STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

December 5, 2002

Agenda ID # 1507
Alternate to Agenda ID # 1408

TO: PARTIES OF RECORD IN APPLICATION # 01-06-039.

Enclosed is the Alternate Draft Decision of Commissioner Brown to the Draft Decision of Administrative Law Judge (ALJ) Wong previously mailed to you.

When the Commission acts on the draft or alternate decision, it may adopt all or part of it as written, amend or modify it, or set aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Public Utilities Code Section 311(e) requires that an alternate to a draft decision be served on all parties, and be subject to public review and comment prior to a vote of the Commission. Rule 77.6(d) provides that comments on the alternate draft decision be filed at least seven days before the Commission meeting.

Please note that the alternate decision makes only one change to the ALJ's draft decision; a footnote is added near the beginning of the discussion section. Also note that the attachments to the draft decision are also applicable to this alternate decision.

Comments on the alternate decision must be filed and served Thursday, December 12, 2002. Reply comments must be filed and served by Tuesday, December 17, 2002.

Pursuant to Rule 77.3 comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ CAROL A. BROWN
Carol A. Brown, Interim Chief
Administrative Law Judge

CAB:vfw

Attachment

Decision **ALTERNATE DRAFT DECISION OF COMMISSIONER BROWN**
(Mailed 12/05/2002)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) for Expedited Approval of Servicing Agreement between State of California Department of Water Resources and Southern California Edison Company Pursuant to Chapter 4 of the Statutes of 2001 (Assembly Bill 1 of the First 2000-2002 Extraordinary Session).	Application 01-06-044 (Filed June 25, 2001)

OPINION APPROVING THE 2003 SERVICING ORDER CONCERNING SOUTHERN CALIFORNIA EDISON COMPANY AND THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

Summary

On October 8, 2002, the California Department of Water Resources (DWR) submitted to this Commission a memorandum and proposed modifications to the "First Amended and Restated Servicing Agreement" (Amended Servicing Agreement) between DWR and Southern California Edison Company (SCE).[1] DWR's submission was made in response to D.02-09-053 (the "Contract Allocation Decision"), which directed DWR and SCE to negotiate appropriate modifications to the Amended Servicing Agreement as a result of the allocation

[1] The Amended Servicing Agreement was previously approved by the Commission in Decision (D.) 02-04-047.

of energy from, and operational responsibility for, DWR's electricity contracts to SCE and the other two large electric utilities.

Today's decision approves a modified version of DWR's proposed modifications, which we have labeled as the "2003 Servicing Order Concerning State of California Department of Water Resources And Southern California Edison Company" (Servicing Order). Because the changes that DWR proposed, and that we here approve with modifications, were not agreed to by SCE, we are constrained to issue a Servicing Order rather than approve a Servicing Agreement. Appendix A of this decision contains a marked version of the revisions to the Servicing Order that we approve today. SCE is ordered to comply with the terms and conditions of the Servicing Order. The Servicing Order sets forth the terms and conditions under which SCE will provide the transmission and distribution of DWR-purchased electricity, as well as billing, collection, and related services on behalf of DWR. The Servicing Order also addresses DWR's compensation to SCE for providing those services.

Today's Servicing Order is needed because DWR and SCE have been unable to negotiate a mutually agreeable servicing arrangement. Due to the upcoming date when SCE is to assume operational control of the DWR contracts allocated to it, a Servicing Order needs to be put into place prior to year's end.

Background

In January 2001, in response to the energy crisis facing California, the Legislature gave DWR the authority to purchase electricity and sell it to the retail customers of California's electric utilities. This authority was provided for in Assembly Bill 1 of the First Extraordinary Session of 2001-2002 (Stats. 2001, Ch. 4) (AB X1).

In March 2001, the Commission ordered SCE to segregate, and hold in trust for the benefit of DWR, certain amounts its customers had paid for DWR's

electricity. (D.01-03-081.) This arrangement was formalized in the "Servicing Agreement Between State of California Department of Water Resources and Southern California Edison Company," which was approved by the Commission with certain modifications in D.01-09-014.

