an irrevocable commitment by the Commission under Pub. Util. Code § 840 et seq., to set charges for electricity sold by DWR that would recover not only DWR's bond-related costs, but also DWR's power-related costs. Parties were provided an opportunity to submit written comments on the summer Rate Agreement. In response to these comments, a

[35] § 80110.

draft decision was prepared that proposed numerous amendments to the summer Rate Agreement. The draft decision was taken up by the Commission at its meeting on October 2, 2001, at which time a majority of the Commission voted against the decision.

Following the Commission's rejection of the summer Rate Agreement, the staffs of the Commission, DWR, and other State agencies continued to work on a bond transaction and a Rate Agreement that would be acceptable to all of the involved agencies. Their work eventually produced a substantially revised bond transaction and Rate Agreement. On January 31, 2002, the revised Rate Agreement (referred to hereafter as "the proposed Rate Agreement") was mailed to the parties for comment. Comments regarding the proposed Rate Agreement were filed on February 5, 2002 by the following parties: DWR, the California Industrial Users, the Energy Producers and Users Coalition ("EPUC/CIU"), the Foundation for Taxpayer and Consumer Rights (the "Foundation"), PG&E, SCE, SDG&E, Sunrise Power Company LLC ("Sunrise"), The Utility Reform Network ("TURN"), and JP Morgan Chase Bank. Most of the commentators found the proposed Rate Agreement far superior to the summer Rate Agreement. A summary of the comments on the proposed Rate Agreement is contained in Appendix A of this decision.

III. Summary of the Proposed Rate Agreement

The purpose of the proposed Rate Agreement is to facilitate the issuance of Bonds in accordance with the Bond transaction that will be set forth in the Financing Documents. The proposed Rate Agreement describes the Bonds and Financing Documents as follows:

> **Bonds** means evidences of indebtedness issued by DWR for the purposes specified in the Act pursuant to Water Code § 80130

> and the Governor's Executive Order dated June 18, 2001, in an aggregate principal amount up to $ 13,423,000,000; provided, however, that (i) notes issued in anticipation of the Bonds and retired from the proceeds of the Bonds shall not be counted against said dollar limitation, (ii) Bonds includes debt issued to refund prior Bonds, but such debt shall not be counted against said dollar limitation; and (iii) Bonds excludes the Interim Loan. (Paraphrase of Section 1.1.)[36]
>
> **Financing Documents** means any resolution, indenture, trust agreement, loan agreement, revolving credit agreement, reimbursement agreement, standby purchase agreement, bond offering documents, or other agreement or instrument adopted or entered into by DWR authorizing, securing or enhancing the Bonds, as amended or supplemented, copies of which shall be provided to the Commission. (Paraphrase of Section 1.1.)

Although DWR is responsible for developing the Financing Documents, DWR must (1) involve the Commission, to the fullest extent possible, in the development and completion of all Financing Documents, and (2) consult with the Commission regarding (i) the sizing of operating and debt service reserves, (ii) debt service coverage, (iii) the maturity and maximum amount of Bonds to be issued, and (iv) any other matters in the Financing Documents which the Commission deems material.[37] The proposed Rate Agreement also states that

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[36] All "Section" references refer to the proposed Rate Agreement. Section 1.1 of the Rate Agreement defines the Interim Loan as obligations under the Credit and Security Agreement dated June 26, 2001. As more fully described in the comments submitted by Morgan Guaranty Trust Company of New York in this proceeding on September 4, 2001, the Interim Loan provided DWR with $4.3 billion to finance electric power purchases. DWR is required by the terms of the Interim Loan to (i) repay the Interim Loan prior to repaying the General Fund, and (ii) pay higher rates of interest on the Interim Loan the longer the Loan remains outstanding.

[37] Section 7.10.

DWR "has submitted to the Commission a summary of the material terms of the Financing Documents securing its Bonds.[38]"

The proposed Rate Agreement provides that DWR must obtain approval from the Commission's designee prior to making any "material changes" to the "material terms.[39]" The Commission is to appoint a designee at the time it adopts the Rate Agreement. Nothing in the Rate Agreement is meant to imply that the Commission or its designee will have the right to approve (i) the final amortization, interest rates, or methods of determination, denominations, redemption provisions or pricing of the Bonds, (ii) final sizing of reserves and debt service coverage based on pricing considerations, (iii) except to the extent set forth in the previous paragraph, the terms of any revolving credit agreement, reimbursement agreement, standby purchase agreement, liquidity or credit enhancement facility, or swap agreement or other hedging agreement entered into in connection with the Bonds, (iv) any agreements or arrangements with any Fiduciary incident to the issuance of the Bonds, or (v) any offering document

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[38] Section 7.10. The Rate Agreement defines "material terms" as the maximum amount of the Bonds authorized, their maturity, a description of the flow of funds, and a description of the sizing or methodology of sizing of reserves held or created pursuant to the Financing Documents or debt service coverage required thereby. (Section 7.10.)

[39] The Rate Agreement defines "material change" as (i) a change in the sizing or methodology of sizing of debt service reserves that would increase the projected net debt service on the Bonds by more than an amount specified in the summary of the material terms of the Financing Documents, (ii) an increase in debt service coverage required by the Financing Documents by more than an amount specified in the summary of the material terms of the Financing Documents; (iii) a change in the sizing or method of sizing of operating reserves by more than an amount specified in the summary of the material terms of the Financing Documents; (iv) any increase in the maximum amount of the bonds authorized; (v) a change in the maturity of the Bonds beyond those changes permitted in the summary of the material terms of the Financing Documents or (vi) a change in the flow of funds beyond those changes permitted in the summary of the material terms of the Financing Documents.

used in connection with the offering of the Bonds, except with respect to sections of the offering document relating to the Commission.[40]

To facilitate the issuance of Bonds, the proposed Rate Agreement establishes two separate streams of revenue. One stream of revenues will come from Bond Charges, which the Rate Agreement describes as follows:

> **Bond Charges** means charges imposed by the Commission upon customers in the Service Areas of PG&E, SCE, and SDG&E based on the aggregate amount of electric power sold to each customer by an Electrical Corporation, DWR, and, to the extent determined by the Commission under Section 4.3 of the Rate Agreement,[41] by an Electric Service Provider (ESP),[42] for the purpose of providing sufficient funds to pay for, or provide for the payment of, Bond-Related Costs as they come due. Bond Charges shall be imposed upon customers at all times required by the Rate Agreement whether or not DWR is selling, or deemed to be selling, Power to such customers until such time as DWR has recovered the portion of its revenue requirements under Water Code § 80134 constituting Bond-Related Costs. (Paraphrase of Section 1.1.)

Revenues from Bond Charges will be used to pay Bond-Related Costs, which Section 1.1 of the Rate Agreement describes, in paraphrased form, as follows:

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[40] Section 7.10.

[41] Section 4.3 states that "Bond Charges may be based on electric power provided to customers by Electric Service Providers only after an order of the Commission providing for such charges becomes final and unappealable."

[42] Section 1.1 defines an ESP as "an entity that provides electrical service to one or more retail customers located within the Service Areas of [PG&E, SCE, or SDG&E], except that [ESP] excludes: [DWR], any other public agency to the extent that it offers electrical service to customers within its jurisdiction or within the service territory of a local publicly owned electric utility, and Electrical Corporations. [ESP] includes the unregulated affiliates and subsidiaries of an Electrical Corporation."

Bond-Related Costs means payments or deposits or other provisions by DWR pursuant to the Financing Documents or the Act for the following components of DWR's revenue requirement under Water Code § 80134:

(i) Bond principal, interest, and premium, and any additional amount required under the Financing Documents to be deposited into the Bond Charge Collection Account to provide debt service coverage of the Bonds.

(ii) Payments required to be made pursuant to: (1) agreements with issuers of credit and liquidity facilities and their participants, including letters of credit, bond insurance, guarantees, debt service reserve fund surety bonds, lines of credit, reimbursement agreements, and standby bond-purchase agreements; (2) agreements relating to other financial instruments entered into in connection with the Bonds, including investment agreements, hedges, interest-rate swaps, caps, options and forward-purchase agreements; and (3) agreements relating to the remarketing of Bonds, including remarketing agreements, dealer agreements, and auction agent agreements.[43]

(iii) Deposits to the Debt Service Reserve Account established under the Financing Documents to the extent necessary to provide therein an amount equal to the requirement for such account under the Financing Documents if not otherwise replenished from Power Charges.

(iv) The cost of Fiduciaries associated with the issuance and administration of the Bonds.

(v) The following costs incurred by DWR when and if DWR no longer sells Power under the Act and Bonds remain outstanding: (i) Bond Charge servicing costs, (ii) costs to prepare and provide the information and reports required by the Financing Documents, the Rate Agreement, and the

[43] Because these financial instruments must be entered into "in connection with the bonds," this provision cannot be interpreted to cover energy or fuel related financial instruments as PG&E suggests.

> Act, and related audit, legal, consulting, and administrative costs, and (iii) costs to comply with arbitrage restrictions and rebate requirements.

Section 5.1(a) of the Rate Agreement requires the Commission to impose Bond Charges that are sufficient to pay all Bond-Related Costs as they come due. The actual Bond Charge for each customer will be based on the aggregate amount of electric power sold to the customer by DWR, an Electrical Corporation, and an ESP under the circumstances described in Section 4.3 of the Rate Agreement.[44] The Bond Charges will be imposed upon customers whether or not DWR is selling power to those customers, until DWR has recovered the portion of its revenue requirements under Water Code § 80134 constituting Bond-Related Costs.

DWR may pledge the revenues from Bond Charges to repay the Bonds.[45] Section 5.1(b) states that DWR's right to receive Bond Charges shall be the property of DWR for all purposes under California law. Section 5.1(c) provides that Sections 5.1(a) and 5.1(b) shall have the force and effect of an irrevocable "financing order" adopted by the Commission pursuant to Pub. Util. Code § 840 et seq. Importantly, only Sections 5.1(a) and 5.1(b) of the proposed Rate Agreement, and no others, will have the force and effect of an irrevocable financing order.

Revenues from Bond Charges will be deposited into the Bond Charge Collection Account (Collection Account).[46] Funds in the Collection Account will

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[44] EPUC/CIU incorrectly suggest the definition of Bond Charge contains an allocation methodology. This decision simply commits the Commission to impose bond charges on power sold by Electrical Corporations and DWR.

[45] Water Code § 80132(c).

[46] Section 1.1. All "accounts" referred herein are to be a part of the Electric Power Fund.

be transferred periodically to the Bond Charge Payment Account (Payment Account).[47] Funds in the Payment Account may only be used to pay for Bond-Related Costs.[48] However, so long as funds remain in the Collection Account, they may be used under the conditions specified in the Financing Documents to pay amounts due under DWR's Priority Long-Term Power Contracts (discussed below).[49] If the Collection Account is used to fund amounts due under Priority Long-Term Power Contracts (defined below), then the Collection Account will be replenished from Power Charges (defined below).[50] The Debt Service Reserve Account will be used to pay for Bond-Related Costs in the event there are insufficient funds available in the Payment Account, the Collection Account, or other funds provided for in the Bond Indenture.[51] The Debt Service Reserve Account will be funded initially with Bond proceeds, and may be replenished, as appropriate, from Bond Charges and Power Charges.[52]

The second stream of revenues established by the Rate Agreement will come from Power Charges, which the Rate Agreement defines as charges imposed by the Commission on Retail End Use Customers[53] for electric power

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[47] Section 1.1.

[48] DWR comments filed on February 5, 2002.

[49] Section 6.4 and DWR comments filed on February 5, 2002.

[50] Section 6.4 states: "In the event that such Department Costs are funded out of the Bond Charge Collection Account, the Department shall take such actions as are required under this Agreement so that the amounts applied from the Bond Charge Collection Account for such purposes shall be replenished from Power Charges, provided that any failure to do so by the Department shall not mitigate or alter the Commission's obligations under Article V."

[51] Section 1.1.

[52] See Section 1.1, definitions of Debt Service Reserve Account, Bond Charges, and Bond-Related Costs, Item (iii).

[53] The Rate Agreement defines "Retail End Use Customer" as "each customer within the Service Area of an Electrical Corporation that is deemed to purchase electric power from the Department under the Act." (Section 1.1) "Service Area" is defined as "the geographic area

Footnote continued on next page.

deemed sold by DWR.[54] Revenues from Power Charges will be used to pay for Department Costs, which the Rate Agreement defines as all amounts that DWR incurs to comply with Water Code § 80134 that DWR is entitled to recover under Water Code § 80110, with the exception of Bond-Related Costs that are recovered through Bond Charges.[55] Section 6.1(a) of the Rate Agreement requires the Commission to impose Power Charges that are sufficient to provide moneys in the amounts and at the times necessary to satisfy the Retail Revenue Requirements (defined below) specified by DWR.[56] Section 6.1(c) provides that Power Charges shall be property of DWR for all purposes under California law.

Revenues from Power Charges will be deposited into the Operating Account. Funds in the Operating Account will be used to pay for Department Costs,[57] and funds also will be transferred to the Priority Contract Account. The Priority Contract Account will be used to pay for the costs that DWR incurs under its Priority Long-Term Power Contracts (PLTPCs).[58] The Operating

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in which an Electrical Corporation distributes electricity." (Ibid.) "Electrical Corporation" is defined as having "the same meaning ascribed thereto in Section 218 of the Public Utilities Code, including any successor and assign thereof." (Ibid.)

[54] Section 1.1. The definition of Power Charges does not include Bond charges. (Ibid.)

[55] Section 1.1. Department Costs includes amounts payable under the Interim Loan. PG&E's suggested revisions to this definition are unjustified. PG&E also provides no support for its contention that § 80116 precludes recovery of losses incurred on the sale of excess power.

[56] The imposition of Power Charges is independent of Bond Charges and vice versa.

[57] Section 1.1.

[58] The costs that DWR incurs under PLTPCs are a subset of Department Costs. Section 1.1 of the Rate Agreement defines PLTPCs as (1) those long-term electric power contracts identified in Appendix A of the Agreement that were entered into prior to August 15, 2001, and (2) any contracts entered into for the purpose of securing fuel for use at generating facilities being operated pursuant to such PLTPCs if that fuel-supply contract contains a provision for the payment of costs thereunder prior to debt service on the Bonds. Section 1.1 also states that DWR shall consult with the Commission prior to entering into any additional contract for the purpose of securing fuel if that contract contains such a provision. Sections 1.1 and 7.8

Footnote continued on next page.

Reserve Account will be used to pay for Department Costs in the event there are insufficient funds in the Operating Account or the Priority Contract Account to pay Department Costs.[59]

To enable the Commission to set Bond Charges and Power Charges, the proposed Rate Agreement requires DWR to submit its Retail Revenue Requirement to the Commission.[60] The Rate Agreement defines Retail Revenue Requirement as the amount of Department Costs that must be recovered from Power Charges.[61] The Agreement uses DWR's submittal of its Retail Revenue Requirement as a vehicle for DWR to notify the Commission not only about Department Costs, but also about Bond-Related Costs.[62]

DWR must review, determine, and revise its Retail Revenue Requirement at least annually, and more frequently as deemed necessary or appropriate by either DWR or the Commission.[63] DWR must also revise its Retail Revenue Requirement if it projects that any of the following will occur within 120 days: (1) there will be insufficient funds in the Priority Contract Account to pay amounts due under the PLTPCs; (2) the balance in the Operating Reserve Account will fall below that required by the Financing Documents; (3) it will be necessary to use funds in the Bond Charge Collection Account to pay for costs

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provide that a contract will cease to be treated as a PLTPC when the contract no longer contains a provision to the general effect that payments by DWR under the contract are to paid or payable prior to that DWR debt which is secured by a pledge or assignment of DWR's revenues under the Act and other amounts in the Electric Power Fund. PG&E fails to justify its suggested revision to the definition of PLTPC.

[59] Section 1.1. PG&E fails to justify its suggested revision to the definition of "Operating Reserve Account."

[60] Section 4.1.

[61] Section 1.1.

[62] Section 4.1.

[63] Sections 4.1(b) and 7.3(a).

incurred by DWR under the PLTPCs; or (4) it will be necessary to use funds in the Debt Service Reserve Account to pay Bond-Related Costs. DWR must also revise its Retail Revenue Requirement, if it has not already done so, no later than three business days after (1) DWR makes a withdrawal from the Bond Charge Collection Account to pay for Department Costs, or (2) the balance in the Operating Reserve Account or the Debt Service Reserve Account falls below that required by the Financing Documents.[64]

In determining its Retail Revenue Requirement, the proposed Rate Agreement requires DWR to take into account any deficiency or surplus in the amounts recovered in earlier periods, as well as any anticipated surpluses.[65] In addition, DWR may include in its Retail Revenue Requirement only those costs that DWR is permitted to collect under the Act.[66]

Each time DWR determines or revises its Retail Revenue Requirement, it must submit the Revenue Requirement to the Commission.[67] Prior to any submittal, DWR must conduct whatever procedures are required by law to determine that the amounts included in the Retail Revenue Requirement communicated to the Commission are just and reasonable within the meaning of Pub. Util. Code § 451.[68] DWR may also submit a separate request to increase Bond Charges under the circumstances described in Section 5.1(d).

After DWR submits its Retail Revenue Requirement and/or a request to increase Bond Charges, the Commission must revise Power Charges and

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[64] Section 4.1(b).

[65] Section 4.1(c).

[66] Section 7.1.

[67] Section 4.1(a).

[68] Section 4.2.

Bond Charges, as necessary, to provide sufficient revenues to pay for Department Costs and Bond-Related Costs, respectively, as they come due.[69] In the event DWR fails to submit a revised Retail Revenue Requirement within the previously specified time frames, and the Commission believes that Power Charges are not sufficient to pay Department Costs (which for this purpose includes replenishment of the Bond Charge Collection Account, Bond Charge Payment Account, or the Debt Service Reserve Account), the Commission may revise Power Charges on an interim basis to cover the shortfall pending DWR's submittal of a revised Revenue Requirement.[70]

The proposed Rate Agreement requires the Commission to impose revised Bond Charges and/or Power Charges, as appropriate and necessary, no later than 120 days following the submittal of DWR's Retail Revenue Requirement and/or request to increase Bond Charges.[71] In addition, the Commission must establish Power Charges and Bond Charges without regard to rates or charges for electric power sold by Electrical Corporations.[72] The Rate Agreement acknowledges that the Commission has exclusive authority to spread DWR's revenue requirement among customer classes and service territories, and to determine the extent and timing of rate changes, consistent with the Commission's obligations under the Rate Agreement.[73]

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[69] Sections 4.1(a), 5.1(a), 5.1(d), 6.1(a), and 6.1(d).

[70] Section 4.1(a).

[71] Sections 5.1(d) and 6.1(d).

[72] Section 6.1(b).

[73] Section 7.4. The Rate Agreement prohibits DWR from attempting to establish charges on Retail End Use Customers for the purpose of paying for Department Costs or Bond-Related Costs. (Ibid.)

So that the Commission has an adequate record to establish and revise Power Charges and Bond Charges, the Rate Agreement requires DWR, at the request of the Commission, to participate in Commission proceedings on matters related to the establishment of Bond Charges or Power Charges. Such participation may include providing witnesses, attending public hearings, and submitting information and documents.[74] DWR must also submit with any Retail Revenue Requirement a projection that contains the following information for each month covered by the Revenue Requirement:[75]

i. The beginning balance of funds in the Electric Power Fund, including the amounts on deposit in each account and subaccount of the Fund.

ii. The amounts necessary to pay or provide for all Bond-Related Costs under the Financing Documents, when payments are due, and the amount of the Bond Charges that must be collected for such purpose.

iii. The amount of its Retail Revenue Requirement for each month.

iv. Any other information requested by the Commission in its proceedings implementing a Retail Revenue Requirement.

In addition to the above information, DWR must provide the Commission with (1) a copy of DWR's annual audit of the Electric Power Fund and any audit conducted pursuant to Water Code § 80270,[76] (2) any financial reports prepared by DWR pursuant to the Financing Documents,[77] and (3) a monthly report of

[74] Section 7.2.

[75] Section 4.1(c).

[76] Section 7.5.

[77] Section 4.2(e).

costs and revenues presented in a form that enables reasonable comparison to the monthly estimates contained in the latest Retail Revenue Requirement.[78]

The proposed Rate Agreement contemplates that DWR will sell Bonds as soon as practicable in amounts sufficient to repay the State for advances made under the Act, together with interest on such advances as provided by the Act. The Agreement contemplates that DWR will use the Bond proceeds to repay the General Fund with the understanding that repayment of the Interim Loan has priority, and that the following costs may have priority also: creation of adequate reserves for Bond-Related Costs and payment of Bond-issuance costs.[79]

The Rate Agreement contains numerous provisions that are designed to protect bondholders. Among those not mentioned above are the following. First, the Agreement requires both the Commission and DWR to comply with the Act and the Rate Agreement.[80] Second, the Agreement requires both agencies to act, as necessary, to protect the tax-exempt status of the Bonds.[81] Third, the Commission may not allow, to the extent it has the authority to do so, any lien on Power Charges or Bond Charges except for liens created pursuant to the Act.[82] Fourth, if either party breaches the Agreement, and the breach is not cured within 30 days of receiving written notice, the aggrieved party may take whatever action at law or in equity that it deems necessary to enforce performance.[83] Finally, DWR may assign to a Trustee the Commission's

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[78] Section 4.1(d).