As a result of D.01-09-014, D.02-02-051, and D.02-02-052,[2] SCE and DWR discussed and negotiated amendments and restatements to the Servicing Agreement. These changes were reflected in the Amended Servicing Agreement, which the two parties signed on March 29, 2002. Subsequently, SCE sought Commission approval of the Amended Servicing Agreement by filing a petition for modification of D.01-09-014. The Commission granted SCE's petition and approved the Amended Servicing Agreement in D.02-04-047.

In D.02-07-039, the Commission approved SCE's second petition to modify D.01-09-014. This petition sought Commission approval of "Amendment No. 1" to the Amended Servicing Agreement.[3] Thus, prior to today's decision, the existing servicing arrangements between SCE and DWR are composed of the Amended Servicing Agreement and Amendment No. 1.

Under AB X1, DWR's authority to contract for electricity purchases expires on January 1, 2003. (Water Code § 80260.) Rulemaking (R.) 01-10-024 was initiated by the Commission to allow the electric utilities to resume the responsibility of procuring electricity for their customers. In D.02-09-053, the Commission ordered SCE, and the other two large electric utilities, to assume all

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[2] D.02-02-051 adopted the Rate Agreement between DWR and the Commission, and D.02-02-052 allocated DWR's 2001-2002 revenue requirement among the customers in the utilities' service territories in California.

[3] Amendment No. 1 implemented the 2002 20/20 Program for energy conservation, and provides for the bond charge to appear as a separate line item on a consolidated utility bill.

of the operational, dispatch, and administrative functions for the electricity contracts that DWR had entered into, effective January 1, 2003. D.02-09-053 also allocated the DWR contracts to the resource portfolios of the three utilities, who are to schedule and dispatch the contracts in a least-cost manner.

As a result of the assumption of the operational duties for the DWR contracts, the Contract Allocation Decision recognized that the "servicing arrangements" that DWR had entered into with SCE, would need to be altered. (D.02-09-053, pp. 15, 59.) In Ordering Paragraph 3 of D.02-09-053, DWR and SCE were directed to negotiate appropriate modifications to their servicing arrangements, and DWR was directed to "submit its proposed modifications" by October 1, 2002. DWR and the three electric utilities were also directed to jointly file proposed operational agreements and proposed standards for reasonableness review by October 1, 2002.

The three utilities requested an extension of the submission date for the proposed modifications to the servicing arrangements and proposed operational agreements. The Commission's Executive Director, in a letter dated September 27, 2002, granted an extension of one week, to October 8, 2002.

In response to the submissions ordered in D.02-09-053, on October 8, 2002, DWR electronically transmitted to the Commission, and to the service list, a memorandum from Peter Garris of DWR, along with the proposed modifications to the existing servicing arrangements for SCE, and the other two utilities.[4] The document containing DWR's proposed modifications to SCE's servicing arrangements is labeled "2003 Servicing Agreement Between State of California Department of Water Resources And Southern California Edison Company."

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[4] DWR also submitted the proposed operating agreement and related attachments.

DWR also transmitted two other documents, one which contains Attachments A through I[5] of the Servicing Order, and the other which contains Attachment J of the Servicing Order.

Due to the earlier extension by the Executive Director, the assigned administrative law judge (ALJ) issued a ruling on October 10, 2002, allowing interested parties additional time to submit comments on the proposed modifications to SCE's servicing arrangements, and reply comments. SCE filed comments and reply comments on October 18, 2002 and October 23, 2002, respectively.[6] On October 23, 2002, DWR transmitted a memorandum entitled "Comments Concerning Submissions Requested by the California Public Utilities Commission Decision 02-09-053."

Summary of Proposed Modifications to the Amended Servicing Agreement

The proposed modifications to the Amended Servicing Agreement and related attachments have been compared to the Amended Servicing Agreement that was approved in D.02-04-047, and to Amendment No. 1 approved in D.02-07-039. In addition, the proposed modifications have been reviewed in light of the Contract Allocation Decision. Appendix A of this decision reflects the proposed modifications to the Amended Servicing Agreement through the use of underlining and strikeout markings.

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[5] The Letter Agreement to Attachment I, dated February 28, 2002 and as amended by the letter dated March 18, 2002, was not included in the transmittal.

[6] SCE's comments and reply comments also addressed the proposed operating agreement, and were filed in this proceeding and in R.01-10-024.

- The proposed modifications fall into the following categories:

- Definitions and requirements relating to the DWR contracts allocated to SCE in the Contract Allocation Decision.

- Definitions and requirements relating to the surplus energy sales and remittances that SCE will be responsible for.

- Definitions and requirements relating to the Operating Order.

- Incorporation of Amendment No. 1 into the modified version of the Amended Servicing Agreement.

- Certain attachments to be provided by SCE in Service Attachment 2.

- Incorporation of Attachment F, approved in D.02-07-039, into the modified version of the Amended Servicing Agreement.

In addition to the proposed modifications, additional changes have been made to the Amended Servicing Agreement and the related attachments. These additional changes are described in the discussion section below, and also reflect that SCE is being ordered to provide the services in accordance with the attached Servicing Order and that an Operating Order is expected to be approved, rather than an Operating Agreement.

Position of the Parties

A. DWR

According to DWR's October 8, 2002 memorandum, DWR distributed the proposed modifications to SCE's servicing arrangements on October 3 and 4, 2002. As of October 8, 2002, DWR was unable to ascertain whether the proposed modifications were acceptable to SCE.

DWR has proposed modifying the Amended Servicing Agreement by making certain changes to the accounting and reporting procedures. According to DWR, these changes are found in Attachments C and J of the Servicing Order. Parallel accounting and reporting provisions are contained in Exhibits C and F of the Operating Order. DWR states that these accounting and reporting procedures are consistent with the policy set forth in the Contract Allocation Decision.

In its October 23, 2002 memorandum, DWR noted that, consistent with AB X1 and the Contract Allocation Decision, that it would still be subject to continuing obligations with respect to the DWR contracts. In particular, these obligations include:

- Servicing the bonds as issuer;
- Managing legal and financial obligations under its long-term contracts;
- Ensuring the integrity of its revenues; and
- Fulfilling its substantial reporting obligations associated with the above.

DWR states that it is working to ensure that there is an efficient and timely transition to the utilities of the operational functions of the DWR contracts, while ensuring that DWR is able to fulfill its continuing obligations. To accomplish this goal:

> "DWR believes that certain principles and arrangements must be established regarding utilities' performance of certain functions under the allocated DWR long-term contracts on behalf of DWR. The operating agreement is a compilation of such principles and arrangements that DWR believes are necessary to achieve these goals.

…

"In preparing the operating agreement, DWR's objective has been to minimize DWR's involvement in the utilities' operation of the integrated portfolio, consisting of utility and allocated DWR contract resources, and to allow the utilities to make substantially all the operating decisions. The operating agreement is intended to provide appropriate mechanisms that allow the utilities to optimize the use of the integrated portfolio of resources on a service territory basis…. After the operational transition, DWR will continue to be legally and financially responsible for the direct costs under the allocated DWR long-term contracts, including gas-related costs. As a result, DWR needs to receive timely reporting of data outlined in Exhibit F of the operating agreement.

"To implement checks and balances while operating the integrated portfolio, DWR has proposed certain accounting and revenue sharing principles in Exhibit C of the operating agreement. DWR believes that the proposed accounting and revenue sharing principles provide greater certainty of revenues and cash flows to the utilities and DWR and, accordingly, aid the utilities in their quest for creditworthy status. Finally, DWR believes that the pro rata revenue-sharing methodology articulated in the Contract Allocation Decision and further reflected in DWR's accounting and revenue sharing principles results in an equitable sharing of risk and reward. The information and data being requested under Exhibit F of the operating agreement are to facilitate DWR's verification of the utilities' remittances to DWR and costs incurred under the allocated contracts rather than to conduct an operational review of the utilities decisions.