[79] Section 7.6.

[80] Sections 6.2(a) and 7.3(a).

[81] Sections 6.2(b) and 7.3(b).

[82] Section 6.3.

[83] Section 8.2(b).

obligation under the Rate Agreement to impose Bond Charges that are sufficient to pay Bond-Related Costs when due.[84] The Trustee may enforce this obligation only after DWR has both defaulted on its obligations contained in the Financing Documents and has failed to enforce the Commission's obligations in accordance with the Agreement.[85] Prior to exercising its rights, the Trustee must (i) give 30-day's written notice,[86] (ii) certify to the Commission that an event of default has occurred under the Financing Documents that is not predicated solely on the Commission's failure to act as required by the Rate Agreement, and (iii) comply or cause DWR to comply with the provisions in the Rate Agreement pertaining to DWR's rights, duties, and obligations.[87]

The proposed Rate Agreement requires DWR to use its best efforts to renegotiate its long-term power contracts.[88] The Rate Agreement does not limit the ability of the Commission or DWR to assert any right that it might have regarding contracts entered into by DWR pursuant to the Act. Nor does the Rate Agreement limit the Commission's right to contest in any venue the legality or effect of any contract entered into by DWR under the Act.[89]

The proposed Rate Agreement applies only to those Retail Revenue Requirements that DWR submits to the Commission after the two parties sign

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[84] Section 8.3(a).

[85] We note in response to TURN's comments that the precise use of "default" in the proposed Rate Agreement relates to the Trustee's ability to enforce certain provisions in the Agreement.

[86] The Trustee may provide less than 30-day's notice if a default has resulted in the amount in the Debt Service Reserve Account being insufficient to timely pay all Bond-Related Costs. (Section 8.3(b).)

[87] Section 8.3(a).

[88] Section 7.7.

[89] Section 11.10.

the Agreement.[90] Once in effect, the Agreement may be amended upon the written consent of both the Commission and DWR,[91] except for Sections 5.1(a) and 5.1(b) which will have the force and effect of an irrevocable "financing order." The Agreement terminates when the Bonds have been retired and all other Bond-Related Costs have been paid or provided for in accordance with the Financing Documents.[92]

Except as set forth in Section 8.3, neither the Commission nor DWR may assign any of its rights or delegate any of its duties under the Rate Agreement without the express written consent of the other party. However, if another governmental entity is designated by law to carry out the rights, powers, duties, and obligations of the Commission and/or DWR, then the Commission and DWR may, if required by such law, transfer and assign its rights, title, and interest in the Rate Agreement to such successor, provided that the successor is bound by the Rate Agreement.[93]

IV. Discussion

For the reasons set forth below, we find that the proposed Rate Agreement will allow DWR to issue Bonds to repay the General Fund. This is a compelling reason to adopt the Rate Agreement. We also find that the proposed Rate Agreement establishes a reasonable framework for implementing the Legislature's intent expressed in Water Code § 80110 and § 80130 to provide for the recovery of DWR's Bond-Related Costs and Department Costs. For the same

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[90] Section 11.9.

[91] Section 10.1.

[92] Section 9.1.

[93] Section 11.11.

reasons, we conclude that the proposed Rate Agreement is, on balance, in the public interest, and we shall adopt it.

A. The Rate Agreement Is in the Public Interest

1. Issuing Bonds Is in the Public Interest

Our decision to adopt this Rate Agreement takes place in the context of the circumstances that led to the passage of the Act and our authority thereunder to enter into the Rate Agreement. These circumstances are succinctly described in AB 1X wherein the Legislature declared: "The furnishing of reliable reasonably priced electric service is essential for the safety, health, and well-being of the people of California. A number of factors have resulted in a rapid, unforeseen shortage of electric power and energy available in the state and rapid and substantial increases in wholesale energy costs and retail energy rates, with statewide impact, to such a degree that it constitutes an immediate peril to the health, safety, life and property of the inhabitants of the state, and the public interest, welfare, convenience and necessity require the state to participate in markets for the purchase and sale of power and energy.[94]"

DWR took prompt action to procure electric power to mitigate the effects of the electric emergency. However, DWR lacked the financial liquidity to procure all the power that was needed to avert the immediate peril to California, which resulted in DWR having to borrow more than $ 10 billion, much of which was borrowed from the State's General Fund. DWR now seeks to issue Bonds to (1) provide long-term and less costly financing for the billions it previously borrowed, and (2) repay the General Fund.

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[94] Water Code § 80000(a).

DWR represents that the proposed Rate Agreement is essential to its ability to issue Bonds. Simply put, DWR cannot sell the Bonds with investment-grade ratings as required by the Act unless investors are confident that DWR will be able to timely pay Bond principal and interest. The Rate Agreement provides the necessary assurance.[95] The Bonds, in turn, are vital to the public interest, since the proceeds will repay the Interim Loan (which has priority) and the State's General Fund.[96] It is imperative that the General Fund be repaid as soon as possible, as the State currently faces a large budget deficit.[97]

In addition to fulfilling DWR's legal obligation to repay the General Fund, the issuance of Bonds provides other significant benefits. First, it allows DWR to spread over many years the huge costs that it incurred during 2001 to stabilize electric rates in the face of outrageously high electricity prices, thereby preventing rate shock and economic dislocation. Second, as described in more detail later in this decision, DWR's procurement of electric power during the height of the electricity crisis averted the economic collapse of the electricity grid, and may have averted the physical collapse as well. Had either collapse occurred, the costs to California would have been significant and long lasting. Issuance of the Bonds allows the costs incurred during the crisis to be paid over several years. It is in the public interest to spread those costs over several years, because, as DWR explains in its comments on the Draft Decision,[98] the

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[95] DWR comments on the proposed Rate Agreement, pp. 1 and 2.

[96] The General Fund will be fully repaid only if there are sufficient Bond proceeds remaining after the Interim Loan is repaid.

[97] Water Code § § 80200(b)(4) directs DWR to repay advances from the General Fund as soon as practicable. It will not be possible to issue Bonds to repay the General Fund until the Rate Agreement is final and can no longer be appealed.

[98] DWR's Comments on the Draft Decision, pp. 7 – 9.

consequences of the avoided collapse would have been felt long into the future. Finally, because the Bonds will have an investment-grade rating as required by the Act, DWR will be able to finance a portion of the debt it incurred in response to the electricity crisis at lower cost to ratepayers.[99]

2. Establishing Separate Bond and Power Charges Is in the Public Interest

The Rate Agreement segregates Bond Charges from Power Charges. Establishing a separate surcharge for Bond-Related Costs in the manner set forth in Section 5.1(a) will provide a secure stream of revenue that may be pledged by DWR for the repayment of Bonds. Creating this independent, secure stream of revenue will facilitate the issuance of Bonds with investment-grade ratings. This revenue stream is all the more secure because it is broad based, i.e., based on the total power sold to customers by both DWR and the utilities. A separate surcharge for Bond-Related Costs also enables DWR to enter into a Bond transaction that does not require DWR to sell power for the life of the Bonds. Under this Rate Agreement, DWR will not have to sell power to pay for its Bond-Related Costs. This should accelerate the time when DWR can terminate its power sales and transfer its procurement activities back to the utilities. The separation of Bond Charges from Power Charges also provides DWR maximum flexibility to renegotiate its power contracts as contemplated by the Rate Agreement. This separation further removes uncertainty associated with the statutory "sunset" of DWR's authority to enter into new contracts from the bond transaction.

[99] The Interim Loan carries a very high rate of interest.

In order to ensure timely repayment of Bond principal and interest, which is a prerequisite to obtaining investment-grade ratings for the Bonds as required by the Act, it is necessary for the Rate Agreement to provide for the recovery of Department Costs. DWR's Priority Long-Term Power Contracts (PLTPCs) have terms that may require DWR to pay for power purchased under these contracts ahead of Bond-Related Costs.[100] The Commission agrees in the Rate Agreement to impose Power Charges that are sufficient to pay for DWR's power-related costs, including amounts due under its PLTPCs. This provision should make it unnecessary to use revenues from Bond Charges to pay for PLTPCs[101] DWR also notes that the mechanisms created by the Rate Agreement as a whole are necessary for its financial transactions, for example, to provide credit enhancement. Sunrise and PG&E are incorrect to suggest that these provisions are not properly addressed in the Rate Agreement.

3. The Rate Setting Provisions in the Rate Agreement Are in the Public Interest

An important attribute of the Rate Agreement is the protection it provides to ratepayers. These protections include: (1) limiting the costs that that DWR may recover in rates to only those that are authorized by the Act; (2) requiring DWR to use its best efforts to renegotiate its long-term power contracts,[102] which may result in new or revised contracts that provide for cheaper power compared to the existing power contracts; and (3) allowing any party to challenge DWR's

[100] The Rate Agreement prohibits DWR from entering into new Priority Long-Term Power Contracts with the exception of certain gas supply contracts.

[101] Section 6.4 of the Rate Agreement provides that In the unlikely event that Bond Charge revenues held in the Collection Account are diverted to pay for PLTPCs, DWR must take such actions as are required under the Agreement to repay the Collection Account with revenues from Power Charges.

[102] Section 7.7.

contracts before the Federal Energy Regulatory Commission (FERC) or a court,[103] consistent with the Commission's continuing legal efforts to revise DWR's power contracts in ways that are beneficial to the public interest, and (4) providing the Commission with an appropriate role in the Bond transaction, which provides an opportunity to structure the transaction in a way that is beneficial to ratepayers.

The Rate Agreement also requires DWR to follow whatever procedures are required by law to determine if its costs are just and reasonable. Contrary to the position taken by several parties, there is no need for the Rate Agreement to prescribe the specific procedures that DWR must use to determine whether its costs are just and reasonable under Pub. Util. Code § 451 because DWR has exclusive authority under the Act to conduct "any just and reasonable review under section 451."[104] Parties' requests that DWR disclose its procedures should be addressed to DWR, not to the Commission.

Likewise, the Rate Agreement properly reflects the Commission's exclusive authority under the Act and the Public Utilities Code to allocate DWR's costs among Service Areas and customers, and to set rates to recover these costs. EPUC/CIU expresses concern that the Rate Agreement binds the Commission to a particular rate design in setting Bond Charges. This concern is misplaced. The Rate Agreement does not determine how Bond Charges should be allocated among service territories or customer classes. Rather, the Commission will determine in future decisions how DWR's costs should be allocated.[105] The

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[103] Section 11.10.

[104] Water Code § 80110.

[105] What the Rate Agreement does determine is that Bond Charges, as defined in the Agreement, shall be imposed in an amount that is sufficient to provide for the timely payment of Bond-Related Costs, as that term is defined in the Rate Agreement. The Rate Agreement does provide that the starting point for calculating the amount of Bond Charges

Footnote continued on next page.

Commission's authority to allocate DWR's costs necessarily includes the power to (i) modify at any time the way the Commission allocates Bond Charges and Power Charges; (ii) prospectively modify the rate design and cost allocation methods used to recover Bond-Related Costs and Department Costs; and (iii) modify utility rates at different times from when rates are set to recover Bond Charges and Power Charges.

The Rate Agreement does not limit how often the Commission may adjust Bond Charges and Power Charges. Because the Rate Agreement will be in effect for many years, it is prudent to provide flexibility regarding how often rates may be revised up or down. Indeed, if the frequency of rate adjustments were restricted, DWR would likely have to increase the amount of money held in reserve for contingencies, which could result in higher costs for ratepayers. EPUC/CIU's comments do not take the benefits of this flexibility into account. Furthermore, because there is no limit on the frequency of rate adjustments, the Commission may require DWR to submit a revised revenue requirement whenever necessary or appropriate.[106] This might be the case, for example, if there is a change in law that affects DWR's Revenue Requirement, or wholesale generators are ordered to refund prior overcharges.

So that we may set rates in a timely manner, the proposed Rate Agreement requires DWR to provide the Commission with an extensive amount of

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shall be the total amount of power sold to a customer by DWR and the Electrical Corporation. (In this way the ability to recover Bond Charges does not depend on whether, or the extent to which, DWR remains in the business of selling power.) Because the proposed Rate Agreement provides assurance to the bondholders that, regardless of the rate design the Commission adopts, the Bond Charges will be sufficient to pay Bond-Related Costs, today's decision determines the total amount of rates than must be recovered without addressing allocation.

[106] Section 4.1(b).

information regarding DWR's costs and financial condition. In addition to providing revenue requirements and revised revenue requirements, we predicate our adoption of the Rate Agreement, in part, on DWR's legal ability to perform its obligation to provide information and revenue requirements according to the Rate Agreement's terms. In the Rate Agreement, DWR covenants that its obligations are valid and enforceable. We interpret this to mean that under existing law, DWR can comply with its obligations, and that, at the time of closing, when DWR indicates the Rate Agreement is valid and enforceable, it will confirm that it can so comply, and the Commission will be able to rely on such confirmation.

All information provided by DWR will be made available to the public in accordance with applicable laws and regulations. In addition, the Rate Agreement requires DWR, when requested by the Commission, to participate in our proceedings where Bond Charges and/or Power Charges are set. Although DWR will be subject to the same Commission Rules as the other parties, such as those pertaining to ex parte communications, we will accord DWR deference, particularly regarding matters that the Rate Agreement indicates are the exclusive responsibility of DWR. Thus, parties should not expect to use Commission proceedings as a vehicle to investigate or contest whether costs included in DWR's Revenue Requirement are just and reasonable under Pub. Util. Code § 451.[107]

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[107] PG&E states in its comments submitted on February 5, 2002, that the definition of Department Costs appears to include losses incurred by DWR on the sales of surplus power to third parties, and that such losses are not recoverable from customers under Water Code § 80116. We find nothing in the definition of Departments Costs that expressly addresses the sale of surplus power by DWR, and we see no need to address in this decision whether DWR is authorized to recover from customers its losses from the sale of surplus power.

We will provide an opportunity for the public and affected interests to participate fully in proceedings where rates are set to recover DWR's Bond-Related Costs and Department Costs. Where necessary, we will provide an opportunity for appropriate hearings in accordance with applicable laws and regulations. However, because the Rate Agreement expressly requires the Commission to set rates within 120 days, we cannot commit in the Rate Agreement to any particular procedures or process.

We recognize that the proposed Rate Agreement provides DWR with considerable influence over electric rates, since the Agreement allows DWR to recover in electric rates its Bond-Related Costs and Department Costs. However, contrary to the Foundation's assertions, the fact that DWR will have this influence does not constitute an unlawful transfer of the Commission's regulatory authority to DWR. Water Code § 80110, § 80130, and § 80134 provide authority for those provisions in the Rate Agreement because these statutes already require the Commission, when requested by DWR, to set rates to recover Bond-Related Costs and Department Costs. Similarly, Water Code § 80110 already makes DWR exclusively responsible for determining whether its costs are just and reasonable.

Due to the unprecedented size of the Bond offering, it is important that the Bond Trustee be above reproach. To this end, the Rate Agreement requires DWR to select a Trustee that has no conflicts of interest to the extent it is practicable to do so.[108] The Rate Agreement also provides that the Trustee's power to enforce the Commission's covenants in the Agreement begins only when there is a default under the Financing Documents that is caused by both the Commission's

[108] Section 7.9.

failure to act and DWR's failure to enforce the Commission's covenants.[109] This provision ensures that the Trustee may act only when there is an adverse impact on the bondholders that is caused by the Commission's failure to fulfill its obligations under the Agreement.

B. Imposition of Bond Charges on the Electric Power Sold by ESPs

The Rate Agreement states that the Commission will not impose Bond Charges at this time on power that is sold by ESPs.[110] The Rate Agreement also provides that the Commission will impose Bond Charges on ESP power only after (1) the Commission issues an order that provides for such charges, and (2) the order becomes final and unappealable.[111]

There is no doubt that the imposition of Bond Charges on the electric power sold by ESPs would help ensure the recovery of DWR's Bond-Related Costs and thereby improve the security of the bondholders. It would also be good public policy to impose Bond Charges on ESP power, since all customers benefited from the debt that was incurred by DWR to procure power during the height of the electricity crisis. However, the issues associated with the imposition of Bond Charges on ESP power are too complicated and time consuming to address at this point, and it is in the public interest to adopt the Rate Agreement and implement separate Power Charges and Bond Charges as soon as possible. We place parties on notice that we plan to consider in a future proceeding whether to impose Bond Charges on the electric power sold by ESPs, and if so, how to do it. Any and all legal or policy challenges to this concept may

[109] Section 8.3.

[110] Section 1.1.

[111] Section 4.3.

be raised in this future proceeding. Among the issues that parties may raise in that proceeding are whether Bond Charges should apply to (1) ESP power delivered to customers that have never received power from DWR, and (2) ESP power delivered by a generator that is not connected to the grid. These concerns are raised in EPUC/CIU's comments. EPUC/CIU should raise these issues in later proceedings, and we decline to make EPUC/CIU's suggested changes to the definition of ESP.

In order to identify which entities are ESPs in the event that Bond Charges are imposed on the power sold by ESPs, Section 1.1 of the Rate Agreement defines an ESP as follows:

> **Electric Service Provider** shall mean an entity that provides electrical service to one or more retail customers located within the Service Areas of [PG&E, SCE, or SDG&E] or any of their respective successors, except that Electric Service Provider excludes: the Department, any other public agency to the extent that it offers electrical service to customers within its jurisdiction or within the service territory of a local publicly owned electric utility,[112] and Electrical Corporations. Electric Service Provider includes the unregulated affiliates and subsidiaries of an Electrical Corporation.

The above definition of ESP is only for purposes of the Rate Agreement and is not applicable for the purpose of determining whether the power sold by any entity is subject to franchise fees.

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[112] Edison suggests clarifying the definitions of "local publicly owned electric utility" and "other public agencies" to prevent some "yet to be identified entities" from seeking exclusion from payment of their portion of DWR charges. PG&E also suggests amending the definition of ESP with regard to "other public agency." These assertions of potential harm are too vague, and we decline to make the suggested changes. Moreover, Edison's suggested changes appear aimed at requiring certain customers of municipal utilities pay Bond Charges; that, however, is an issue for the legislature.

C. The Financing Documents and the Commission's Designee

The Bond transaction that is being undertaken by DWR and the State Treasurer's Office (STO) will be implemented in accordance with the Financing Documents. The Financing Documents are not yet final, as the Financing Documents are subject to revision until the Bond transaction is closed. Once the transaction is closed, the Commission will be provided with a copy of the final Financing Documents.

It is not possible to condition our approval of the Rate Agreement on our review and approval of the final Financing Documents. Because the Bond transaction depends on the Rate Agreement, the Financing Documents cannot be finalized until after the Commission and DWR have entered into a Rate Agreement.[113] Furthermore, the Financing Documents are being prepared by DWR and STO as part of their responsibility for issuing the Bonds. It is neither our role to decide whether the Bonds should be issued, nor our responsibility to determine the detailed terms and conditions of the Bond transaction. Our role is to review the Financing Documents as a sister State agency that is required by law to provide for the recovery of the costs that DWR incurs under the Act while simultaneously protecting ratepayer interests.[114] As discussed below, we approve the Rate Agreement for the reason that it contains a mechanism allowing us to participate in the drafting of the Financing Documents, and that

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[113] Assuming, *arguendo*, that we could condition our approval of the Rate Agreement on our subsequent review and approval of the Financing Documents, the Bond transaction could not proceed until after the period for filing appeals on the Rate Agreement has ended and the appeals, if any, have been resolved. This would delay the issuance of the Bonds, which need to be issued as soon as possible for reasons stated elsewhere in this decision.

[114] Water Code § 80016 directs all State agencies, when requested by DWR, to provide DWR with reasonable assistance or other cooperation in carrying out the purposes of to Act.

the General Counsel will keep us informed of any "material" changes to the transaction.

The Rate Agreement establishes a mechanism for the Commission to provide appropriate advice and assistance to DWR and STO. More specifically, Section 7.10 of the Rate Agreement states that DWR has submitted to the Commission a summary of the "material terms" of the Financing Documents ("the Summary").[115] If DWR makes any "material changes" to the material terms, the Rate Agreement provides that the Commission's "designee" must approve those changes.[116] The Summary also allows DWR to revise the material terms within designated parameters without the consent of the Commission's designee. Any changes beyond the designated parameters will require approval by the designee. The Rate Agreement states that the Commission will appoint a designee at the time the Commission adopts the Rate Agreement.

In order to ensure the timely sale of the Bonds, it is essential that a person be authorized to approve additional material changes within guidelines established by the Commission. Accordingly, we will appoint the Commission's General Counsel as our designee for the purposes set forth in Section 7.10 of the

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[115] The Rate Agreement defines "material terms" as the maximum amount of the Bonds authorized, their maturity, a description of the flow of funds, and a description of the sizing or methodology of sizing of reserves held or created pursuant to the Financing Documents or debt service coverage required thereby. (Section 7.10.)

[116] The Rate Agreement defines "material change" as (i) a change in the sizing or methodology of sizing of debt service reserves that would increase the projected net debt service on the Bonds by more than an amount specified in the Summary; (ii) an increase in debt service coverage required by the Financing Documents by more than an amount specified in the Summary; (iii) a change in the sizing or method of sizing of operating reserves by more than an amount specified in the Summary; (iv) any increase in the maximum amount of the Bonds authorized; (v) a change in the maturity of the Bonds beyond those changes permitted in the Summary; or (vi) a change in the flow of funds beyond those changes permitted in the Summary. (Section 7.10.)

Rate Agreement. We may, by separate action today, and from time to time, authorize the General Counsel to approve additional changes beyond the parameters specified in the Summary, as necessary or desirable, to ensure timely Bond issuance. However, it is not, as TURN suggests, necessary for us to review the final terms of the Bond transaction to approve the Rate Agreement. Our consideration of any subsequent changes will not occur in the rubric of this formal proceeding. In fact, we have separately heard today the General Counsel's report to the Commission describing the terms of the Summary.[117]

By today's decision we delegate to the General Counsel the ministerial tasks of (1) reviewing the Financing Documents for the purpose of determining whether they are in compliance with the Summary or such changes beyond the Summary that we have approved, and (2) issuing whatever certificate, opinion, or similar documentation on the part of the Commission that is necessary to verify DWR's compliance with Section 7.10.[118] The General Counsel shall not approve a material change to any material term that falls outside the guidelines approved by the Commission. The Commission may alter its delegation of authority to the General Counsel beyond the parameters expressed in the Summary without an opportunity for parties to comment on that. This is because we will not be making a formal Commission decision. Rather, we will

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[117] DWR provided a Summary to the Commission on February 15, 2002, and to the parties in this proceeding on February 16, 2002. DWR provided a revised Summary to the Commission on February 21, 2002.

[118] The Commission has authority to delegate ministerial tasks to the General Counsel, who is appointed pursuant to Pub. Util. Code § 307. (See, e.g., Klevesahl v. Byington, 1 Cal. App. 2d 671, 676; Mecchi v. Lyon Van & Storage Co., 38 Cal. App. 2d 674, 682; and 2 *McQuillin*, Municipal Corporations, § 10.41, at pp. 856-857.)

be acting in our capacity as a State agency providing advice and assistance to a sister agency.[119]

In its comments on the Draft Decision, DWR raises the issue of granting additional authority to the General Counsel, beyond that already provided by the Summary, to approve changes to the "material terms" of the Bond transaction. Today's decision does not address the Summary. We will address the issue of granting additional authority to the General Counsel in accordance with the mechanism described herein.

In its comments on the Draft Decision, PG&E objects to the fact that several terms in the Rate Agreement are defined, in part, by reference to the Financing Documents. Contrary to PG&E's contention, not all of the significant definitions contain references to the Financing Documents. This reference occurs only in the definitions that describe the accounts that will be established pursuant to the Financing Documents. Furthermore, in addition to containing a reference to the fact that these terms will be more precisely defined in the Financing Documents, each of these definitions contains a brief statement of the purpose of the account. This form of definition is entirely appropriate. The Rate Agreement sets out a general definition of each of these accounts and then permits a more detailed definition to be included in the Financing Documents. As explained above, it is impossible to determine all of the details of the Bond transaction at this time, and inadvisable to wait until all of those terms are known before approving the Rate Agreement.[120]

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[119] Water Code § 80016 direct all State agencies, when requested by DWR, to provide DWR with reasonable assistance or other cooperation in carrying out the purposes of the Act.

[120] To the extent that parties may be interested in understanding aspects of the flow of funds that are not established in all their detail by this decision and the Rate Agreement, DWR has

Footnote continued on next page.

D. Legal Authority for Rate Agreement

1. General Legal Authority

The Commission and DWR have explicit legal authority under Water Code § 80110 and § 80130 to enter into the Rate Agreement. Many provisions in the Agreement are also expressly authorized by the Act. For example, Sections 3.2, 6.1(c), and 7.9 of the Rate Agreement are expressly authorized by the Water Code or address topics expressly referred to in the Act (e.g., Water Code §§ 80132(f), 80112, and 80132(b)). Authority for the remaining provisions in the Rate Agreement comes from the discretion that the Commission and DWR have under the Act to negotiate terms and conditions that are not expressly provided for in the Act, so long as such terms and conditions are not inconsistent with the Act or other laws.[121] In addition to its authority under the Act, the Commission may adopt the proposed Rate Agreement pursuant to its authority under the Public Utilities Code (see, e.g., Pub. Util. Code §§ 701, and 840 et seq.).

2. Legal Authority for Separate Power Charges and Bond Charges

The Rate Agreement requires the Commission to impose Power Charges to recover DWR's Department Costs, and separate Bond Charges to recover DWR's Bond-Related Costs. The Agreement also requires the Commission to impose (1) Power Charges on the electric power that is sold to Retail End Use Customers by DWR under the Act, and (2) Bond Charges on the electric power sold to all customers in the Service Areas of PG&E, SCE, and SDG&E, regardless

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provided with its Summary of material terms a description of the currently proposed flow of funds. The Summary was provided to the parties on February 16, 2002. The revised Summary provided to the Commission on February 21, 2002, does not alter the proposed flow of funds.

[121] There are no terms and conditions in the proposed Rate Agreement that are inconsistent with the Act or other laws.

of whether the power is sold by DWR, the utility, or, under the circumstances described in Section 4.3, by an ESP. Legal authority for the imposition of separate Power Charges and Bond Charges is described below.

a. Legal Authority for Power Charges

Both the Act and the Public Utilities Code provide legal authority for Power Charges. Water Code § 80002.5, § 80012, et al., authorize DWR to sell power to Retail End Use Customers. Water Code § 80110, § 80134, et al., authorize DWR to recover as a revenue requirement the costs that it incurs to procure and deliver power, as well as other costs that it incurs to administer the Act. Water Code § 80104 obligates Retail End Use Customers to pay DWR for power they receive from DWR, and Water Code § 80110 authorizes the Commission to establish electric charges to collect DWR's revenue requirement from electric customers. We note that both relevant agencies interpret the Act to allow the imposition of Power Charges.

The adopted Rate Agreement establishes a mechanism for DWR to submit its revenue requirement to the Commission and for the Commission to set Power Charges to recover the revenue requirement from Retail End Use Customers that receive power from DWR. This mechanism is properly contained in the Agreement,[122] since the financial well being of DWR, which is of keen interest to potential bondholders, depends on Power Charges. Also, the availability of funds to pay Bond principal and interest depends, in part, on Power Charges being adequate to recover DWR's Department Costs, particularly the costs incurred under its Priority Long Term Power Contracts.

[122] Pursuant to § 80110, the Rate Agreement is an agreement between the Commission and DWR. The Rate Agreement provides that it may only be amended upon the written mutual consent of the parties.

b. Legal Authority for Bond Charges Under the Act

The portions of the Rate Agreement that most affect the Bond transaction—those pertaining to Bond Charges—will be irrevocable. Legal authority for Bond Charges is provided by both the Act and the Public Utilities Code. The Act provides the Commission and DWR with authority to agree on the provisions in the Rate Agreement pertaining to Bond Charges. Water Code § 80110 states, in pertinent part, as follows:

> The department shall be entitled to recover, as a revenue requirement, amounts and at the times necessary to enable it to comply with Section 80134,[123] and shall advise the commission as the department determines to be appropriate…For purposes of this division…the Public Utility Commission's authority as set forth in Section 451 of the Public Utilities Code shall apply, except any just and reasonable review under Section 451 shall be conducted and determined by the department. <u>The commission may enter into an agreement with the department</u> with respect to charges under Section 451 for purposes of this division, and that agreement shall have the force and effect of a financing order adopted in accordance with Article 5.5 (commencing with Section 840) of Chapter 4 of Part 1 of Division 1 of the Public Utilities Code, as determined by the commission. (Emphasis added.)

Because the Act allows the Commission and DWR to enter into an agreement regarding the nature of the charges the Commission will impose to

[123] Section 80134 provides that DWR "may covenant to…establish and revise revenue requirements sufficient, together with any moneys on deposit in the [Electric Power Fund], to provide all of the following:" (i) amounts necessary to timely pay the principal, interest, and other costs associated with the bonds issued by DWR; (ii) the amounts necessary to pay for power purchased by DWR, including the costs of transmission, scheduling, and other related expenses; (iii) reserves in such amount as DWR deems necessary or desirable; (iv) repayment of advances from the General Fund; (v) interest on moneys advanced by the General Fund; and (vi) the costs incurred by DWR to administer the Act. This section further requires DWR to notify the Commission of its revenue requirement pursuant to § 80110.

recover DWR's costs, the Act necessarily allows DWR and the Commission to jointly develop the terms and conditions of a mutually agreeable recovery mechanism. Therefore, because the separate Bond Charge mechanism is a product of negotiation between DWR and the Commission, it is a charge that is specifically contemplated by the Act. We also note that both agencies interpret the Act to authorize the imposition of Bond Charges.

Moreover, by explicitly stating in § 80110 that "the [Commission's] authority as set forth in Section 451 of the Public Utilities Code shall apply," and by providing for an agreement "with respect to charges under Section 451 of the Public Utilities Code," the Act specifically contemplates that the Commission might use its broad ratemaking authority[124] and discretion to devise and implement charges to recover DWR's revenue requirement.

Water Code § 80110 places no restrictions on the ratemaking mechanisms that may be used to recover DWR's Bond-Related Costs. Because there is nothing in § 80110 or elsewhere in the Act that requires the use of a particular ratemaking method to recover DWR's Bond-Related Costs, we conclude that we may use our discretion to devise and implement an appropriate ratemaking mechanism to recover such costs.[125]

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[124] See, e.g., Pacific Tel. & Tel. Co. v. Pub. Util. Commission, 62 Cal.2d 634, 647 (1965) ("The Commission…may choose its own criteria or method of arriving at its decision, . . . provided unreasonableness is not clearly established."); Wood v. Pub. Util. Commission, 4 Cal.3d 288, 294-95 (1971) (In fixing rates that provide a reasonable return, the Commission "has wide discretion to make rate classifications that reflect a broad and varied range of economic concerns."); Dyke Water Co. v. Pub. Util. Commission, 56 Cal.2d 105, 129 (1961) (Commission was "not bound to the use of any single formula or combination of formulae in determining rates…" citing Federal Power Com. v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944)).

[125] See Market St. R. Co. v. Railroad Commission, 24 Cal.2d 378, 393 (1944), aff'd, 324 U.S. 548 (1945).

Water Code § 80130 similarly demonstrates the Legislature's intent to provide the Commission and DWR with great flexibility in establishing a mechanism to repay the Bonds. That section states: "[B]efore the issuance of bonds, the department shall establish a mechanism to ensure that the bonds will be sold at investment grade rates and repaid on a timely basis from pledged revenues. This mechanism may include, but is not limited to, an agreement between the department and the commission as described in Section 80110." (Emphasis added.) This broad language contains no restrictions on the means by which DWR may recover its Bond-Related Costs.

Other provisions in the Act support the conclusion that the Legislature did not intend to limit the recovery of Bond-Related Costs in any particular way, for example to electric charges that are imposed only on the power sold by DWR. Water Code § 80100 authorizes DWR to enter into power contracts that terminate at a time determined by DWR. Water Code § 80132 authorizes DWR to issue Bonds that mature at such time or times as determined by the Director of DWR and approved by the Director of Finance and the State Treasurer. Nothing in the Act requires DWR to repay the Bonds prior to, or simultaneously with, the termination of its power sales under the Act. In fact, DWR has authority under the Act to issue Bonds with maturities that extend well beyond the term of DWR's power contracts. As a result, the Act cannot be read to require DWR to sell power in order to recover its Bond-Related Costs.[126] Indeed, at the time the

[126] If the Act were interpreted as limiting the Commission's authority to recover Bond-Related Costs solely through charges imposed on power sold by DWR, then DWR might have to sell power, and incur the associated power-related costs, for the sole purpose of enabling the Commission to impose charges on such power in order to recover DWR's Bond-Related Costs. There is no indication that the Legislature intended DWR to sell power for the sole purpose of recovering Bond-Related Costs. On the other hand, the Legislature specifically

Footnote continued on next page.

Act was passed, it was unknown how the energy crisis would unfold and how long DWR might be selling power.

Water Code § 80132(a) further reinforces the conclusion that the Commission and DWR have authority to devise the Bond Charge mechanism contained in the Rate Agreement. Water Code § 80132(a) states, in pertinent part, as follows: "The bonds shall be sold…on such terms and conditions, as shall be specified in such determination [of DWR approved by the Director of Finance and the State Treasurer], and such determination may contain or authorize any other provision, condition, or limitation not inconsistent herewith and such provisions as may be deemed reasonable and proper for the security of the bondholders." Thus, in selling the Bonds, DWR is authorized to include provisions not specifically mentioned in the Act, so long as they are not inconsistent with the Act. It would not be inconsistent with the Act for DWR to include a provision in the Bond offering which states that the Bonds will be repaid with revenues from Bond Charges that are imposed on the electric power sold to customers, regardless of whether it is sold by DWR, the utility, or an ESP under the circumstances described in Section 4.3 of the Rate Agreement.

c. Legal Authority for Bond Charges Under the Public Utilities Code

Water Code § 80110 authorizes the Commission to use its powers under Pub. Util. Code § 451 to establish a mechanism that provides for the recovery of DWR's Bond-Related Costs. Section 451, in turn, provides the Commission with broad authority to devise ratemaking mechanisms for the recovery of costs associated with the provision of utility service, including a surcharge mechanism

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authorized the issuance of the Bonds in a sum exceeding $10 billion dollars, and, therefore, must have contemplated that the Bonds might be paid off over an extended period.

such as the Bond Charge.[127] The Commission has used this authority to devise surcharge mechanisms in the past. For example, in cases implementing the California Safe Drinking Water Bond Act of 1976,[128] the Commission implemented a surcharge mechanism to provide water utilities with the funds necessary to repay loans that the utilities had obtained under the Water Bond Act.[129] The Commission's broad authority under § 451 allowed it to design a surcharge as a means to address a variety of concerns, including the need to provide lender's security and the need to inform customers of financing costs.[130] The Commission did not require express statutory authority to implement a surcharge mechanism to recover costs in those cases. In addition, there is no constitutional impediment to the imposition of Bond Charges for the reasons described herein.

In addition to its ratemaking authority under Public Util. Code § 451, Public Util. Code § 701 provides the Commission with plenary authority to take necessary actions, such as imposing Bond Charges. That section states:

> The commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part [the Public Utilities Act] or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction.

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[127] In Pacific Tel. & Tel. Co. v. Pub. Util. Commission, 62 Cal.2d 634, 647 (1965), the Court held that the "Commission…may choose its own criteria or method of arriving at its decision…provided unreasonableness is not clearly established."

[128] Water Code § 13850 et seq. The California Safe Drinking Water Bond Act authorized water companies to apply to the California Department of Health and Water Resources for low interest loans to finance necessary improvements to meet health and safety code standards.

[129] See, e.g., In re Quincy Water Co., [D.88973] 1978 Cal. PUC Lexis 199, 84 CPUC 79 (1978).

[130] Id. at *16-17.

As explained in Consumers Lobby Against Monopolies v. Pub. Util. Commission (1979) 25 Cal. 3d 891, 905-06, Pub. Util. Code § 701 provides the Commission with an open-ended grant of authority that allows the Commission to do things for which there is otherwise no express statutory authorization. This broad authority empowers the Commission to fill the interstices and gaps of statutes directing how public utilities shall be regulated.[131] The Commission has, for example, relied on § 701 to interpret statutes where specific terms are not defined.[132] While the courts have recognized the broad authority the Commission has under § 701, they note that this authority may not be used in a manner that would contravene legislative directives or express restrictions on its authority in the Public Utilities Code.[133] The Bond Charge does not contravene any express direction of the Legislature, and actually advances the purpose of the Act. Reading Pub. Util. Code § 701 and Water Code § 80110 together provides a clear legislative foundation for the Commission to impose the Bond Charge.

d. The Use of a Bond Charge is Reasonable Under the Circumstances

As described earlier, it was necessary for DWR to incur billions of dollars of debt to finance power purchases during the height of the electricity crisis. If DWR had not purchased the power and incurred the related debt, there would have been repeated and prolonged blackouts extending over large portions of the State. Because of the imbalance between supply and demand, and because of the

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[131] See, e.g., City of Vernon v. Atchison, Topeka & Santa Fe Railroad [D.96-11-015] 1996 Cal. PUC LEXIS 1139, 69 CPUC2d 150 (1996).

[132] See e.g., In re Application of PG&E [D.97-11-074] 1997 Cal. PUC LEXIS 1093, *40-41 (1997).

[133] (See, e.g. , Assembly v. Pub. Util. Commission, 12 Cal.4th 87, 103 (1995); Southern California Gas Co. v. Pub. Util. Commission, 24 Cal.3d 653, 657-60 (1979).)

restrictions placed utilities buying power, it can be inferred that DWR's participation in the electricity markets averted blackouts that would have been caused by the lack of a creditworthy purchaser. As we observed in March 2001 during the height of the crisis:

> SCE's and PG&E's financial problems have compromised the integrity of the state's electrical system. The utilities are in debt to the ISO and to power sellers that will not or cannot sell additional power unless they are paid. The state's energy supply system is further compromised because some suppliers have also refused to sell PG&E natural gas that it needs to purchase for its natural gas customers. Blackouts across the state on March 19 and 20 were attributable in part to the refusal of energy suppliers, including qualifying facilities (QFs), to sell electricity to the ISO and the utilities. While the failure of some of these suppliers to provide available power to the grid may stem from their desire to maximize profits, others say they are on the verge of insolvency as a result of the utilities' failure to pay. Whether or not the power sellers' actions are lawful, and whether or not we approve of those actions, without a rate increase it will become increasingly difficult to keep the lights on in California. (D.01-03-082, *mimeo.*, pp. 13 - 14).

As DWR points out, the Western Systems Coordinating Council and other independent sources predicted up to 300 hours of outages for California during 2001, resulting in rolling blackouts to maintain operations of the grid.[134] Widespread and prolonged blackouts would have disrupted California's emergency services, law enforcement, schools, hospital, homes, businesses, and agriculture.[135] Furthermore, had there been 300 hours of blackouts, there would

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[134] DWR's Comments on the Draft Decision, p. 8.

[135] Governor's Proclamation of a State of Emergency dated January 17, 2001, a copy of which is in Appendix B of this decision.

have been repeated cycling of circuits, thereby causing abnormal wear on circuit breakers, switches, transformers, and series compensators, which would have jeopardized the physical integrity of the State's electricity grid.[136]

We agree with DWR's comments that the loss of current and future business from the blackouts would have been enormous.[137] Indeed, we believe that the economic costs from widespread blackouts and the collapse of the electricity grid would have been long lasting[138] and far in excess of the debt that DWR incurred to avert the disaster. Ultimately, all Californians will benefit from DWR's expenditures and the related debt that was incurred by DWR, including future customers who were not living in California at the height of electricity crisis.

The specific facts of the electricity crisis weigh heavily in favor of separate Bond and Power Charges. Separate charges will give the State flexibility to shape the future structure of the retail electric market. Nothing in the Bond financing structure reflected in the proposed Rate Agreement will prevent the discontinuation of DWR power purchases and sale of power to Retail End Use Customers, if that is desirable. As a result, at least two policy goals become achievable. First, California's electric utilities can resume their traditional role of meeting the power needs of their customers. Second, the long-term power contracts that DWR was forced to sign at the height of the crisis can be re-evaluated.

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[136] DWR's Comments on the Draft Decision, pp. 8-9.

[137] DWR's Comments on the Draft Decision, p. 7.

[138] The conditions at the height of the electricity crisis constituted an extreme peril to the safety of persons and property within the State. (See D.01-04-006, *mimeo.*, page 14, and the Governor's Proclamation of a State of Emergency, dated January 17, 2001, in Appendix B of this decision.)

The importance of these goals should not be underestimated. DWR stepped into its energy role at a time of great crisis, but the Act does not contemplate that this emergency role should be expanded to establish DWR as a permanent supplier of electricity to Californians. If DWR were required to sell electricity in order to generate revenue to pay for bonds it would effectively be required to adopt that permanent role, frustrating California's efforts to rehabilitate its utilities and restore the status quo ante. The Commission's ability to separate Power and Bond Charges into two revenue streams in order to obtain this flexibility is a proper exercise of our authority to establish charges under the Act and the Public Utilities Code.