"At this time, DWR does not believe that there is a consensus on the accounting and revenue sharing principles proposed by DWR. … The resolution of the issues related to the accounting and revenue sharing principles will require a significant shift from the existing remittance policy and DWR believes that such a policy implementation can only be

achieved with the Commission's support and active involvement." (DWR October 23, 2002 Memorandum, pp. 1-2.)

B. SCE

A review of SCE's comments to the proposed modifications to the Amended Servicing Agreement and related attachments disclose seven different concerns, which fall into the following categories:

- Although DWR and the utilities have engaged in numerous negotiations, they have been unable to reach a consensus on the scope or the specific language of the proposed modifications.

- The proposed modifications to the Amended Servicing Agreement are duplicative of some of the provisions in the proposed Operating Agreement. SCE believes that the provisions relating to the mutual financial obligations of SCE and DWR should remain in the servicing agreement, and that the Operating Agreement should be limited to defining the nature of SCE's use of the generating assets allocated to it, and the mutual duties and obligations of the parties arising from that use.

- SCE is concerned that a broad agency relationship may be created, instead of an agency relationship which is specifically limited in its duties and obligations. The broadening of the relationship could be interpreted to allow DWR to micromanage SCE's use of the generation resources, or to direct the appearance of SCE's customer bills.

- SCE is concerned that the proposed modifications to the Amended Servicing Agreement and attachments is that DWR is given a priority to the revenues in preference to SCE resources.

- SCE believes that a mechanism should be established to allow each utility to allocate and track costs on a monthly basis as a result of the DWR contracts that have been allocated to each utility. A triggering mechanism should also apply in the event an adjustment to the forecasted revenue requirement is needed because of an over or under forecast. Once such mechanisms are developed, they should be reflected in the servicing agreement.

- SCE does not believe that it should be required to post collateral or collateral-like instruments in connection with its administration of the DWR contracts.

- SCE should not be exposed to, or assume any additional risk, with respect to the DWR contracts. That is, from a risk and liability standpoint, SCE should not be in any worse position than DWR was prior to the adoption of the Servicing Order.

As part of SCE's comments and reply comments, SCE appended its proposed modifications to the Amended Servicing Agreement and attachments.

Discussion

In deciding whether we should approve the proposed modifications to the Amended Servicing Agreement and related attachments, the Commission is mindful of the course of action we have taken in R.01-10-024 and in D.02-09-053. One of the goals of R.01-10-024 is to allow the utilities "to resume purchasing electric energy, capacity, ancillary services and related hedging instruments to fulfill their obligation to serve and meet the needs of their customers." (R.01-10-024, p. 1.)

In order for SCE and the other utilities to undertake the operational responsibilities associated with the allocated DWR contracts beginning on January 1, 2003, certain operational arrangements and servicing arrangements need to be in place. With less than one month to go before the utilities are to take

over the operational responsibilities for the DWR contracts, DWR and SCE have been unable to agree on a mutually acceptable servicing arrangement. To ensure a seamless transition of the DWR contracts allocated to SCE, while ensuring that DWR's legal and financial responsibilities for the DWR contracts continue to be fulfilled, it is imperative that servicing arrangements be in place before the end of 2002.

D.02-09-053 also required DWR to submit proposed operational agreements. As noted in the positions of the parties, certain provisions of the proposed operational agreement that DWR submitted may affect certain provisions of the proposed modifications to the Amended Servicing Agreement and the related attachments. The proposed operating agreement is being considered by the Commission in R.01-10-024. Since DWR and the utilities have been unable to mutually agree on a proposed operational agreement, the Commission will consider concurrently adopting an Operating Order when a Servicing Order for SCE is adopted.

We now turn to SCE's concerns with the proposed modifications to the Amended Servicing Agreement.[7] As part of this review, we compared SCE's proposed modifications to the proposed modifications suggested by DWR.

SCE's proposed modifications to the Amended Servicing Agreement would delete the use of the phrase "or is deemed to have provided" in section 1.51 of the Amended Servicing Agreement. SCE does not believe that DWR's concept of "deemed delivery" is consistent with D.02-09-053 because it would set up a priority for DWR power to serve load over any other power.