Similarly, the establishment of a separate Bond Charge facilitates on-going efforts to renegotiate DWR's long-term power contracts. The adopted Rate Agreement specifically provides that DWR will use its best efforts to renegotiate those contracts. By separating monies that flow to bondholders from monies that flow to the providers of electric power, DWR will not be hampered in its negotiations. For example, DWR will not be required to choose specific contracts that it must keep in place so that it has at all times enough power available to generate sufficient revenues to pay for its Bonds.

The establishment of a separate Bond Charge also recognizes the nature of the costs that DWR will finance with its bond transaction. These are costs that DWR incurred at the height of a crisis. The Legislature designated DWR as the agency that would act to maintain the physical and economic structure of California's power grid. The fact that DWR bought power when no other entity was available to buy power preserved the structure of the grid to the benefit of California now and in the future. While some parties criticize DWR's actions, and while DWR itself may overstate the benefits of its long-term contracts as

opposed to its purchases in 2001, DWR's actions to prevent the collapse of the electricity grid, even at a high price, provided a service to all California electricity consumers now and in the future. Because the costs that DWR incurred to save the grid have future benefits, they should be amortized over time.

The Commission's authority under Pub. Util. Code § 451 and § 701 to impose rate mechanisms such as Bond Charges extends to situations where the charge is not in proportion to the direct benefit received by each customer paying the Charge.[139] This would be the case, for example, for future ratepayers who will pay Bond Charges despite the fact that they only received the benefits of DWR's grid-stabilizing activities, and did not receive any of the electric power that was procured by DWR during the height of the electricity crisis. There is precedent for requiring future ratepayers to pay off bonds. In AB 1890, which enacted Pub. Util. Code § 849, the Legislature directed electric utilities to reduce their rates by 10%, and to finance the rate reduction by issuing bonds. In D.00-06-034, the Commission held that it is reasonable for future ratepayers to pay off the bonds issued pursuant to AB 1890, even though some future ratepayers might not have benefited from the bonds:

> 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 bond costs would be paid by certain future customers well after the benefits from rate reduction bonds were realized. To the extent that this specific

[139] It is often not possible, as a practical matter, to precisely match the rates paid by utility customers with the benefits received by the customers. This is particularly true in the case of gas and electric customers whose rates are routinely adjusted to make up for prior differences between the rates paid by the customers and actual cost of the service provided to the customers. The adjustment of rates after the fact inevitably results in some ratepayers (e.g., new ratepayers who did not receive service in prior periods) paying more or less than the actual cost of service.

> outcome is inequitable to future ratepayers, we defer to the overall wisdom of the Legislature in balancing the overall benefits and costs of restructuring. (2000 Cal. PUC LEXIS 505, *111)

Addressing timing differences between costs and revenues is a normal part of the Commission's ratemaking responsibility. The general rule established by the California Constitution is that the Commission may devise and implement ratemaking procedures "subject to statute and due process." (California Constitution Article XII, Section 5.) For example, in Southern California Edison (SCE) v. Commission, 20 C. 3d 813, the Court addressed a case where the Commission had ordered an electric utility to refund excess revenues it had collected over a three-year period beginning on the date of the order. The utility had received the excess revenues for several years prior to the order. In the absence of a contrary statutory directive, the Court approved this procedure, applying a "fair and reasonable" standard to the Commission's action.[140] Significantly, the Court in SCE drew on a line of cases involving federal income tax expense that assumed that so long as the Commission adopted an approach that fairly balanced the interests of ratepayers as a class with the utility, significant timing differences between costs and revenues would be tolerated.[141]

In the mid-1970's the Legislature acted in two specific instances involving refunds and balancing accounts to limit the Commission's discretion by prescribing a relatively close temporal relationship between the occurrence of a

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[140] 20 C. 3d 813, 824.

[141] 20 C.3d 813, 826-832. "…[W]e advised the commission that it could compensate for such past overcollections by the device of reducing the utilities' rates of return in the future…." 20 C.3d 813, 831, citing City of Los Angeles v. Commission, 15 C. 3d 680, 704-05.

cost and the recovery of the cost in rates. In Public Utilities Code § 453.5[142] the Legislature prescribed a procedure for distributing refunds that attempted to match refund payment with the customers whose rates reflected the excessive costs that were the subject of the refund. In Pub. Util. Code § 792.5[143] the Legislature authorized the use of balancing accounts and required "subsequent rate adjustments" to amortize any over- or undercollection recorded in the balancing accounts.

These cases and statutes demonstrate that ratemaking mechanisms involving the temporal shifting of costs or revenues are not automatically suspect. Where the Legislature has prescribed a method, it must be followed. Where there is no statutory direction, the Commission may exercise its discretion and the result will be upheld so long as it is fair and reasonable.

Here the Legislature, in Water Code § 80130 and § 80200(b)(4), authorized DWR to issue bonds to repay General Fund advances "as soon as practicable." Water Code § 80110 explicitly incorporates the provisions of Pub. Util. Code § 840 et seq., which deals with securitization of current costs, i.e., the creation of a stream of revenue over time that may be sold or pledged, with the proceeds of the sale or pledge being used to defray current costs. In addition, Water Code § 80110 provides the Commission with authority to devise a ratemaking mechanism to recover the bond-related costs. These statutory provisions provide clear authority (1) to issue bonds for the purpose of shifting much of the cost of the electricity crisis to future ratepayers, and (2) for the Commission to use its

[142] Chapter 897, Stats. 1977.
[143] Chapter 520, Statutes 1976.

discretion to implement a ratemaking mechanism to recover these costs from future ratepayers.

As a result, the shifting of bond costs to the future is contemplated by the Act when it provides DWR with authority to issue Bonds that have maturities that extend far into the future,[144] and directs DWR to notify the Commission of its revenue requirement associated with the Bonds at least annually, if not more frequently, for as long as the Bonds remain outstanding.[145] These provisions make all ratepayers liable for electricity costs incurred by DWR during the emergency. Likewise under the Act, the Commission is required to impose charges that are sufficient to recover DWR's Bond-Related Costs for as long as the Bonds remain outstanding.[146] In light of these provisions in the Act, the Legislature must have foreseen the possibility that future ratepayers who did not consume the electricity that was financed with the Bond proceeds would nonetheless have to pay rates to recover DWR's Bond-Related Costs. We note that DWR concurs in our interpretation of the Act.

In addition to temporal shifting of costs and revenues, there are many other examples where customers are required to pay rates that are not based on the exact cost of utility service provided to each customer.[147] For instance, the

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[144] Water Code 80132(a) provides that maturity of the Bonds will be determined by DWR and approved by the Director of Finance and the State Treasurer.

[145] Water Code 80134(a) and 80134(a)(6).

[146] Water Code 80110.

[147] It is quite common for one group of ratepayers to payer higher rates in order to provide affordable utility service to others. For example, most telephone ratepayers currently pay higher rates in order to subsidize the provision of affordable basic exchange services in rural areas. Similarly, most electric, gas, and telephone ratepayers pay higher rates in order to subsidize the provision of affordable utility service to low-income households. In the case of the electricity crisis, it was necessary for DWR to borrow money to subsidize the provision of affordable electric power to customers during a period of exorbitant power costs. To prevent

Footnote continued on next page.

Commission in 1979 established a program authorizing Pacific Bell Telephone Company to provide specialized equipment to hearing impaired customers at a subsidized rate. The Commission found it had discretionary authority to provide specialized equipment at subsidized rates[148]. The Commission initially elected to embed the subsidy in basic exchange rates charged to all customers, which had the effect of spreading the cost of the subsidy across the entire customer base. Subsequently, the Legislature codified a requirement for the Commission to create such a program, but left the funding mechanism unspecified.[149] The Commission then established the Deaf Equipment Acquisition Fund (DEAF) and changed the funding from an implicit subsidy hidden in rates to an explicit surcharge for each access line.[150] Later, the Legislature codified the express surcharge on every telephone as a funding mechanism for this program.

In the DEAF case, the Commission exercised its general authority to fund a program with a surcharge that bore no relationship to the direct individual benefit each customer received, without express statutory authorization. When the Legislature eventually codified the program, it initially left the funding mechanism unspecified and the Commission continued to use its authority to

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rate shock and economic dislocation from the exorbitant prices, it is reasonable for future ratepayers to subsidize the provision of affordable electric service during the electricity crisis by repaying the borrowed money. It should be noted, however, that the Commission is vigorously pursuing all legal options to obtain refunds for excessive wholesale electricity prices during the height of the electricity crisis. If the Commission is successful, the refunds may substantially reduce the burden on future ratepayers.

[148] See Application of PT&T Co. for a general rate increase [D.90642], 1979 Cal. PUC Lexis 826, *223 (1979).

[149] Pub. Util. Code § 2831 states: "The commission shall establish a rate recovery mechanism to allow telephone corporations to recover costs as they are incurred under this section."

[150] See D.92603.

maintain the surcharge. In this case, the Act leaves the funding mechanism for resolving the electricity crisis unspecified, and the Commission will, in conjunction with DWR, exercise its authority to establish Bond Charges.

3. Legal Authority for Designating Power and Bond Charges the Property of DWR

Section 5.1(b) of the Rate Agreement provides that Bond Charges shall be the property of DWR for all purposes under California law. Similarly, Section 6.1(c) provides that Power Charges shall be the property of DWR for all purposes under California law. Authority for these sections is provided by Water Code § 80110 and § 80112, which state, in relevant part, as follows:

> **§ 80110:** "The [Department] shall retain **title** to all power sold by it to the retail end use customers…The [Department] shall have the same rights with respect to payment by retail end use customers for power sold by the [Department] as do the providers of power to such customers...The [commission} may enter into an agreement with the [Department] with respect to charges…for purposes of this division, and that agreement shall have the force and effect of a financing order adopted in accordance with [Pub. Util. Code § 840 et seq.] as determined by the [Commission]." (Emphasis added.)
>
> **§ 80112:** "All money collected with respect to any power acquired and sold pursuant to this division and the Governor's Emergency Proclamation dated January 17, 2001, and all money paid directly or indirectly to or for the account of the [Department] with respect to any sale, exchange, transfer, or disposition of power acquired pursuant hereto, shall constitute **property** of the [Department]…." (Emphasis added.)

The above-quoted provisions provide that all money collected "with respect to" any power acquired and sold pursuant to the Act and the Governor's Executive Order are the property of DWR. These provisions clearly apply to Power Charges, which are meant to recover the cost of power sold by DWR.

These provisions also apply to Bond Charges, since DWR is authorized by the Water Code to use Bond proceeds to pay for past, current, and future power-related costs.[151] Thus, the provisions in § 80112 which establish that revenues "with respect to" any power acquired and sold by DWR are the property of DWR apply with equal force and effect to Bond Charges, as the revenues from the Bond Charges will ultimately be used to pay for power-related costs.

Water Code § 80110 also supports the conclusion that Bond Charges are the property of DWR. This section authorizes the Commission to enter into an agreement with DWR that (1) establishes "charges" for the recovery of DWR's Bond-Related Costs, and (2) has the force and effect of a "financing order" adopted by the Commission pursuant to Pub. Util. Code § 840 et seq. The effect of Pub. Util. Code § 840 et seq., is to allow the Bond Charge to be established by a financing order. Any financing order created pursuant to § 840 et seq., establishes a property right in the rates and charges imposed by the financing order and the proceeds that flow from the rates and charges imposed pursuant to the financing order.[152] Accordingly, Pub. Util. Code § 840 et seq., may be used to create a DWR property right in the proceeds from the Bond Charges.

Although revenues from Bond Charges are the property of DWR, this does not affect the ability of the utilities to recover their revenue requirement over time. Section 6.1 (b) of the Rate Agreement provides:

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[151] See, e.g., Water Code § 80200 and § 80130 et seq. A substantial portion of the Bond proceeds will be used to repay advances from the State General Fund. DWR used these advances to pay for power purchases.

[152] Concepts such as "irrevocability" of the order, the ability of DWR to pledge, assign or secure the property covered by the financing order, and the binding nature of the financing order on future Commissions are all contained in Pub. Util. Code § 840 et seq.

> Power Charges and Bond Charges shall be established by the Commission without regard to the levels or amounts of any particular rates or charges authorized by the Commission to be charged by any Electrical Corporation for electrical power sold by such Electrical Corporation.

The effect of Section 6.1(b) is that the utilities' ability to recover their own revenue requirements over time cannot be affected by Bond Charges. We recognize, however, that the timing of a utility's recovery of its revenue requirement, and decisions about which customers' rates will pay for revenue requirements may be affected by the size of Bond Charges. For example, the Commission's recent settlement with SCE provides that the timing of SCE's recovery of certain costs will be determined by residual calculations. Also, Water Code § 80110 provides that rates for residential usage of up to 130% of baseline are capped at the rates that were in effect at the time AB 1X was enacted. We note that DWR concurs in this interpretation of the Act.

4. Legal Authority for the Irrevocable Provisions in the Rate Agreement

Section 5.1(c) of the Rate Agreement provides that Sections 5.1(a) and 5.1(b) of the Agreement shall have the force and effect of an irrevocable financing order adopted by the Commission pursuant to Pub. Util. Code § 840 et seq. Authority for Section 5.1(c) is provided by Water Code § 80110, which states that the Commission may enter into an agreement with DWR that has the force and effect of a financing order adopted in accordance with Pub. Util. Code § 840 et seq. Pub. Util. Code § 841(c) and 842(d), in turn, permit a financing order issued pursuant to § 840 et seq., to be irrevocable.[153]

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[153] Water Code § 80110 provides the Commission with discretion to determine what portions of the Rate Agreement will have the force and effect of a financing order: "The commission

Footnote continued on next page.

In its comments on the proposed Rate Agreement, PG&E argues that numerous provisions of the Rate Agreement, beyond those made irrevocable by Section 5.1(c), "bind" future Commissions, and that this is improper. PG&E ignores the Commission's express authority under the Act to enter into an "agreement" with DWR. Because the Rate Agreement is, in essence, a contract with a sister State agency, and is specifically authorized by statute, it can bind future Commissions in a way that would not occur if the Commission were simply issuing a decision in the normal course of regulating utilities.

Because the Rate Agreement is a contract, it may be amended in the future by mutual agreement of the parties, except that Sections 5.1(a) and 5.1(b) are irrevocable and cannot be amended on or after the issuance of Bonds in reliance on the Rate Agreement. (See Sections 5.1(c) and 10.1.) However, we anticipate that DWR will agree in the Financing Documents not to permit any amendments to those other portions of the Rate Agreement that would be detrimental to bondholders. These terms of the Rate Agreement still allow for some flexibility. For example, DWR and the Commission could mutually agree on a change that was also acceptable to bondholders. Similarly, the Legislature could determine that DWR and the Commission should adopt a specific change (again, only if it did not impair the rights of bondholders). This greater flexibility contrasts with the "irrevocable" portions of the Rate Agreement, which will not change for the life of the Bonds. We intend the "non-irrevocable" portions of the Rate

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may enter into an agreement with [DWR] with respect to charges under Section 451 for purposes of this division, and that agreement shall have the force and effect of a financing order adopted in accordance with [Pub. Util. Code § 840 et seq.,], as <u>determined by the commission</u>." (Emphasis added.) Sunrise's assertion that portions of the Rate Agreement relating to Power Charges must be designated a financing order does not take account of this provision.

Agreement to be amended or terminated only in accordance with the provisions of the Rate Agreement itself, and not as a result of any unilateral Commission action. PG&E indicates that this is an appropriate result in its comments on the Draft Decision, since PG&E believes these provisions should not be irrevocable.

PG&E asks that the Commission amend these provisions, so that they are not read as having any binding effect on future Commissions. We disagree with this approach. Pursuant to our discretion over the content of the Rate Agreement, we have determined the terms on which the Rate Agreement should be amended or terminated, and have agreed upon those terms with DWR. Once the Commission enters into that agreement, it cannot unilaterally change those provisions. Such is the nature of agreements, and the Commission has authority to enter into an "agreement" with DWR by virtue of AB 1X, which is the basis for the representation in Section 2.2 of the proposed Rate Agreement.

As a result, we believe it is clear from existing law that the Commission has the ability to enter into the proposed Rate Agreement. However, to the extent this is not clear, we note that AB 1X authorizes us to determine how the Rate Agreement will have the “force and effect” of a financing order. We have exercised that discretion by agreeing to the amendment and termination provisions of the proposed Rate Agreement. If it is necessary for the Commission to characterize the proposed Rate Agreement as a financing order—albeit not an “irrevocable” one—those portions of the Rate Agreement not now characterized as a financing order, we will do so.

5. Conclusion

The Act requires the Commission to set rates to recover DWR’s revenue requirement without limiting the methods by which that revenue requirement is to be recovered. There is no legislative directive that compels the Commission to

recover DWR's revenue requirement strictly by means of charges imposed on power sold by DWR, nor is any restriction found elsewhere in California law that prevents the Commission from collecting DWR's revenue requirement by the separate Bond Charges and Power Charges set forth in the Rate Agreement. Accordingly, the language of the Act, as well as the Commission's plenary authority to regulate public utilities, provides the Commission with the authority to collect DWR's revenue requirement by directing the relevant utilities to collect Bond Charges and Power Charges from their customers.

When the Act and the Commission's authority are considered together, the adoption of a separate surcharge mechanism to recover DWR's Bond-Related Costs is reasonable and lawful. California law recognizes an administrative agency's right to interpret a statute, especially if such an interpretation is needed to put the statute into effect. For legislatively created agencies, judicial deference is at the level of "respect" if a court must decide whether or not an agency has authority to act.[154] Separate law exists defining the Commission's authority to interpret statutes, because the Commission is constitutionally created. Those cases confirm that there is a strong presumption that the Commission's orders are valid, and, at least with respect to the Public Utilities Code, and that the Commission's interpretation of statutes should not be disturbed unless it fails to bear a reasonable relation to statutory purposes.[155] The Act concerns the Public Utilities Code as well as the Water Code, and it is clear that the Commission has

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[154] Compare California for Political Reform v. FPPC, 61 Cal. App. 4th 472 [71 Cal. Rptr. 2d 606 (1998)]; Environmental Protection Information Center v. Department of Forestry, 43 Cal. App. 4th 1011, 1017 [50 Cal. Rptr. 2d 892] (1996).

[155] Greyhound Lines, Inc. v. Pub. Util. Commission, 68 Cal. 2d 406 (1968); Market St. R. Co. v. Railroad Commission, 24 Cal.2d 378, 393 (1944).

a role in its implementation. Accordingly, it is within the Commission's authority to interpret relevant provisions of the Act.

V. Revisions to the Proposed Rate Agreement

We have made minor revisions to the definition of Priority Long Term Power Contracts in Section 1.1 of the proposed Rate Agreement as circulated for comment on January 31, 2002, and other minor revisions to Sections 10.1 and 11.11.

In its comments on the Draft Decision, DWR recommends that the word "may" in the fourth line of Section 5.1(d) be changed to "shall," at the request of a rating agency. The effect of this change would be to impose an additional duty on DWR. Since this change imposes an additional duty on DWR, which it wishes to assume, we see no reason not to adopt this change. The adopted Rate Agreement is revised accordingly.

VI. The Adopted Rate Agreement

The Rate Agreement adopted by this decision is contained in Appendix C. The Commissioners voting to adopt the Rate Agreement, should they constitute a majority of this Commission, shall sign the adopted Rate Agreement on behalf of the Commission. Once executed by DWR and finalized through the Commission's rehearing process, Sections 5.1(a) and 5.1(b) of the Commission-adopted Rate Agreement will have the force and effect of a financing order issued pursuant to Pub. Util. Code § 840 et seq. Once DWR has signed the Rate Agreement, the Commission's Executive Director shall file and serve a copy of the signed Rate Agreement. The Commission's General Counsel will retain the Commission's copies of the original signed Rate Agreement.

VII. Pub. Util. Code Section 311(g) – Public Review and Comment

Pub. Util. Code § 311(g)(1) generally requires that a draft decision be served on all parties and subject to at least 30 days of public review and comment prior to a vote of the Commission. However, pursuant to Rules 77.7(f) and 77.7(f)(9), the Commission may waive the 30-day period if required by public necessity. These rules state, in relevant part, as follows:

> The Commission may reduce or waive the period for public review and comment . . . for a decision where the Commission determines, on the motion of a party or on its own motion, that public necessity requires reduction or waiver of the 30-day period for public review and comment. For purposes of this subsection, "public necessity" refers to circumstances in which the public interest of the Commission adopting a decision before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment . . . When acting pursuant to this subsection, the Commission will provide such reduced period for public review and comment as is consistent with the public necessity requiring reduction or waiver.

DWR and the Department of Finance represent that it is imperative for the Commission to approve the Rate Agreement as soon as possible in order to protect and maintain the financial condition of the State. DWR explains that in order to issue the Bonds no later than June 30, 2002, the Commission must adopt the Rate Agreement in February 2002. The Department of Finance indicates that the budget for the State of California assumes that DWR will repay the State's General Fund by June 2002.

The proposed Rate Agreement was jointly developed after October 2001, and contains significant changes, as Edison, PG&E, and TURN note. It has also been vetted with the financial community, as DWR notes. Contrary to

EPUC/CIU's claims, this was accomplished as quickly as possible, and the Rate Agreement could not have been circulated any earlier. Because the Bonds cannot be issued until a final Rate Agreement is in effect, we determine pursuant to Rule 77.7(f)(9) that the public interest in the Commission issuing a decision regarding the Rate Agreement before the expiration of the 30-day review and comment period outweighs the public interest in having the full comment period.[156]

The proposed Rate Agreement was provided to the parties via a ruling issued by Administrative Law Judge (ALJ) Kenney on January 31, 2002. Comments regarding the proposed Rate Agreement were submitted on February 5, 2002. The substance of these comments was reflected in the Draft Decision of ALJ Kenney that was mailed to the parties on February 14, 2002, in accordance with Pub. Util. Code § 311(g)(1). The Draft Decision, however, did not include citations to specific portions of the parties' comments on the proposed Rate Agreement. Comments regarding the Draft Decision were filed properly on February 19, 2002, by DWR, the Department of Finance, EPUC, PG&E, SCE, and SDG&E. These comments have been reflected, as appropriate, in the final decision adopted by the Commission. In addition, the final decision has been revised to indicate where in the decision we have addressed the parties' comments on the proposed Rate Agreement that are relevant to today's decision, and to explain how we have disposed of certain comments on the proposed Rate Agreement.

[156] The shortened period for public review and comment on the draft decision does not unduly prejudice any party, since the parties had an opportunity to comment on the proposed Rate Agreement as described elsewhere in this decision.

VIII. Rehearing and Judicial Review

This decision construes, applies, implements, and interprets the provisions of AB 1X. Therefore, Pub. Util. Code § 1731(c) (applications for rehearing are due within 10 days after the issuance of the order or decision) and Pub. Util. Code § 1768 (procedures applicable to judicial review) are applicable.

Findings of Fact

1. In AB 1X the Legislature declared: "The furnishing of reliable reasonably priced electric service is essential for the safety, health, and well-being of the people of California. A number of factors have resulted in a rapid, unforeseen shortage of electric power and energy available in the state and rapid and substantial increases in wholesale energy costs and retail energy rates, with statewide impact, to such a degree that it constitutes an immediate peril to the health, safety, life and property of the inhabitants of the state, and the public interest, welfare, convenience and necessity require the state to participate in markets for the purchase and sale of power and energy."

2. In response to the electricity crisis, Governor Davis proclaimed a state of emergency on January 17, 2001, and ordered DWR to immediately procure electricity to mitigate the effects of the emergency.

3. The State's General Fund has loaned more than $ 6 billion to DWR in response to the electricity crisis. DWR has used the funds to procure electric power for millions of Californians.

4. On June 18, 2001, Governor Davis issued an Executive Order that authorized DWR to accept up to $5 billion in loans for the following purposes: (i) purchase electric power, (ii) purchase natural gas to generate electricity; and (iii) fund capitalized interest and reserves required in connection with the loans. The Executive Order indicates that all provisions in the Act apply to the loans.

On June 26, 2001, DWR obtained an Interim Loan in the amount of $4.3 billion pursuant to its authority under the Governor's Executive Order.

5. DWR is required by the terms of the Interim Loan to (i) repay the Interim Loan prior to repaying the General Fund, and (ii) pay higher rates of interest on the Interim Loan the longer the Loan remains outstanding.

6. The purpose of the proposed Rate Agreement is to facilitate the issuance of Bonds by DWR. DWR will use the Bond proceeds to (i) repay the Interim Loan, and (ii) repay the State's General Fund for billions of dollars that were loaned to DWR to purchase electric power in response to the electricity crisis.

7. The Rate Agreement defines Bonds as follows: Indebtedness issued by DWR pursuant to Water Code § 80130 and the Governor's Executive Order dated June 18, 2001, in an aggregate principal amount up to $ 13,423,000,000; provided, however, that (i) notes issued in anticipation of the Bonds and retired from the proceeds of those Bonds shall not be counted against said dollar limitation, and (ii) Bonds shall include indebtedness issued to refund prior Bonds, but such refunding indebtedness shall not be counted against said dollar limitation; and, (iii) the definition of Bonds excludes the Interim Loan.

8. The Bond transaction will be subject to the Financing Documents. The proposed Rate Agreement defines Financing Documents as follows: Any resolution, indenture, trust agreement, loan agreement, revolving credit agreement, reimbursement agreement, standby purchase agreement or other agreement or instrument adopted or entered into by DWR authorizing, securing, or enhancing the Bonds, as amended from time to time or supplemented in accordance therewith.

9. The proposed Rate Agreement requires DWR to (i) involve the Commission to the fullest extent possible in the development of the Financing

Documents, (ii) consult with the Commission on the sizing of operating and debt service reserves, debt service coverage, the maturity and maximum amount of Bonds to be issued, and any other matters in the Financing Documents that the Commission deems material, and (iii) provide a copy of all Financing Documents to the Commission.

10. DWR has submitted to the Commission a summary of the material terms of the Financing Documents ("the Summary"). The Rate Agreement defines "material terms" as the maximum amount of the Bonds authorized, their maturity, a description of the flow of funds, and a description of the sizing or methodology of sizing of reserves held or created pursuant to the Financing Documents or debt service coverage required thereby.

11. The proposed Rate Agreement requires DWR to obtain the approval of the Commission's designee prior to making a "material change" to any material term in the Summary. The Rate Agreement defines "material change" as (i) a change in the sizing or methodology of sizing of debt service reserves that would increase the projected net debt service on the Bonds by more than an amount specified in the Summary; (ii) an increase in debt service coverage required by the Financing Documents by more than an amount specified in the Summary; (iii) a change in the sizing or method of sizing of operating reserves by more than an amount specified in the Summary; (iv) any increase in the maximum amount of the Bonds authorized; (v) a change in the maturity of the Bonds beyond those changes permitted in the Summary; or (vi) a change in the flow of funds beyond those changes permitted in the Summary.

12. The proposed Rate Agreement states that the Commission will appoint the designee referred to in the prior Finding of Fact at the time the Commission adopts the Rate Agreement.

13. The Summary permits DWR to revise material terms within designated parameters described in the Summary without having to obtain the consent of the Commission's designee. Any change beyond those parameters will require approval by the Commission's designee.

14. In order to ensure the timely sale of the Bonds, it is essential that a person be authorized to approve the Financing Documents within guidelines established by the Commission.

15. The Summary of material terms is an item separate from today's decision.

16. Because the Bond transaction depends on the Rate Agreement, the Financing Documents cannot be finalized until after the Commission and DWR have entered into a Rate Agreement.

17. It is not possible for the Commission to condition its approval of the Rate Agreement on its subsequent review and approval of the Financing Documents.

18. The Rate Agreement establishes two streams of revenue. One stream of revenues will come from Bond Charges, and the other from Power Charges.

19. The proposed Rate Agreement describes Bond Charges as charges imposed by the Commission on customers in the Service Areas of PG&E, SCE, and SDG&E for the purpose of recovering DWR's Bond-Related Costs. The Rate Agreement states that (i) the Bond Charge for each customer will be based on the aggregate amount of power sold to the customer by an Electrical Corporation, DWR, and, to the extent determined under Section 4.3 the Rate Agreement, by an ESP, and (ii) Bond Charges shall be imposed upon customers in the Service Areas of PG&E, SCE, and SDG&E at all times required by the Rate Agreement whether or not DWR is at the time selling, or deemed to be selling, Power to such customers until such time as DWR has recovered the portion of DWR's revenue requirements under Water Code § 80134 constituting Bond-Related Costs.

20. The Rate Agreement defines an ESP as follows: An entity that provides electrical service to one or more retail customers located within the Service Areas of PG&E, SCE, or SDG&E, except that ESP excludes: (i) DWR, (ii) any public agency to the extent it offers electrical service to customers within its jurisdiction or within the service territory of a local publicly owned electric utility, and (iii) Electrical Corporations. ESP includes the unregulated affiliates and subsidiaries of an Electrical Corporation.

21. Section 4.3 of the proposed Rate Agreement states that Bond Charges may be based on power provided to customers by ESPs only after an order of the Commission providing for such charges becomes final and unappealable. No such order has been issued at the time of this decision.

22. Revenues from the Bond Charges will be used to pay Bond-Related Costs, which the Rate Agreement describes as including all of the following:

> (i) Principal of, premium, if any, and interest on Bonds and any additional amount required under the Financing Documents to be deposited into the Bond Charge Collection Account to provide debt service coverage of the Bonds.
>
> (ii) Payments required to be made pursuant to: (1) agreements with issuers of credit and liquidity facilities and their participants, including but not limited to, letters of credit, bond insurance, guarantees, debt service reserve fund surety bonds, lines of credit, reimbursement agreements, and standby bond purchase agreements; (2) agreements relating to other financial instruments entered into in connection with the Bonds, including but not limited to investment agreements, hedges, interest-rate swaps, caps, options and forward purchase agreements; and (3) agreements relating to the remarketing of Bonds, including, but not limited to remarketing agreements, dealer agreements, and auction agent agreements.

(iii) Deposits to the Debt Service Reserve Account established under the Financing Documents to the extent necessary to provide therein an amount equal to the requirement for such account under the Financing Documents if not otherwise replenished from Power Charges.

(iv) The cost of Fiduciaries associated with the issuance and administration of the Bonds.

(v) When and if DWR no longer sells Power under the Act and Bonds remain outstanding, DWR's Bond Charge servicing costs, costs of preparing and providing the information and reports required under the Financing Documents, this Agreement and the Act, related audit, legal and consulting costs, related administrative costs, and costs of complying with arbitrage restrictions and rebate requirements.

23. Section 5.1(a) of the Rate Agreement requires the Commission to impose Bond Charges upon electric customers in the Service Areas of PG&E, SCE, and SDG&E that are sufficient to provide the Bond Charge Payment Account with enough money to pay for all Bond-Related Costs as they come due.

24. Section 5.1(b) of the Rate Agreement states that DWR's right to receive Bond Charges as provided for in the Rate Agreement, Water Code § 80110, and Pub. Util. Code § 840 et seq., shall be property of DWR for all purposes under California law.

25. Section 5.1(c) of the Rate Agreement states that Sections 5.1(a) and 5.1(b) shall have the force and effect of an irrevocable financing order adopted by the Commission pursuant to Pub. Util. Code § 840 et seq.

26. Revenues from Bond Charges will be deposited into the Bond Charge Collection Account. Funds in the Collection Account will be transferred periodically to the Bond Charge Payment Account. Funds in the Payment Account may only be used to pay for Bond-Related Costs. However, so long as funds remain in the Collection Account, they may be used, if necessary, to pay

for certain Department Costs specified in the Financing Documents. If the Collection Account is used to pay PLTPCs, then it is the intent of the Rate Agreement that the Collection Account be replenished from Power Charges.

27. The Debt Service Reserve Account will be used to pay for Bond-Related Costs in the event there are insufficient funds available in the Payment Account, the Collection Account, or other funds provided for in the Bond Indenture. The Debt Service Reserve Account will be funded initially with Bond proceeds, and may be replenished, as appropriate, from Bond Charges and Power Charges.

28. The proposed Rate Agreement describes Power Charges as charges imposed by the Commission on Retail End Use Customers for Power deemed sold by DWR.

29. The proposed Rate Agreement defines "Retail End Use Customer" as "each customer within the Service Area of an Electrical Corporation that is deemed to purchase electric power from DWR under the Act. "Service Area" is defined as "the geographic area in which an Electrical Corporation distributes electricity." "Electrical Corporation" is defined as having "the same meaning ascribed thereto in Section 218 of the Public Utilities Code, including any successor and assign thereof."

30. The Rate Agreement provides that revenues from Power Charges will be used to pay for Department Costs, which the Agreement defines as all amounts that DWR is entitled to recover under Water Code § 80110 to enable it to comply with § 80134, with the exception of Bond-Related Costs that are recovered through Bond Charges.

31. The Rate Agreement requires the Commission to impose Power Charges on Retail End Use Customers for Power deemed sold to such customers by DWR

that are sufficient to provide moneys in the amounts and at the times necessary to satisfy the Retail Revenue Requirements specified by DWR.

32. The Rate Agreement states that, as provided by Water Code § 80112, Power Charges shall be property of DWR for all purposes under California law.

33. Under the Rate Agreement, the imposition of Power Charges is independent of Bond Charges and vice versa.

34. Revenues from Power Charges will be deposited into the Operating Account. Funds in the Operating Account will be used to pay for Department Costs, and funds also will be transferred to the Priority Contract Account. The Priority Contract Account will be used to pay for costs that DWR incurs under its PLTPCs. The Operating Reserve Account will be used to pay for Department Costs in the event there are insufficient funds in the Operating Account or the Priority Contract Account.

35. Section 1.1 of the Rate Agreement defines PLTPCs as (i) those long-term electric power contracts identified in Appendix A of the Agreement that were entered into prior to August 15, 2001, and (ii) any contracts entered into for the purpose of securing fuel for use at generating facilities being operated pursuant to such PLTPCs if that fuel-supply contract contains a provision for the payment of costs thereunder prior to debt service on the Bonds. Section 1.1 also states that DWR shall consult with the Commission prior to entering into any additional contract for the purpose of securing fuel if that contract contains such a provision. Sections 1.1 and 7.8 provide that a contract will cease to be treated as a PLTPC when the contract no longer contains a provision to the general effect that payments by DWR under the contract are to paid or payable prior to that DWR debt which is secured by a pledge or assignment of DWR's revenues under the Act and other amounts in the Electric Power Fund.

36. The costs that DWR incurs under PLTPCs are a subset of Department Costs.

37. To enable the Commission to set Bond Charges and Power Charges, the proposed Rate Agreement requires DWR to submit its Retail Revenue Requirement to the Commission. The Rate Agreement defines Retail Revenue Requirement as the amount of Department Costs that must be recovered from Power Charges. The Agreement uses DWR's submittal of its Retail Revenue Requirement as a vehicle for DWR to notify the Commission not only about Department Costs, but also about Bond-Related Costs.

38. The proposed Rate Agreement requires DWR to review, determine, and revise its Retail Revenue Requirement at least annually, and more frequently as deemed necessary or appropriate by either DWR or the Commission.

39. The proposed Rate Agreement requires DWR to revise its Retail Revenue Requirement if it projects that any of the following will occur with 120 days: (i) there will be insufficient funds in the Priority Contact Account to pay amounts due under the PLTPCs; (ii) the balance in the Operating Reserve Account will fall below that required by the Financing Documents; (iii) it will be necessary to use funds in the Bond Charge Collection Account to pay for costs incurred by DWR under the PLTPCs; or (iv) it will be necessary to use funds in the Debt Service Reserve Account to pay Bond-Related Costs.

40. The proposed Rate Agreement requires DWR to revise its Retail Revenue Requirement, if it has not already done so, no later than three business days after (i) DWR makes a withdrawal from the Bond Charge Collection Account to pay for Department Costs, or (ii) the balance in the Operating Reserve Account or the Debt Service Reserve Account falls below that required by the Financing Documents.

41. In determining its Retail Revenue Requirement, the proposed Rate Agreement requires DWR to take into account any deficiency or surplus in the amounts recovered in earlier periods, as well as any anticipated surpluses. In addition, DWR may include in its Retail Revenue Requirement only those costs that DWR is permitted to collect under the Act.

42. Each time DWR determines or revises its Retail Revenue Requirement, it must submit the Revenue Requirement to the Commission. Prior to any submittal, DWR must conduct whatever procedures are required by law to determine that the amounts included in the Retail Revenue Requirement communicated to the Commission are just and reasonable within the meaning of Pub. Util. Code § 451.

43. DWR may submit a separate request to increase Bond Charges under the circumstances described in Section 5.1(d).

44. After DWR submits its Retail Revenue Requirement and/or a request to increase Bond Charges, the proposed Rate Agreement requires the Commission to revise Power Charges and Bond Charges, as necessary, to provide sufficient revenues to pay for Department Costs and Bond-Related Costs as they come due. In the event DWR fails to submit a revised Retail Revenue Requirement within the time frames specified in the Rate Agreement, and the Commission believes that Power Charges are not sufficient to pay Department Costs, the Commission may revise Power Charges on an interim basis to cover the shortfall pending DWR's submittal of a revised Retail Revenue Requirement.

45. The proposed Rate Agreement requires the Commission to impose revised Bond Charges and/or Power Charges, as appropriate and necessary, no later than 120 days following the submittal of DWR's Retail Revenue Requirement and/or request to increase Bond Charges.

46. The proposed Rate Agreement requires the Commission to establish Power Charges and Bond Charges without regard to rates or charges for electric power sold by Electrical Corporations.

47. The Rate Agreement acknowledges that the Commission has exclusive authority to spread DWR's revenue requirement among customer classes and service territories, and to determine the extent and timing of rate changes, consistent with the Commission's obligations under the Rate Agreement.

48. The proposed Rate Agreement prohibits DWR from attempting to impose charges on Retail End Use Customers for the purpose of paying for Department Costs or Bond-Related Costs.

49. The Rate Agreement requires DWR to (i) provide the Commission with the information specified in the body of this decision at the times set forth in the body of this decision, and (ii) participate in Commission proceedings, at the request of the Commission, on matters related to the establishment of Bond Charges or Power Charges. Such participation may include providing witnesses, attending public hearings, and submitting information and documents.

50. The proposed Rate Agreement contemplates that DWR will sell Bonds as soon as practicable in amounts sufficient to repay the State for advances made under the Act, together with interest on such advances as provided by the Act. The Agreement also contemplates that DWR will use the Bond proceeds to repay the General Fund with the understanding that repayment of the Interim Loan has priority, and that the following costs may have priority also: creation of adequate reserves for Bond-Related Costs and payment of Bond-issuance costs.

51. The proposed Rate Agreement contains the following additional provisions that are intended to protect the interests of Bondholders: (i) both the Commission and DWR must comply with the Act and the Rate Agreement;

(ii) both the Commission and DWR must act, as necessary, to protect the tax-exempt status of the Bonds; (iii) the Commission cannot allow, to the extent it has the authority to do so, any lien on Power Charges or Bond Charges except for liens created pursuant to the Act; (iv) if either party breaches the Agreement, and the breach is not cured within 30 days of receiving written notice, the aggrieved party may take whatever action at law or in equity that it deems necessary to enforce performance; and (v) DWR may assign to a Trustee the Commission's obligation under the Rate Agreement to impose Bond Charges that are sufficient to pay Bond-Related Costs when due.

52. The Trustee may enforce the Commission's obligations under the Rate Agreement only after DWR has both defaulted on its obligations contained in the Financing Documents and has failed to enforce the Commission's obligations in accordance with the Agreement.

53. Prior to exercising its rights, the Trustee must (i) give 30-day's written notice, (ii) certify to the Commission that an event of default has occurred under the Financing Documents that is not predicated solely on the Commission's failure to act as required by the Rate Agreement, and (iii) comply or cause DWR to comply with the provisions in the Rate Agreement pertaining to DWR's rights, duties, and obligations. The Trustee may provide less than 30 day's notice if a default has resulted in the amount in the Debt Service Reserve Account being insufficient to timely pay all Bond-Related Costs.

54. The proposed Rate Agreement requires DWR, to the extent practicable, to appoint as Trustee a bank, trust company, or other qualified entity or person that does not itself, or by or through any of its corporate affiliates, trade in electricity or natural gas commodity markets, and does not itself, or any of its affiliates,

appear on the list of top twenty creditors for any Electrical Corporation or any entity providing power to DWR that has petitioned for bankruptcy.

55. The proposed Rate Agreement requires DWR to use its best efforts to renegotiate its long-term power contracts. The Rate Agreement does not limit the ability of the Commission or DWR to assert any right that it might have regarding contracts entered into by DWR pursuant to the Act. Nor does the Rate Agreement limit the Commission's right to contest in any venue the legality or effect of any contract entered into by DWR under the Act.

56. The proposed Rate Agreement applies only to those Retail Revenue Requirements that DWR submits to the Commission after the two parties sign the Agreement. Once in effect, the Agreement may be amended upon the written consent of both the Commission and DWR, except for Sections 5.1(a) and 5.1(b) which will have the force and effect of an irrevocable "financing order." The Agreement terminates when the Bonds have been retired and all other Bond-Related Costs have been paid or provided for in accordance with the Financing Documents.

57. Except as set forth in Section 8.3, neither the Commission nor DWR may assign any of its rights or delegate any of its duties under the Rate Agreement without the express written consent of the other party. However, if another governmental entity is designated by law to carry out the rights, powers, duties, and obligations of the Commission and/or DWR, then the Commission and DWR may, if required by such law, transfer and assign its rights, title, and interest in the Rate Agreement to such successor, provided the successor is bound by the Rate Agreement.