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[7] If there are inconsistencies between the Operating Order draft decision and this Servicing Order draft decision, parties may delineate such differences in their comments on this draft decision, including any recommendations for reconciliation between the draft Orders.

SDG&E, in its comments to the proposed modifications to SDG&E's servicing agreement, raised a similar concern.

We agree with SCE. The use of the phrase could be interpreted to mean that DWR power has a priority over any other power. We will delete the phrase in section 1.51. of the Servicing Order.

SCE seeks to remove from the servicing agreement most of the references to the proposed Operating Agreement. SCE contends that the servicing agreement should be able to stand alone with an Operating Agreement, and that any provisions relating to settlements and remittances, including the calculation of DWR revenues resulting from surplus energy sales, should be in the servicing agreement and not in the Operating Agreement. SCE proposes that Exhibit D of the proposed Operating Agreement should be included in the Servicing Order as part of Attachment J. SCE also proposes that Exhibit C of the proposed Operating Agreement should be included in the Servicing Order as part of Attachments H and J.

We decline to adopt SCE's proposal to remove the references to the Operating Agreement or Operating Order from the Servicing Order, and to incorporate Exhibits C and D of the proposed Operating Agreement into the Servicing Order. The provisions of the proposed Operating Agreement are being examined separately in R.01-10-024. It is premature at this point to remove the references to the Operating Order from the Servicing Order or to incorporate Exhibits C and D of the proposed Operating Agreement into the Servicing Order.

SCE seeks to delete section 2.2.(b) from the Amended Servicing Agreement. SCE notes that this section will need to be updated with the scheduling procedures that are effective on January 1, 2003. We will not delete section 2.2.(b) at this time. DWR and SCE should discuss how this section should be updated.

SCE has raised concerns about the costs associated with credit risk management and the incremental costs associated with the sales of surplus energy.

We will accept DWR's proposed modification to sections 3.1(c) and 3.1(d) of the Servicing Order. This is consistent with the Commission's goal of reducing the utilities' reliance on the use of state resources. We will not adopt SCE's recommendation to add an additional sentence about the recovery of costs to section 3.5 of the Servicing Order.

SCE proposes to remove section 10.(b), the reference to DWR and SCE agreeing to negotiate changes to the Servicing Order if the rating agencies request changes to the Servicing Order. We decline to adopt SCE's proposal because it could have an impact on DWR's bonds.

SCE also seeks to add a section to the Servicing Order regarding "Dispute Resolution." Given the current inability of DWR and SCE to reach a mutually agreeable servicing agreement, the addition of such a section would not be realistic at this time.

SCE proposes to delete section 2.2.(d) of Service Attachment 1. This section was approved in D.02-07-039 as part of Amendment No. 1 at the request of SCE. We see no need to remove it from this attachment.

SCE has questioned the need for the information that DWR seeks in Service Attachment 2. SCE states that DWR expects the utilities to prepare this attachment, but little or no discussion about this attachment has occurred. DWR's October 8, 2002 submission only included the one page "Service Attachment 2," which described the "Title" of seven sections. DWR's Service Attachment 2 also notes that this is "To be provided by Utility." We will retain the Service Attachment 2 page as part of the Servicing Order, with the

understanding that DWR and SCE will need to discuss what kind of information DWR wants from SCE.

The majority of the proposed modifications to the Amended Servicing Agreement reflect the actions taken in the Contract Allocation Decision, and are also linked to the proposed Operating Agreement. All of the proposed modifications, as shown in the attached Servicing Order and as discussed above, are consistent with the directives ordered in D.01-09-014, D.02-02-051, D.02-02-052, and D.02-09-053.

Since DWR and SCE have been unable to timely agree on a mutually acceptable modified Amended Servicing Agreement, we have further modified DWR's proposed modifications to the Amended Servicing Agreement to turn the document into a Servicing Order. The marked version of the Servicing Order, which is attached to this decision as Appendix A, is approved.[8] SCE shall be directed to comply with the terms and conditions of the attached Servicing Order.