58. Section 11.8 of the proposed Rate Agreement states that nothing in the Agreement, whether express or implied, shall be construed to give any person or

entity, other than the parties to the Agreement and the Beneficiaries, any legal or equitable right, remedy, or claim under or with respect to (i) the agreement, or (ii) any covenants, agreements, representations, or provisions contained therein.

59. In order to ensure timely repayment of Bond principal and interest, it is necessary for the Rate Agreement to provide for the timely recovery of Department Costs. This is because DWR's PLTPCs may have terms that require DWR to pay for power purchased under these contracts ahead of Bond-Related Costs.

60. The Rate Agreement's establishment of a separate surcharge to recover Bond-Related Costs will provide a secure stream of revenue that may be pledged by DWR for the repayment of Bonds.

61. DWR cannot sell the Bonds with investment-grade ratings as required by the Act unless investors are confident that there is a mechanism in place that ensures DWR will be able to timely pay Bond principal and interest. The Rate Agreement provides the necessary assurance.

62. A separate surcharge for Bond-Related Costs enables DWR to enter into a bond transaction that does not require DWR to sell power for the life of the bonds, since the recovery of DWR's Bond-Related costs will not depend on the sale of power by DWR. This should enable DWR to eventually terminate its power sales under the Act and thereby allow electric utilities to resume their traditional role of satisfying the power needs of their customers. It should also give the State flexibility to shape the future structure of the retail electric market.

63. The Rate Agreement provides the following significant benefits: (i) it enables DWR to issue bonds so that it can repay billions of dollars of debt owed to the State's General Fund; (ii) it creates a long-term financing mechanism that allows the Commission to spread the impact of the outrageously high electricity

prices encountered in 2001 over a number of years, thereby preventing rate shock and economic dislocation; (iii) it enables DWR to issue Bonds with investment-grade ratings, thereby allowing DWR to finance portions of the debt it incurred in response to the electricity crisis at lower cost to ratepayers; (iv) it establishes a mechanism for the Commission to provide appropriate advice and assistance to DWR regarding the Bond transaction, which helps ensure that the Bond transaction will be structured in a way that is beneficial to ratepayers; (v) it accelerates the time when California's electric utilities can resume their traditional role of satisfying the power needs of their customers; (vi) it requires DWR to use its best efforts to renegotiate its long-term power contracts, which may result in new or revised contracts that provide for cheaper power compared to the existing power contracts; (vii) it enhances DWR's ability to renegotiate its long-term power contracts by decoupling DWR's power-related costs from its Bond-Related Costs; (viii) it gives the State flexibility to shape the future structure of the retail electric market; (ix) it limits the costs that DWR may recover in rates to only those that are both authorized by the Act and just and reasonable under Pub. Util. Code § 451; (x) it requires DWR to follow whatever procedures are required by law to determine whether its costs are just and reasonable; and (xi) it allows any party to challenge DWR's contracts before FERC or a court, consistent with the Commission's continuing legal efforts to revise DWR's power contracts in ways that are beneficial to the public interest.

64. All current and future electric customers will benefit from the Rate Agreement for the reasons set forth the previous Finding of Fact.

65. It was necessary for DWR to incur billions of dollars of debt to finance power purchases during the height of the electricity crisis. If DWR had not purchased the power and incurred the related debt, there would have been

repeated and prolonged blackouts extending over large portions of the State. Widespread and prolonged blackouts would have disrupted California's emergency services, law enforcement, schools, hospital, homes, businesses, and agriculture. The blackouts might also have caused the physical and economic collapse of the electricity grid, which would have had catastrophic consequences not only for the grid, but for all of California. The economic costs for all Californians would have been staggering and long lasting, and far in excess of the debt that DWR incurred to avert the catastrophe.

66. All current and future electric customers will benefit from the debt that was incurred by DWR during the electricity crisis for the reasons set forth in the previous Finding of Fact.

67. The imposition of Bond Charges on future ratepayers who did not consume the electricity that was financed with the Bond proceeds would not be the first time that ratepayers have paid amounts that are not based on the exact cost of utility service provided to each customer. Previous examples include the DEAF program and programs in which one group of ratepayers pays higher rates in order to provide affordable utility service to others.

68. The Department of Finance represents that the Governor's 2002-03 budget forecasts a deficit of $12.5 billion. The Department also represents that the cash-flow forecast underlying the Governor's 2002-03 budget assumes that DWR will have repaid $6.1 billion in loans from the State's General Fund by June 2002. The Department asserts that DWR's repayment of $6.1 billion is essential to the State's ability to fund education, public safety, and other priority programs.

69. DWR represents that in order to obtain investment-grade ratings for the Bonds there must be no unresolved litigation concerning (i) the authority of DWR and the Commission to enter into the adopted Rate Agreement, or (ii) the

authority of the Commission to impose the types of charges described in the proposed Rate Agreement.

70. DWR represents that the issuance of the Bonds cannot occur until after the resolution of any applications for rehearing of the Commission's decision adopting the Rate Agreement and any appeals to the California Supreme Court. DWR also notes that the process of preparing, marketing, selling, and delivering the Bonds will take additional time.

71. DWR and the Department of Finance represent that it is imperative that that the Commission adopt the Rate Agreement as soon as possible.

72. It will not be possible for the Commission to determine Bond Charges until a time that is proximate to the issuance of the Bonds.

73. The proposed Rate Agreement was publicly released and provided to the parties as soon as it was complete.

74. DWR recommends that the word "may" in the fourth line of Section 5.1(d) be changed to "shall," at the request of a rating agency. The effect of this change would be to impose an additional duty on DWR.

Conclusions of Law

1. The Commission and DWR have discretionary authority under Water Code § 80110 and § 80130 to enter into the proposed Rate Agreement.

2. The Commission and DWR have authority under the Act to negotiate the specific terms and conditions of the Rate Agreement, so long as such terms and conditions are not inconsistent with the Act or other laws.

3. All terms and conditions in the proposed Rate Agreement are (i) expressly authorized by the Act, and/or (ii) can be agreed upon by the Commission and DWR pursuant to their general authority under the Act to negotiate the specific

terms and conditions of the Rate Agreement. There are no terms and conditions in the proposed Rate Agreement that are inconsistent with the Act or other laws.

4. DWR is authorized by Water Code § 80134(a) to establish and revise a revenue requirement that is sufficient, together with any moneys on deposit in the Electric Power Fund, to provide for the Bond-Related Costs and Department Costs that are identified and defined in the proposed Rate Agreement.

5. The definitions of Bond-Related Costs and Department Costs contained in the proposed Rate Agreement include only costs that DWR is authorized to recover as a revenue requirement under Water Code § 80134(b) and § 80110.

6. DWR is required by Water Code § 80134(a) to determine annually, if not more frequently, the revenue requirement described in the two previous Conclusions of Law (COLs). Section 4.1(b) of the proposed Rate Agreement implements this statutory requirement.

7. DWR is required by Water Code § 80134(b) and § 80110 to notify the Commission of the revenue requirement described in the three previous COLs. Sections 4.1(a), 4.1(b), and 5.1(d) of the proposed Rate Agreement implement this statutory requirement.

8. DWR is entitled by Water Code § 80110 to recover the revenue requirement described in the previous COL via electricity charges established by the Commission. The proposed Rate Agreement implements this statutory entitlement.

9. Under the Rate Agreement, Power Charges may be imposed only on customers that receive power from DWR.

10. The Commission is required by Water Code § 80110 to impose electricity charges that are sufficient to recover the Bond-Related Costs and Department Costs that DWR communicates to the Commission pursuant to Water Code

§ 80134(b) and § 80110. Sections 4.1(a), 5.1(a), 5.1(d), 6.1(a), and 6.1(d) of the proposed Rate Agreement implement this statutory requirement.

11. So that the Commission may discharge its statutory obligation under Water Code § 80110 to impose electricity charges that are sufficient to recover the revenue requirement that DWR communicates to the Commission pursuant to Water Code § 80134(b) and § 80110, it is necessary for DWR to (i) provide the Commission with the information set forth in Sections 4.1(b), 4.1(c), and 4.1(d) of the Rate Agreement, and (ii) participate in Commission proceedings as set forth in Section 6.4 of the Rate Agreement.

12. Water Code § 80110 provides that the Commission's authority to establish electric rates to recover DWR's revenue requirement shall be as set forth in Pub. Util. Code § 451, except that any determination of whether DWR's revenue requirement is just and reasonable shall be conducted by DWR. Sections 4.2 and 7.4 of the proposed Rate Agreement implement this statutory provision.

13. Sections 4.2 and 7.1 of the Rate Agreement require DWR to fulfill its obligation under the Act to submit a revenue requirement to the Commission that contains only those costs that are both (i) just and reasonable within the meaning if Pub. Util. Code § 451, and (ii) authorized by the Act.

14. The Act provides DWR with exclusive authority to determine if its revenue requirement is just and reasonable under Pub. Util. Code § 451. Consequently, it is unnecessary for the Rate Agreement to prescribe the procedures that DWR must use to determine if its costs are just and reasonable under § 451.

15. Section 5.1(b) of the Rate Agreement states that Bond Charges authorized by the Commission and DWR's right to receive Bond Charges as provided in the Rate Agreement shall be the property of DWR for all purposes under California law. Legal authority for this provision is provided by:

(i) Water Code § 80130 et seq., and § 80200, which authorize DWR to issue bonds to pay for past, current, and future power-related costs. Thus, the provisions in § 80112 which establish that revenues "with respect to" any power acquired and sold by DWR are the property of DWR apply with equal force and effect to Bond Charges, since the revenues from the Bond Charges will ultimately be used to pay for power-related costs.

(ii) Water Code § 80110, which authorizes the Commission to enter into an agreement with DWR that (a) establishes charges for the recovery of DWR's Bond-Related Costs, and (b) has the force and effect of a financing order issued by the Commission pursuant to Pub. Util. Code § 840 et seq. The effect of Pub. Util. Code § 840 et seq., is to allow the Bond Charge to be established by a financing order. Any financing order created pursuant to § 840 et seq., establishes a property right in the rates and charges imposed by the financing order and the proceeds that flow from the rates and charges imposed pursuant to the financing order. Accordingly, Pub. Util. Code § 840 et seq., may be used to create a DWR property right in the proceeds of the Bond Charges.

16. Water Code § 80110 provides authority for Section 5.1(c) of the Rate Agreement, which states that Sections 5.1(a) and 5.1(b) of the Agreement shall have the force and effect of an irrevocable financing order adopted by the Commission pursuant to Pub. Util. Code § 840 et seq.

17. Water Code § 80134(b) and Pub. Util. Code § 451 and § 701 provide authority for Section 6.1(b) of the Rate Agreement, which states that the Commission shall establish Power Charges and Bond Charges without regard to the rates or charges for electric power sold by Electrical Corporations.

18. The creation of Bond Charges and Power Charges as authorized by the Water Code and the Public Utilities Code is consistent with the State and Federal constitutions.

19. The effect of Section 6.1(b) is that the utilities' ability to recover their own revenue requirements over time cannot be affected by Bond Charges. However, that the timing of a utility's recovery of its revenue requirement and decisions about which customers' rates will pay for revenue requirements may be affected by the size of Bond Charges.

20. Water Code § 80110 and § 80112 provide authority for Section 6.1(c) of the Rate Agreement, which states that Power Charges shall by the property of DWR for all purposes under California law.

21. Water Code § 80130 and § 80132(a) provides authority for Sections 6.2(a) and 7.3(b) in the Rate Agreement that require the Commission and DWR, respectively, to take action to protect the tax-exempt status of the Bonds.

22. Water Code § 80132(g) provides authority for Section 6.3 of the Rate Agreement, which states that the Commission will not allow, to the extent it has the power to do so, the creation of any lien upon or pledge of the Power Charges or Bond Charges except for liens and pledges created pursuant to the Act as security for the enforcement of DWR's obligations entered into pursuant thereto.

23. Water Code § 80132(b) provides authority for those provisions in the Rate Agreement pertaining to the Trustee.

24. The Commission has broad legal authority under Water Code § 80110 and Pub. Util. Code § 451 and 701 to devise ratemaking mechanisms to recover the revenue requirement that DWR communicates to the Commission pursuant to Water Code § 80110 and 80134(b).

25. Because the Act allows the Commission and DWR to enter into an agreement regarding the nature of the charges the Commission will impose to recover DWR's costs, the Act necessarily allows DWR and the Commission to jointly develop the terms and conditions of a mutually agreeable recovery

mechanism. Therefore, because the separate Bond Charge mechanism is a product of negotiation between DWR and the Commission, it is a charge that is specifically contemplated by the Act.

26. The Act does not require Bond-Related Costs to be recovered through charges that are imposed only on the power that is sold by DWR. Nor does the Act require the use of a particular ratemaking method to recover DWR's Bond-Related Costs or Department Costs. Therefore, the Commission may use its broad authority under Water Code § 80110 and Pub. Util. Code § 451 and § 701 to devise and implement the separate Power Charges and Bond Charges set forth in the Rate Agreement.

27. Water Code § 80130 requires DWR to establish a mechanism to ensure that the Bonds are sold at investment-grade ratings and repaid on a timely basis. The statute also states that the mechanism "may include, but is not limited to, an agreement between" DWR and the Commission. This broad language evinces a legislative intent to give DWR and the Commission broad discretion to devise a mechanism to repay the bonds. The Bond Charge mechanism in the Rate Agreement is within the scope of discretion conferred by Water Code § 80130.

28. DWR has authority under Water Code § 80100 and § 80132 to issue Bonds with maturities that extend well beyond the term of DWR's power contracts, which indicates that the Act does not require DWR to sell power in order to recover its Bond-Related Costs.

29. At the time the Act was passed into law, it was unknown how the energy crisis would unfold or how long DWR might be selling power, which suggests that the Legislature intended to provide DWR and the Commission with great flexibility in the Act to devise a means to recover DWR's revenue requirement.

30. Water Code § 80132(a) authorizes DWR to include provisions in the Bond offering that are not specifically mentioned in the Act, so long as such provisions are not inconsistent with the Act. It would not be inconsistent with the Act to include a provision in the Bond offering that states Bond-Related Costs will be paid from Bond Charges that are imposed on the electric power sold to customers, regardless of whether the power is sold by DWR, a utility, or an ESP under the conditions described in Section 4.3 of the Rate Agreement.

31. Section 4.3 of the proposed Rate Agreement states that bond Charges may be based on electric power provided to customers by ESPs only after an order of the Commission providing for such charges becomes final and unappealable.

32. The Commission's authority under Pub. Util. Code § 451 and § 701 to impose Bond Charges extends to situations where the Charge is not in proportion to the direct benefit received by each customer paying the Charge.

33. Water Code § 80132 provides DWR with authority to issue Bonds that have maturities that extend far into the future, and Water Code § 80110 entitles DWR to recover its Bond-Related Costs. Water Code § 80134 provides DWR with authority to use the Bond proceeds to (i) pay for the costs that it incurs to procure power, and (ii) repay the State for amounts that were loaned to DWR so that DWR could procure power. The Commission, in turn, is required by § 80110 to impose charges that are sufficient to recover DWR's Bond-Related Costs for as long as the Bonds remain outstanding. These statutory provisions evince a legislative intent to (i) use the Bonds as means to shift the costs that DWR incurs to mitigate the electricity crisis to future ratepayers, and (ii) provide the Commission with authority to require future ratepayers to pay charges to recover DWR's Bond-Related Costs, even though some future ratepayers might not have consumed the electricity that was financed with the Bond proceeds.

34. For the reasons set forth in the Findings of Fact, all current and future electric ratepayers benefited from the debt that was incurred by DWR to mitigate the effects of the electricity crisis. Therefore, it is reasonable for future ratepayers to pay Bond Charges to repay that debt.

35. Case law and statutes demonstrate that ratemaking mechanisms involving the temporal shifting of costs or revenues are not automatically suspect. Where the Legislature has prescribed a method, that method must be followed. Where there is no statutory direction, the Commission may exercise its discretion and the result will be upheld so long as it is fair and reasonable. The Bond Charge set forth in the Rate Agreement adheres to this framework for the reasons set forth in the previous COLs.

36. For the reasons set forth in the Findings of Fact and the previous COLs, the Rate Agreement provides a fair, reasonable, and legally solid framework for implementing the Legislature's intent expressed in Water Code § 80110 and § 80130 to provide for the recovery of DWR's Bond-Related Costs and Department Costs.

37. The Act, the Public Utilities Code, and the Rate Agreement provide the Commission with exclusive authority to allocate DWR's Department Costs and Bond-Related Costs among Service Areas and customer classes, and to set rates to recover these costs. This authority includes the power to (i) modify at any time the way the Commission allocates DWR's costs; (ii) prospectively modify the rate design and cost allocation methods used to recover Bond-Related Costs and Department Costs; and (iii) modify utility rates at different times from when rates are set to recover DWR's costs.

38. The Rate Agreement does not limit how often the Commission may revise Bond Charges and Power Charges. Because the Rate Agreement will be in effect

for many years, it is prudent to provide flexibility regarding how often rates may be revised up or down. Additionally, if rate increases are restricted to once per year, DWR would likely have to increase the amount of money held in reserve for contingencies, which would result in higher costs for ratepayers.

39. In setting rates to recover Department Costs and Bond-Related Costs, the Commission is obligated to provide an opportunity for appropriate hearings in accordance with applicable laws and regulations.

40. All information that DWR provides to the Commission pursuant to the Rate Agreement will be made available to the public in accordance with applicable laws and regulations.

41. The Rate Agreement does not unlawfully transfer the Commission's regulatory authority to DWR. Water Code § 80110, § 80130, and § 80134 provide authority for those provisions in the Rate Agreement that require the Commission, when requested by DWR, to set rates to recover Bond-Related Costs and Department Costs. Similarly, Water Code § 80110 provides authority for those provisions that make DWR exclusively responsible for determining whether its costs are just and reasonable.

42. The Rate Agreement provides that the Trustee may enforce the Commission's covenants in the Agreement only when there is a default under the Financing Documents that is caused by both the Commission's failure to act and DWR's failure to enforce the Commission's covenants. This provision ensures that the Trustee may act only when there is an adverse impact on the bondholders that is caused by the Commission's failure to fulfill its obligations under the Rate Agreement.

43. The Rate Agreement contemplates that the Commission may develop and impose Bond Charges on power sold to customers of PG&E, SCE, and SDG&E by

ESPs to the extent consistent with the Act. Notwithstanding this decision's findings regarding the application of Bond Charges to current and future customers, today's decision does not determine the extent to which legal authority exists to support the imposition of Bond Charges on the power sold by ESPs, nor does it impose Bond Charges on the power sold by ESPs. The Commission may consider in a future proceeding whether the power sold by ESPs should be subject to Bond Charges, and if so, how to do it. If necessary, an evidentiary hearing will be held prior to the imposition of Bond Charges on the power sold by ESPs.

44. The definition of ESP contained in the Rate Agreement should not be used to determine whether the power sold by any entity is subject to franchise fees.

45. There are no provisions in the Rate Agreement that bind future Commission's except those made irrevocable by Section 5.1(c) of the Agreement.

46. The "non-irrevocable" portions of the Rate Agreement may be amended or terminated only in accordance with the provisions of the Rate Agreement itself, not as a result of any unilateral Commission action.

47. Because the Rate Agreement is a contract with a sister State agency, and is specifically authorized by statute, it can bind future Commissions in a way that would not occur if the Commission were simply issuing a decision in the normal course of regulating utilities.

48. Because the Rate Agreement is a contract, it may be amended in the future by mutual agreement of the parties, except that Sections 5.1(a) and 5.1(b) are irrevocable and cannot be amended on or after the issuance of Bonds in reliance on the Rate Agreement.

49. Although DWR might agree in the Financing Documents not to permit any amendments to those other portions of the Rate Agreement that would be

detrimental to bondholders, the Rate Agreement still allows for some flexibility. For example, DWR and the Commission could mutually agree on a change that was also acceptable to bondholders. Similarly, the Legislature could determine that DWR and the Commission should adopt a specific change that does not impair the rights of bondholders. This greater flexibility contrasts with the "irrevocable" portions of the Rate Agreement, which will not change for the life of the Bonds.

50. The "irrevocable" sections of the proposed Rate Agreement should not be amended to make them revocable. The Commission has determined pursuant to its discretion under the Act which terms in the Rate Agreement should be amended or terminated, and has agreed on those terms with DWR. Once the Commission enters into that agreement, it cannot unilaterally change those provisions.

51. It is not appropriate for the Commission to condition its approval of the Rate Agreement on the Commission's subsequent approval of the Financing Documents, since the Financing Documents are being prepared by DWR and STO as part of their responsibility for issuing the Bonds. The Commission's appropriate role is to review the Financing Documents as a sister State agency.

52. The Commission's General Counsel should be appointed the Commission's designee as set forth in Section 7.10 of the Rate Agreement. The following ministerial tasks should be delegated to the General Counsel in the Counsel's role as designee: (i) review the Financing Documents to determine if they comply with the Summary or such changes beyond the Summary that have been approved by the Commission, and (ii) issue whatever certificate, opinion, or similar documentation on behalf of the Commission that is necessary to verify DWR's compliance with Section 7.10.

53. The Commission may authorize the General Counsel to approve additional changes to the material terms beyond the parameters specified in the Summary as the Commission determines to be necessary or desirable to ensure timely issuance of the Bonds.

54. The Commission's General Counsel should not approve any material change to any material term that falls outside the guidelines approved by the Commission.

55. The Commission has authority to delegate to the Commission's General Counsel the ministerial tasks as set forth in today's decision.

56. It is in the public interest for DWR to issue Bonds in order to provide funds to repay the State's General Fund for billions of dollars that were loaned to DWR to purchase electric power in response to the electricity crisis.

57. Water Code § 80200(b)(4) directs DWR to repay advances from the General Fund as soon as practicable. It will not be possible to issue Bonds to repay the General Fund until the Rate Agreement is final and can no longer be appealed.

58. Sections 1.1, 5.1(d), 10.1, and 11.11 of the proposed Rate Agreement should be modified to reflect the minor revisions set forth in Appendix C of this decision.

59. The modified Rate Agreement in Appendix C of this decision is in the public interest and should be adopted.

60. In the Rate Agreement, DWR covenants that its obligations are valid and enforceable. This means that under existing law, DWR can comply with its obligations, and that, at the time of closing, when DWR indicates the Rate Agreement is valid and enforceable, it will confirm that it can so comply, and the Commission will be able to rely on such confirmation.

61. Once the Rate Agreement is executed by DWR and finalized through the Commission's rehearing process, Sections 5.1(a) and 5.1(b) of the Commission-adopted Rate Agreement will have the force and effect of an irrevocable financing order issued pursuant to Pub. Util. Code § 840 et seq.

62. This decision does not have the effect of determining How Bond Charges should be allocated among service territories and customer classes.

63. After adoption of this decision, all that remains to be determined in order to fix the initial Bond Charges is the total amount of Bond-Related Costs and how those costs shall be allocated among service territories and customer classes. This determination may include a decision about whether Bond Charges should be based on the amount of power sold by ESPs, but absent such a decision that has become final and unappealable, ESP power will not be included in the determination of Bond Charges.

64. If the Commission does not adopt a Rate Agreement in February 2002, it will not be possible for DWR to issue the Bonds by June 30, 2002.

65. In order to protect and maintain the financial condition of the State, it is vital that DWR issue Bonds as soon as possible to repay the State's General Fund for the billions of dollars that were loaned to DWR to purchase electric power. Because the Bonds cannot be issued until after the Commission adopts the Rate Agreement and it is final and can no longer be appealed, public necessity requires that the Commission exercise its authority under Rule 77.7(f)(9) to reduce the 30-day period for public review and comment so that the Rate Agreement in Appendix C may be adopted and implemented expeditiously.

66. The shortened period for public review and comment on the draft decision regarding the adoption of the proposed Rate Agreement does not unduly

prejudice any party, since the parties had an opportunity to comment on the proposed Rate Agreement.

67. Nothing in the adopted Rate Agreement, whether express or implied, gives any person or entity, other than the parties to the Agreement and the Beneficiaries (as defined in the Agreement), any legal or equitable right, remedy, or claim under or with respect to (i) the Agreement, or (ii) any covenants, agreements, representations, or provisions contained herein.

68. This decision construes, applies, implements, and interprets the provisions of AB 1X. Therefore, Pub. Util. Code § 1731(c) (applications for rehearing are due within 10 days after the issuance of the order or decision) and Pub. Util. Code § 1768 (procedures applicable to judicial review) are applicable.

69. The following order should be effective immediately so the adopted Rate Agreement may be signed and implemented expeditiously.

INTERIM ORDER

IT IS ORDERED that:

1. The Rate Agreement between the California Department of Water Resources (DWR) and the California Public Utilities Commission (Commission) contained in Appendix C of this order is adopted by the Commission pursuant to Water Code § 80110 and § 80130.

2. The Commissioners who voted to approve the Rate Agreement shall sign the adopted Rate Agreement on behalf of the Commission. Once DWR has signed the Rate Agreement, the Executive Director shall file and serve a copy of the signed Agreement. The Commission's General Counsel shall retain the Commission's copies of the original signed Rate Agreement.

3. Once all parties to the Agreement have signed the adopted Rate Agreement, Sections 5.1(a) and 5.1(b) of the Rate Agreement, and only these Sections, shall have the force and effect of an irrevocable financing order issued by the Commission pursuant to Pub. Util. Code § 840 et seq.

4. The Commission's General Counsel shall serve as the Commission's designee as set forth in Section 7.10 of the Rate Agreement. The following ministerial tasks are delegated to the General Counsel in the Counsel's role as designee: (i) reviewing the Financing Documents to make sure they comply with the Summary or such changes beyond the Summary that the Commission has approved, and (ii) issuing whatever certificate, opinion, or similar documentation is necessary to verify DWR's compliance with Section 7.10.

5. The General Counsel shall not approve any material change to any material term in the Summary that is described in Section 7.10 of the Rate Agreement without express authority from the Commission.

6. The Commission may, from time to time, authorize changes to the material terms beyond those described in the Summary without opportunity for parties to comment.

7. This decision does not decide whether Bond Charges should be levied on customers to the extent they purchase power from an Electric Service Provider (as that term is defined in the Rate Agreement). That issue shall be addressed in a future decision of the Commission. Prior to issuing that future decision, the Commission will provide an opportunity for parties to present all legal and policy considerations relevant to reaching that decision.

8. This decision does not decide the amount of the Bond Charges that should be levied, as that can only be determined closer to the time the Bonds are issued.

This decision shall not have the effect of determining how the Bond Charges should be allocated among service territories or customer classes.

9. This decision shall have the effect of requiring the Commission to impose Bond Charges in an amount that is sufficient in total to provide for the timely payment of Bond-Related Costs as that term is defined in the Rate Agreement, which is not inconsistent with the two preceding Ordering Paragraphs.

This order is effective today.

Dated February 21, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

I will file a dissent.

/s/ HENRY M. DUQUE
Commissioner

I will file a concurrence.

/s/ RICHARD A. BILAS
Commissioner

Appendix A

Summary of Comments on the Proposed Rate Agreement and the Draft Decision

The Commission received comments regarding the Rate Agreement and/or the Draft Decision from the following: the California Department of Water Resources (DWR); the Department of Finance; the Energy Producers and Users Coalition (EPUC) and the California Industrial Users (CIU); the Foundation for Taxpayer and Consumer Rights (FTCR); JP Morgan Chase Bank (JP Morgan); Pacific Gas and Electric Company (PG&E); San Diego Gas & Electric Company (SDG&E); Southern California Edison Company (SCE); Sunrise Power Company, LLC (Sunrise), and The Utility Reform Network (TURN).

With the exception of the filing by FTCR, comments of the parties regarding the Rate Agreement generally are favorable, although all parties suggest modifications to the Rate Agreement. Most of the proposed modifications relate to clarifying definitions in the agreement, particularly the definition of "Electric Service Provider." As it has in the past, TURN urges that the material terms of the Financing Documents be made available for review by parties with appropriate provision for confidentiality.

A. California Department of Water Resources

DWR urges adoption of the Rate Agreement, stating that it is essential to the sale of DWR bonds for the purpose of repaying the General Fund. DWR notes that under Section 80130 of the Water Code it is required to establish a mechanism to ensure that the bonds will be sold at investment grade ratings, and that the mechanism may include an agreement between DWR and the

Commission. Based on its discussions with credit rating agencies, DWR states that it has concluded that an agreement with the Commission is a prerequisite to obtaining investment grade ratings for the bonds.

DWR commends the determination that portions of the Rate Agreement have the force and effect of a financing order, stating that such finding is necessary for DWR to obtain investment grade ratings. DWR states that execution of the Rate Agreement in the form proposed can be expected to decrease interest costs and the costs of bond insurance and letters of credit.

DWR contends that the Rate Agreement is reasonable and in the public interest. The agency recalls the emergency circumstances that compelled the Governor's Emergency Proclamation and the enactment of AB 1X and the potential that the emergency conditions had to substantially harm all retail end use customers in the state. DWR's Power Supply Program benefited both current and future customers of the utilities, the agency states. Among other things, the agency states, that program substantially reduced the portion of the net short load that had to be purchased in the volatile spot market, reduced and stabilized the cost of spot market purchases, avoided predicted blackouts, and created a financing mechanism that allows the Commission to spread the impact of short-term price spikes over a number of years.

According to DWR, adoption of the Rate Agreement and imposition of its Bond Charge and Power Charge is within the authority of the Commission pursuant to AB 1X and well-established Commission powers. Pub. Util. Code § 701 provides what the California Supreme Court has termed an "open-ended grant of authority" to the Commission:

> "The commission may supervise and regulate every public utility in the State and may do all things, whether specifically

> designated in this part or in addition thereto, which are necessary and convenient in the exercise of such jurisdiction." (Consumers Lobby v. Public Utilities Commission (1979) 25 Cal.3d 891, 906.)

DWR adds that California courts have liberally construed the power of the Commission to exercise its jurisdiction as "necessary and convenient" under § 701, provided that such exercise remains "cognate and germane to the regulation of public utilities…" (Morel v. Railroad Commission (1938) 11 Cal.2d 488, 492.)

DWR states that the Rate Agreement will permit DWR to recover its costs without discriminating against current customers in favor of future ratepayers. Among these costs are General Fund advances totaling $6.1 billion and an interim loan of $4.3 billion. Under the Rate Agreement, DWR would issue long-term bonds to repay these amounts and repay the bonds over an extended period. DWR endorses the Rate Agreement's two types of charges, stating:

> "Recovery of the Department's revenue requirements through two distinctive types of charges is appropriate and beneficial to customers and bondholders alike. The creation of distinct Power Charges and Bond Charges will afford the Department and the Commission the maximum flexibility in implementing a transition back to the electrical corporations as the source of the residual net short load for retail end use customers in the state. Under the proposed Rate Agreement, the Department can recover its revenue requirements through (1) Bond Charges primarily designed to pay costs related to bonds issued to finance costs which could not be paid from revenues then available to the Department and (2) Power Charges primarily designed to pay ongoing power costs of the Department….The use of separate Bond Charges and Power Charges will also allow the Department maximum flexibility to renegotiate any power purchase contracts, as contemplated by the Rate Agreement."

According to DWR, basing bond charges on power provided to each customer by DWR and the electrical corporations will provide the state with flexibility in determining the future structure of the retail electric market, and will assure investors that they will be paid debt service when due.

In its comments on the Draft Decision, DWR supports the Commission's adoption of the Draft Decision as quickly as possible so that appeals, if any, can be resolved promptly. DWR notes that one of the conditions to obtaining investment grade ratings for its bonds is that there be no unresolved litigation regarding the authority of DWR and the Commission to enter into the proposed Rate Agreement or the authority of the Commission to impose charges of the types described in the proposed Rate Agreement.

DWR states that it concurs in minor changes to the draft Rate Agreement. It suggests an additional change, substituting the word "shall" for "may" in the fourth line of Section 5.1(d) of the Rate Agreement. DWR states that one of the rating agencies requested this change, and DWR agrees that the language would then more accurately reflect the intent of the department.

DWR also notes that the Draft Decision indicates that the Commission will be authorizing its designee to approve certain changes to the terms included in the Summary of Material Terms submitted by DWR in accordance with Section 7.10 of the Rate Agreement. Since DWR will be seeking "A" ratings for its bonds, the agency urges that the Commission designee be given authority to approve final terms beyond those expressly permitted by the Summary of Terms. Specifically, DWR asks the Commission to authorize its designee to approve changes to the material terms included in the Summary determined by DWR to be necessary or appropriate to obtain ratings (including ratings in the "A" category) from each of the rating agencies.

To further support the Commission's discussion of the legal authority for the Rate Agreement and for those provisions that would have the force and effect of a financing order, DWR suggests an additional Conclusion of Law, as follows:

> "By authorizing the Commission and the Department to enter into agreements with respect to charges with the force and effect of a financing order adopted in accordance with Article 5.5 (commencing with Section 840) of Chapter 4 of Part 1 of Division 1 of the Public Utilities Code, the Legislature authorized the Commission to impose, and periodically adjust, for the recovery of costs incurred by the Department pursuant to AB 1X, charges which are nonbypassable to the extent determined by the Commission."

DWR states that certain modifications to the existing Servicing Agreements between it and the utilities will be necessary to implement the Rate Agreement and the Bond Charges. DWR asks that the Commission order the investor-owned utilities promptly to make the following modifications:

- Change the definition of "DWR Charge" to encompass the concepts of Bond Charges and Department Charges, as defined in the Rate Agreement, and revise other related definitions to reflect the Rate Agreement structure.
- Change Section 2.3 of the Servicing Agreements (and the related section of the PG&E Servicing Order) to clarify that the Bond Charges and Power Charges, whether based on the delivery of power by DWR or from some other source, are property of DWR.
- Change the term of the Servicing Agreements and the PG&E Servicing Order to 180 days after the later of (i) the date DWR stops selling power or (ii) the date charges stop being imposed under the Rate Agreement, including Bond Charges.
- Add provisions concerning the transition to the new rate structure.
- Expand the reporting by investor-owned utilities to include power provided by the utilities and (if the Commission later determines that

Bond Charges may be based upon power provided by Electric Service Providers) to such Electric Service Provider-furnished power.

- Expand the procedures for adjusting remittances upon the availability of final ISO settlement data for power provided by DWR to include adjustments for final data on power provided by the investor-owned utilities and, if applicable to power provided by Electric Service Providers.

B. Department of Finance

In its comments on the Draft Decision, the Department of Finance urges adoption of the proposed Rate Agreement on February 21, 2002, stating that prompt issuance of DWR bonds and repayment to the General Fund are "essential to enable the State to make commitments to continue funding its education, public safety and other priority programs at appropriate levels in these difficult economic times." The Department of Finance contends that the State of California has experienced a precipitous decline in revenues, attributable to the sharp drop in the stock market in 2001 and the resulting reversal of the surge in capital gains and stock options income. The Governor's 2002-04 Budget identifies a budget gap of $12.5 billion, according to the Department of Finance, and the cash flow forecast underlying the Governor's Budget assumes the General Fund repayment from the Electric Power Fund by June 2002. The Department also notes that effective date of the Rate Agreement may be affected by appeals or litigation brought forth by various parties. The Department states that repayment of the General Fund within the timeframe assumed by the Governor's budget is practicable only if the Commission holds to the current schedule and approves the proposed Rate Agreement on February 21, 2002.

C. Comments of (1) the Energy Producers and Users Coalition and (2) The California Industrial Users

In joint comments regarding the proposed Rate Agreement, the EPUC and CIU urge clarification of certain terms of the Rate Agreement, and they protest the shortened time in which this matter is being considered.

EPUC and CIU state that Section 7.4 of the Rate Agreement acknowledges the Commission's "exclusive authority" to spread DWR's revenue requirement among customer classes and service territories, but the Commission's authority to do so is limited by the Commission's obligations under the agreement. EPUC and CIU state that there is ambiguity in the Rate Agreement's definition of "Bond Charge" to include Electric Service Providers. But the definition of Electric Service Providers, according to these parties, is overbroad and would include any entity that generates electricity and delivers electricity to a consumer, including generators that had not taken delivery of DWR power and those that are not connected to the grid. EPUC and CIU would revise the definition of "Bond Charge" to exclude Electric Service Providers.

To the extent that the references to Electric Service Providers is intended to provide for payment of Bond Charges by Direct Access customers remaining in the program, EPUC/CIU urges the Commission to clarify that intent and tailor the language accordingly.

EPUC/CIU also raise concerns that the Rate Agreement determines the allocation of DWR costs among customer classes or to individual customers. EPUC/CIU's concern focuses primarily on the definition of Bond Charges which provides that the Commission shall impose a charge upon utility distribution company customers "based on the aggregate amount of electric power sold to that customer" by an Electrical Corporation, the Department or an Electric

Service Provider. According to EPUC/CIU, this definition binds the Commission to a particular rate design in setting Bond Charges. EPUC/CIU suggests tailoring the definition of Bond Charges to Water Code section 80104 which states: "Upon the delivery of power to them, the retail end use customers shall be deemed to have purchased that power from the department. Payment for any sale shall be a direct obligation of the retail end use customer to the department."

More broadly, EPUC and CIU object that the expedited review and comment period in this matter may violate due process and could delay issuance of bonds by the state. The parties note that the Rate Agreement was first provided to the public on January 31, 2002, and comments were required on February 5, 2002, three business days later. The schedule proposes another week for comments on a proposed decision, rather than the 20 days set forth in Rule 77 of the Rules of Practice and Procedure. The parties argue that citing emergency conditions for this shortened time is groundless in light of the procedural history of this case and the state's current circumstances. According to the parties, the Commission has had nearly a year to work out its agreement with DWR and has chosen to take its time at the cost of public review of its work product. EPUC and CIU state that if the changes they seek are not made, they reserve the right to seek additional time for notice, hearing and briefing on the allocation of DWR costs among customer classes and customers.

EPUC and CIU also urge the Commission to state that it will limit or extend the period for recovery of DWR costs if necessary to prevent rate shock or frequent increases. And they urge the Commission to require DWR to expressly determine that any cost for which recovery is sought is just and reasonable.

In its comments on the Draft Decision, EPUC urges (1) adoption of a formal Conclusion of Law that Power Charges may be recovered solely from Retail End Use Customers that actually receive the power for which Power Charge costs are incurred; and (2) clarification of the decision's reservation of rights to challenge in future proceedings the application of Bond Charges to power sold by Electric Service Providers.

EPUC notes that Water Code Section 80104 states that "[u]pon the delivery of power to them, the retail end use customers shall be deemed to have purchased that power from the department. Payment for any sale shall be a direct obligation of the retail end use customer to the department." In other words, EPUC states, Section 80104 establishes a direct relationship between DWR as seller and the consumer as purchaser, and the purchase obligation arises only "[u]pon the delivery of power" to the consumer. EPUC suggests the following Conclusion of Law to address the Draft Decision's conclusions on the "Legal Authority for Power Charges":

> "Water Code § 80104 applies to the development and imposition of Power Charges. Power Charges for power purchased by the DWR may be imposed only on retail end use customers that receive that power."

EPUC notes with approval the Draft Decision's statement that Bond Charges are not imposed on the power sold by Electric Service Providers, although the Commission may consider such charges in a future proceeding. According to EPUC, however, this provision may be undermined by the Draft Decision's conclusion that the Commission may impose Bond Charges on any customer regardless of whether or not that customer actually consumed the electricity that was financed with the Bond proceeds. (See, Conclusion of Law

30.) To correct this, EPUC proposes modifying the definition of "Bond Charge" as follows (with bracketed language deleted):

> "'Bond Charge' shall mean a charge imposed by the Commission, by order promulgated as a result of this Agreement, upon customers in each of the Service Areas of Pacific Gas & Electric, Southern California Edison Company, and San Diego Gas & Electric Company or any of their respective successors [based on the aggregate amount of electric power sold to that customer by an Electrical Corporation and the Department, and to the extent determined under Section 4.3 hereof, by an Electric Service Provider] consistent with the Act…"

According to EPUC, this change would make the Rate Agreement silent on the question of application of Bond Charges to Electric Service Providers and would remove the issue from controversy. According to EPUC, it also would provide for full development of the Electric Service Provider issues surrounding Bond Charges in future proceedings.

At a minimum, EPUC urges the Commission to clarify the scope of the reservation created in proposed Conclusion of Law 42. EPUC urges that the conclusion be revised as follows:

> "42. The Rate Agreement contemplates that the Commission may develop and impose Bond Charges on power sold to customers of Pacific Gas & Electric, Southern California Edison Company and San Diego Gas & Electric Company by ESPs to the extent consistent with the Act. Notwithstanding this decision's findings regarding the application of Bond Charges to current and future customers, today's decision does not determine the extent to which legal authority exists to support the imposition of such charges, nor does it impose Bond Charges, on the power sold by ESPs. The Commission may consider in a future proceeding whether the power sold by ESP's should be subject to Bond Charges, and if so, how to do

> it. If necessary, an evidentiary hearing will be held prior to the imposition of Bond Charges on the power sold by ESPs."

D. Foundation for Taxpayer and Consumer Rights

FTCR opposes the draft Rate Agreement, arguing that it will "reduce the PUC to nothing more than a rubber stamp for Governor Davis and his energy consultants at DWR." It charges that under the plan, DWR will be granted unprecedented powers to increase rates or continue unnecessarily high prices without public scrutiny.

Moreover, FTCR argues that the relevant sections of the governing statute (Water Code §§ 80110 and 80130) do not require the Commission to enter into the Rate Agreement. Instead, they state that the Commission "may" enter into an agreement with DWR with regard to collection power costs and "may" include an agreement as to collection of bond debt from ratepayers.