We note that today's approval of the Servicing Order does not prevent DWR and SCE from negotiating a mutually agreeable modified servicing agreement in the future and bringing such an agreement to us for approval. However, due to the approaching deadline for when SCE is to take over the operational aspects of the DWR contracts allocated to SCE, the attached Servicing Order is needed so that the operational transition for the DWR contracts can proceed smoothly.

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[8] Given the time constraints, we were unable to generate a "clean"copy (i.e., without the revision marks) of the Servicing Order from DWR's October 8, 2002 transmittal. DWR's transmittal contained underlining and strikeout marks that were already embedded in the document.

Rehearing and Judicial Review

This decision construes, applies, implements, and interprets the provisions of AB X1. Pursuant to Public Utilities Code § 1731(c) any application for rehearing of this decision must be filed within 10 days of the date of issuance of this decision, and the provisions of Public Utilities Code § 1768 are applicable to any judicial review of this decision.

Comments on Draft Decision

Pursuant to Public Utilities Code §311(g)(1) and Rule 77.7 of the Commission's Rules of Practice and Procedure, the draft decision of the ALJ was mailed to the parties on November 19, 2002. In accordance with Rule 77.7(b) and Rules 77.2 and 77.5, comments to the draft decision shall be filed with the Commission's Docket Office within 20 days from the date of mailing, and any reply comments shall be filed five days after the opening comments are filed.

Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and John S. Wong is the assigned ALJ in this proceeding.

Findings of Fact

1. In response to D.02-09-053, on October 8, 2002, DWR submitted a memorandum and its proposed modifications to the Amended Servicing Agreement.

2. Prior to today's decision, the existing servicing arrangement between DWR and SCE are composed of the Amended Servicing Agreement and Amendment No. 1.

3. D.02-09-053 allocated the DWR contracts, and ordered SCE and the other two large electric utilities, to assume all of the operational, dispatch, and administrative functions for the allocated electricity contracts, effective January 1, 2003.

4. The proposed modifications to the Amended Servicing Agreement and related attachments have been compared to the Amended Servicing Agreement that was approved in D.02-04-047, to Amendment No. 1 approved in D.02-07-039, and have been reviewed in light of the Contract Allocation Decision.

5. One of the goals of R.01-10-024 is to allow the utilities to resume purchasing electric energy, capacity, ancillary services and related hedging instruments to fulfill their obligation to serve and meet the needs of their customers.

6. In order for SCE and the other utilities to undertake the operational responsibilities associated with the allocated DWR contracts beginning on January 1, 2003, certain operational arrangements and servicing arrangements need to be in place before that date.

7. Certain provisions of the proposed operating agreement may affect certain provisions of the proposed modifications to the Amended Servicing Agreement and related attachments.

8. The proposed operational agreement is being considered by the Commission in R.01-10-024.

9. The concerns of SCE over the proposed modifications to the Amended Servicing Agreement and related attachments have been reviewed and considered, and appropriate changes have been made as discussed in this decision.

10. Notwithstanding today's approval of the Servicing Order, DWR and SCE are free to submit a mutually agreeable modified servicing agreement for our approval.

Conclusions of Law

1. All of the proposed modifications to the Amended Servicing Agreement and the related attachments are consistent with the directives ordered in prior Commission decisions.

2. Since DWR and SCE have been unable to timely agree on a mutually acceptable modified Amended Servicing Agreement, the Commission has made additional modifications to convert the modified Amended Servicing Agreement into a Servicing Order.

3. The Servicing Order attached to this decision should be approved.

4. SCE should be directed to comply with the terms and conditions contained in the approved Servicing Order.

O R D E R

IT IS ORDERED that:

1. The "2003 Servicing Order Concerning State of California Department of Water Resources And Southern California Edison Company" (Servicing Order), a copy of which is attached hereto as Appendix A and which contains the revision marks, is approved.

2. Southern California Edison Company shall comply with all of the terms and conditions of the approved Servicing Order.

3. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Alternate Draft Decision of Commissioner Brown on all parties of record in this proceeding or their attorneys of record.

Dated December 5, 2002, at San Francisco, California.

/s/ VANA WHITE
Vana White

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.