FTCR also objects to "the extremely shortened timeline for comments," stating that the abbreviated comment period denies the public full opportunity to absorb, investigate and respond to the proposed Rate Agreement.

E. JP Morgan

JP Morgan filed comments on the proposed Rate Agreement in its capacity as agent under the Credit and Security Agreement of June 26, 2001 among itself, DWR and various lenders. JP Morgan states that DWR received $4.3 billion in interim loans to enable DWR to continue purchasing electric power through the summer and fall months of 2001. Repayment was structured to provide for periodic interest rate increases as an incentive for prompt repayment. Accordingly, JP Morgan states, adoption of the Rate Agreement is a crucial step in issuance of DWR bonds, and it supports the adoption of the Rate Agreement in the form recently filed.

F. Pacific Gas and Electric Company

PG&E, while commenting that the draft Rate Agreement includes several improvements over prior drafts, argues that the agreement is still legally and financially flawed in at least two respects. Additionally, PG&E urges modifications of some of the definitions in the agreement. According to PG&E, the Rate Agreement is still flawed because:

(1.) It attempts to remove the independent authority of the Commission now and in the future to amend or modify the terms of the Rate Agreement and to review and approve increases and decreases in rates. In the past, PG&E states, the Commission has found that it is not permitted to bind itself or future Commissions regarding exercise of its regulatory authority. (*Re Pacific Gas and Electric Company (Diablo Canyon)* (1988) 30 CPUC2d 189, 223-225.) Moreover, PG&E argues that Water Code § 80110 does not exempt DWR from regulation under the Public Utilities Code, but expressly preserves the independent authority of the Commission under the Code. Finally, PG&E states that the draft Rate Agreement by its terms provides that only Sections 5.1(a) and (b), relating to recovery of DWR's Bond Charges, are to be irrevocable and have the force and effect of a "financing order" under Water Code § 80110. Thus, according to PG&E, "it does not make legal or policy sense for the CPUC to agree in the Draft Rate Agreement to preclude itself and future Commissions from making future changes in the agreement or DWR ratemaking which are unrelated to recovery of DWR's Bond Charges."

(2.) The Commission in PG&E's view is proposing to automatically adopt future changes in DWR's revenue requirement without providing sufficient due process, including prior notice and an opportunity for evidentiary hearings; access to DWR information, books and records; rights to audit DWR's accounts and expenditures; and the discovery available under Pub. Util. Code §§ 451, 454, 728 and 1708. PG&E argues that the draft Rate Agreement purports to bind PG&E, its customers and interested parties to the

automatic pass through of DWR's costs for at least 15 years, with no opportunity for public review or regulatory oversight. Again, PG&E states, AB 1X did not exempt DWR from public scrutiny but, rather, applied Pub. Util. Code § 451 to DWR's ratemaking through the express language of Water Code § 80110. PG&E notes that it has challenged in California Superior Court DWR's assertion that it is not required to comply with the California Administrative Procedure Act (APA) when it conducts its review of whether its costs are just and reasonable. PG&E urges the Commission to require DWR to conduct reasonableness proceedings in compliance with the APA.

In addition to these general comments, PG&E suggests revisions in a number of definitions contained in the Rate Agreement, specifically:

1. Definition of "Bond Related Costs." PG&E states that the definition is overbroad in that it could be construed to permit recovery of power or fuels-related costs under the sub-definition "caps, options and forward purchase agreements." PG&E would limit the sub-definition to "interest-related instruments."

2. Definition of "Department Costs." PG&E states that the definition appears to include Bond Related Costs not recovered from Bond Charges. Because the Commission has authority to adjust Bond Charges to recover Bond Related Costs in full, PG&E would clarify the definition to exclude such costs from "Department Costs" except under the limited circumstances where the Commission fails to adjust the Bond Charges. In addition, according to PG&E, losses incurred by DWR on sales of surplus power to third parties are not recoverable from retail end-use customers under Water Code § 80116 and should be excluded from the definition.

3. Definition of "Electric Service Provider." PG&E believes the definition has implications for identifying retail end-use customers who should pay their fair share of DWR charges. It states that the exclusion of "any other public agency" from the definition may create a loophole for avoidance of DWR charges. PG&E urges that the definition be made subject to amendment based on the outcome of the Commission's proceedings regarding the liability of Electric Service Provider customers.

4. Definition of "Operating Reserve Account." PG&E believes the definition should be clarified to state that the account will be funded from bond proceeds, and should specify what particular risks it is intended to cover.

5. Definition of "Priority Long Term Power Contracts." PG&E states that the definition should not include fuel contracts associated with dispatchable power contracts to the extent that DWR's decision to purchase such fuel is discretionary and not a legal obligation under the Priority Contracts.

In its comments on the Draft Decision, PG&E accuses the Commission of failing to respond to the earlier comments of it and other parties, and that this failure violates the due process requirements for reasoned decisionmaking under the Public Utilities Code and procedural due process standards. The utility states that, in its judgment, those provisions of the Rate Agreement that are not deemed to be a financing order are not binding on the Commission in the future. It states that AB 1x 1 does not purport to give the Commission the authority to enter into a binding rate agreement that is not a financing order.

Even the provisions of the Rate Agreement that relate directly to its financing order aspect present significant problems, according to PG&E. It states that currently, nearly all the significant defined terms are, in effect, undefined. This is because nearly all of the definitions directly or indirectly rely on "Financing Documents" that are not provided and apparently are not available in final form. According to the utility, this means either that (1) the definitions are so nebulous that the Rate Agreement is not ready for adoption, or (2) the definitions should be directly included in the Rate Agreement, and cross-references to non-existent Financing Documents should be eliminated.

PG&E notes that a prehearing conference has been set for February 22, 2002, to begin consideration of the extent to which direct access customers should pay a fee associated with the costs that DWR has incurred. The Draft Decision also states that the Commission intends to consider in a future

proceeding whether to impose Bond Charges on the power sold by Electric Service Providers. PG&E urges that the Commission include the Bond Charge issues in the direct access proceeding.

Finally, PG&E notes that two findings of fact and two conclusions of law purport to find that DWR's power purchases averted an economic "catastrophe" and have benefited all present and future ratepayers to an extent far in excess of the debt that DWR incurred. PG&E asserts that these findings and conclusions have no support in the record of this proceeding and should be deleted. The utility contends that these findings and conclusions are intended to undermine any effort by the Commission to exercise its independent authority to seek renegotiated changes to the price and non-price terms of DWR's existing power contracts and to seek regulatory changes to such contracts before the Federal Energy Regulatory Commission.

G. San Diego Gas & Electric Company

While suggesting one minor clarification, SDG&E supports the Rate Agreement, saying that it "conforms with SDG&E's understanding of the financial relationships among DWR, the customers it serves, and the utilities acting as billing and collection agents for DWR." According to the utility, the Rate Agreement makes it clear that the Commission must charge Retail End Use Customers the proper rates to recover the Power Charges and Bond Charges. At the same time, the utility states that the Commission cannot require SDG&E to remit funds to DWR for Retail Revenue Requirements that SDG&E has not recovered from Retail End Use Customers for identifiable Power Charges.

SDG&E would modify the definition of Electric Service Provider to make it clear that it does not eliminate the ability of SDG&E and other utilities to collect municipal surcharges, which would cause lost revenue to local governments.

SDG&E suggests modifying the definition to state that DWR may be considered an Electric Service Provider solely for the purpose of imposing the municipal surcharge pursuant to Pub. Util. Code §§ 6350-6354.

In its comments on the Draft Decision, SDG&E expresses support for the Draft Decision and urges the Commission to adopt it promptly. According to SDG&E, the decision "is well written and thorough; SDG&E has not identified any errors therein." The utility states that it has reviewed the minor changes made to the draft Rate Agreement and does not oppose them.

H. Southern California Edison Company

SCE also recommends modification of the definition of Electric Service Provider, but overall believes that the proposed agreement "is a vast improvement over the earlier versions." SCE states that many of the issues identified in the prior proposed agreement have been resolved.

However, SCE believes that the definition of Electric Service Provider creates a potential ambiguity that could create a loophole for some entities to escape their financial responsibility. The definition excludes the following entities from the definition of Electric Service Provider:

> "…the Department [DWR], any other public agency to the extent that it offers electrical service to customers within its jurisdiction or within the service territory of a local publicly owned electric utility, and Electrical Corporations."

SCE believes that the exclusion of "other public agencies" is so broad that many entities for which DWR purchased power and incurred debt could avoid their obligation to pay DWR charges. To correct this, SCE suggests that the exclusion be limited to those public agencies that served customers before the date DWR began its purchases. Thus, customers who were part of the utility

load when DWR began its procurement program would remain responsible for DWR charges, while customers of public agencies who were not part of the load DWR planned to serve would not be required to pay DWR charges. SCE suggests changing the definition to read "any other public agency to the extent that it offered, prior to January 17, 2001, electrical service…"

SCE also proposes that the term "local publicly owned electric utility" be defined as it is in Government Code § 9604. Otherwise, SCE believes, entities outside of that definition may seek to be excluded from their responsibility to pay DWR charges.

In its comments on the Draft Decision, SCE asserts that the definition of Energy Service Provider continues to be vague and is susceptible to abuse by entities seeking to avoid responsibility for paying DWR charges. SCE acknowledges that the Draft Decision accurately describes SCE's comments in an appendix. At the very least, the utility argues, the Commission's final decision should discuss the reasons why these changes are not made.

I. Sunrise Power Company, LLC

Sunrise suggests changes to the proposed Rate Agreement to clarify DWR's obligations under long-term power purchase contracts like the one between Sunrise and DWR for all of the electric output and capacity of Sunrise's facility in Kern County. To avoid potential conflict with the terms of the Sunrise-DWR contract, Sunrise proposes that references in Section 6.4 to "certain specified Department Costs" be revised to refer to costs incurred under the "Priority Long Term Power Contracts."

Sunrise also proposes that Section 4.2 be revised to provide that DWR's execution of long-term power purchase contracts is final and conclusive evidence

that DWR has conducted all just and reasonable determinations of the power purchase costs contained in those contracts.

Sunrise would also amend Article VI to require that "Power Charges" are given the force and effect of an irrevocable financing order, just as "Bond Charges" are in Section 5.1(c). Sunrise proposes that Section 5.1(d) be changed to use the phrase "Priority Long Term Power Contracts" in lieu of "certain specified Department Costs," and that the Commission's obligation to "respond" to any new revenue requirement or bond charge be changed to obligate the Commission to "calculate and impose" such charges.

J. The Utility Reform Network

TURN states that it is pleased to see that under the terms of the proposed Rate Agreement, DWR will provide and the Commission will review "material terms" in the Financing Documents. TURN states, "While the proposed Agreement currently does not allow for third party review of the 'material terms' of the Financing Documents, it at least requires disclosure by DWR to the Commission of this critical information." TURN renews its prior request that this information be released to third parties for review prior to approval, subject if necessary to an appropriate confidentiality agreement.

TURN believes that to comply with Water Code § 80110 and the referenced Pub. Util. Code § 451, DWR must conduct a public hearing and compile a record supporting its determination that power charges to be collected in rates are just and reasonable. According to TURN, assumption of the Commission's authority to make a "just and reasonable" determination under Section 451 carries the corresponding responsibility to conduct or participate in a public hearing. To make this clear, TURN would amend Section 4.2 to provide that, before including any cost in revenue requirements, DWR "will conduct or participate in

a public hearing and compile a record or provide record evidence supporting its determination" that such cost is just and reasonable.

Section 7.9 of the proposed Rate Agreement allows DWR to appoint banks or other private entities as Trustee. To ensure that a disinterested party is engaged in the process if a Trustee should replace DWR, TURN recommends that the State Treasurer be appointed as Co-trustee at the same time that the Trustee is appointed.

Noting that Section 7.10 refers to a Summary of "material terms" in the Financing Documents that has been submitted by DWR to the Commission, TURN urges that this information also be disclosed to the parties before the Rate Agreement is approved. TURN argues that disclosure is necessary "to enable an informed review of the proposed Agreement."

TURN also would amend Section 8.1 to clarify the definition of "event of default," correcting what it perceives to be conflicting language. In particular, TURN urges that events of default based upon DWR's actions or failure to take actions should be defined in the Rate Agreement.

Appendix B

Proclamation Issued by the Governor of the State of California on January 17, 2001

OFFICE OF THE GOVERNOR

PROCLAMATION by the Governor of the State of California

WHEREAS, shortages of electricity available to California's utilities have today resulted in blackouts affecting millions of Californians; and

WHEREAS, unanticipated and dramatic increases in the price of electricity have threatened the solvency of California's major public utilities, preventing them from continuing to acquire and provide electricity sufficient to meet California's energy needs; and

WHEREAS, the California Public Utilities Commission, the Independent Systems Operator and the Electricity Oversight Board have advised that the electricity presently available from California's utilities is insufficient to prevent widespread and prolonged disruption of electric service within California; and

WHEREAS, this energy shortage requires extraordinary measures beyond the authority vested in the California Public Utilities Commission; and

WHEREAS, the imminent threat of widespread and prolonged disruption of electrical power to California's emergency services, law enforcement, schools, hospitals, homes, businesses and agriculture constitutes a condition of extreme peril to the safety of persons and property within the state which, by reason of its magnitude, is likely to be beyond the control of the services, personnel, equipment, and facilities of any single county or city; and

WHEREAS, under the provisions of Section 8558(b) of the California Government Code, I find that an emergency exists;

NOW, THEREFORE, I, GRAY DAVIS, Governor of the State of California, in accordance with the authority vested in me by the California Emergency Services Act, and in particular, Section 8625 of the California Government Code,

HEREBY PROCLAIM A STATE OF EMERGENCY to exist within the State of California; and

IT IS ORDERED that all agencies of the state government utilize and employ State personnel, equipment and facilities for the performance of any and all activities to alleviate this emergency.

IT IS FURTHER ORDERED that the Department of Water Resources, separate and apart from its powers and responsibilities with respect to the State Water Resources Development System, shall enter into contracts and arrangements for the purchase and sale of electric power with public and private entities and individuals as may be necessary to assist in mitigating the effects of this emergency. The Department is hereby directed to enter into these contracts as expeditiously as possible and is hereby authorized to do so notwithstanding the provisions of the Government Code and the Public Contract Code applicable to state contracts, including but not limited to, advertising and competitive bidding requirements, which provisions are suspended pursuant to Government Code section 8571 to the extent that they would prevent, hinder or delay the prompt mitigation of the effects of this emergency. The Department is further directed to maintain as separate and distinct the obligations incurred and the funding of such contracts and arrangements from the funds, monies and obligations of the State Water Resources Development System.

I FURTHER DIRECT that as soon as hereafter possible, this proclamation be filed in the Office of the Secretary of State and that widespread publicity and notice be given to this proclamation.

IN WITNESS WHEREOF I have hereunto set my hand and caused the Great Seal of the State of California to be affixed this 17th day of January 2001.

Governor of California

ATTEST:

Secretary of State

Appendix C

Adopted Rate Agreement

A.00-11-038 et al.
D.02-02-051

Commissioner Henry M. Duque dissenting:

Today's decision is momentous for this Commission. The State's coffers are rapidly being emptied. The DWR bond measure is at $10 billion dollars, an historic figure. We are told that DWR's ability to issue bonds depends on our prompt approval of the rate agreement.

Once again I am told that we must vote. Once again I must decry the lack of meaningful opportunity for public review and comment on today's complex decision. The rate agreement was provided to the parties on January 31st and comments were due on February 5th, just three business days later. Yet the parties only received the summary of its material terms by email on Saturday, February 16th. It is difficult, if not impossible, to understand the rate agreement without that summary. Reply comments were then due one business day later, after a holiday, on February 19th. Substantive changes to the rate agreement arrived late Wednesday and were made public only one hour before the meeting. We have had almost a year to finalize a rate agreement and chose to take our time at the expense of public review and comment.

The rate agreement does include several improvements over the prior rate agreement. I appreciate that DWR and the Commission have moved a very long way. However, the rate agreement still perpetuates many bad governmental policies that have been set in motion. I do not believe that the rate agreement is a fair, reasonable or legally solid framework for implementing AB1X. AB1X does <u>not</u> require that the Commission enter into an agreement with DWR. Rather, AB1X only requires that the Commission allow DWR to recover its costs. The rate agreement goes further. It allows DWR to circumvent a public process on its revenue requirement, a process now called into question by a recent superior court ruling. There is no provision for the parties to have notice, discovery, or hearings regarding DWR's revenue requirement requests. More importantly, there is no one to represent the interests of the ratepayers. The rate agreement instead allows DWR to act as its own judge and jury over critical rate matters.

The rate agreement is a blank check to DWR to pay for all power purchases no matter how imprudent. Our decision even includes findings that it was necessary and reasonable for DWR to incur billions of dollars of debt. This is despite the egregious lack of record evidence. DWR should be at risk for over-contracting, not the utilities or the ratepayers. Nothing in AB1X contemplates the comprehensive dismantling of the Commission's oversight functions as set forth in the rate agreement.

The rate agreement also removes the independent authority of the Commission now and in the future to amend the rate agreement. It does not make sense for the Commission to preclude itself and future Commissions from making changes to the rate agreement or DWR ratemaking, which are unrelated to the recovery of bond charges.

Finally, I think it is quite telling that ordering paragraph 2 only has those Commissioners who voted for the rate agreement sign on behalf of the Commission. You will not find my name on the dotted line.

For these reasons, I must dissent.

Henry M. Duque

Commissioner

February 21, 2002

San Francisco, California

A.00-11-038 et al.
D.02-02-051

Commissioner Richard A. Bilas, concurring:

I do not vote for the rate agreement because it is necessarily good public policy, or because it makes perfect sense. I vote for the rate agreement because there is simply no other option.

I am reminded of the story about the woman living in depression-ravaged New York City during the 1930's. She was living in a beautifully furnished mansion. Unfortunately, because of the stock market crash, she had lost all of her cash and was now penniless. Still, she was surrounded by opulent furnishings. When winter came, she took axe in hand and broke grand pianos, Louis IV chairs, and other antiques into firewood so she wouldn't freeze. Did her actions make perfect sense? No. Could she turn back the clock and make different decisions? No. Did she have any other alternative? No.

Like the poor widow in the story, the Commission is in a similar situation. The State of California is facing a deficit of billions of dollars. We are on the verge of bankruptcy unless we find a way to pay our energy bills with this rate agreement. This decision is not about what we could have done to prevent the catastrophic events related to electric restructuring and some of the delayed reactions that exacerbated the energy crisis of last year. Those events are done. Hand-wringing and finger-pointing at this point in time do not make the state deficit go away.

The rate agreement is not the best option we have before us, it is the only option. Draconian cuts in the state budget that could reduce essential human services are not a realistic option.

There are several items in the decision that I would like to discuss.

First, is Ordering Paragraph 2, which says, "The Commissioners who voted to approve the Rate Agreement shall sign the adopted Rate Agreement on behalf of the Commission." When an order of the Commission has a majority vote, it is binding on the whole Commission. Signing the Rate Agreement does not mean a Commissioner necessarily agrees with the Rate Agreement. It only means that the Rate Agreement was adopted by the majority of the Commission. The vote on the original order is what counts. Concurrences or dissents of any Commissioner will always be a part of the record.

I cannot recall ever seeing such an ordering paragraph in a Commission decision.

Second, we are delegating to the General Counsel the responsibility to ensure that the Financing Documents comply with the Summary of Material Terms. I fully expect the General Counsel to approach this task with a very narrow construct and to err on the side of caution. If there is the least doubt that a change is outside the Material Terms, the General Counsel should bring the matter back to the Commission for a decision.

Third, we received a letter today from the Department of Water Resources that addresses that agency's revenue requirement for power purchases to be allocated among Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company. We will be voting on that issue in another docket at today's meeting. The good news is that the DWR is giving us a lower revenue requirement that we need to allocate among the three utilities. The bad news is that the Bond Amount will have to be raised in this docket. The dicta in this order speaks eloquently about the precedent for requiring future ratepayers to pay off the need for bonds caused by current ratepayers. The rationale for adopting a ratemaking mechanism with inter-temporal inequities should be exercised infrequently and with great care. The immediate purpose of the "use now, pay later" ratemaking mechanism is the creation of a stream of revenue over time that may be sold, with the proceeds of the sale being used to defray current costs. The new purpose appears to make sure that current rates do not increase, even at the expense of future ratepayers. The transparent efforts to ensure that rates for the utilities do not have to be raised, even to the extent we defer more costs to the future during an election year is obvious.

Finally, the issue of whether to impose Bond Charges on the power sold by the Electric Service Providers is put off to another proceeding. I take that statement at face value. There should be no prejudging this issue.

With these reservations, I support this decision.

/s/ RICHARD A. BILAS
RICHARD A. BILAS
Commissioner

San Francisco, California
February 21, 2002