STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

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

July 14, 2004 Agenda ID #3727

TO: PARTIES OF RECORD IN APPLICATION 03-12-010

This is the proposed decision of Administrative Law Judge (ALJ) Galvin, previously designated as the principal hearing officer in this proceeding. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. This matter was categorized as ratesetting and is subject to Pub. Util. Code § 1701.3(c). Pursuant to Resolution ALJ-180 a Ratesetting Deliberative Meeting to consider this matter may be held upon the request of any Commissioner. If that occurs, the Commission will prepare and mail an agenda for the Ratesetting Deliberative Meeting 10 days before hand, and will advise the parties of this fact, and of the related ex parte communications prohibition period.

The Commission may act at the regular meeting, or it may postpone action until later. If action is postponed, the Commission will announce whether and when there will be a further prohibition on communications.

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

Parties to the proceeding may file comments on the proposed decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening 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/ ANGELA K. MINKIN by PSW
Angela K. Minkin, Chief
Administrative Law Judge

ANG:tcg

Decision **PROPOSED DECISION OF ALJ GALVIN** (Mailed 7/14/2004)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902 E) for a Finding of Prudence Regarding its Power Procurement Activities, and for Approval of Expenses Recorded to the Electric Resource Recovery Account.	Application 03-12-010 (Filed December 1, 2003)

Jeffrey M. Parrott, Attorney at Law, and Gina M. Dixon, for San Diego Gas & Electric Company, applicant.
Regina DeAngelis, Attorney at Law, for the Office of Ratepayer Advocates.

OPINION ON THE REASONABLENESS AND PRUDENCE OF SAN DIEGO GAS & ELECTRIC COMPANY'S ENERGY RESOURCE RECOVERY ACCOUNT

I. Summary

We find that San Diego Gas & Electric Company's (SDG&E) administration of power purchase agreements and procurement of least-cost dispatch power activities for the period beginning January 1, 2003 and ending September 30, 2003 were reasonable and prudent. We also find that SDG&E's $83.3 million Energy Resource Recovery Account (ERRA) overcollected balance at September 30, 2003 and its procurement-related revenue and expenses recorded in its ERRA from January 1, 2003 through September 30, 2003 were reasonable and prudent.

II. Background

Decision (D.) 02-10-062 established an ERRA balancing account for the major energy utilities to track fuel and purchased power revenues against actual recorded costs. That decision also required the major energy utilities to establish a fuel and purchased power revenue requirement forecast, a trigger mechanism, and a schedule for semiannual ERRA proceedings.

Subsequently, D.02-12-074 modified and clarified the cost recovery mechanisms adopted in D.02-10-062. That decision established a June 1 and December 1 semiannual ERRA application schedule for SDG&E. June 1 applications are to address SDG&E's energy resource forecast for the upcoming twelve months and a new ERRA rate based on that forecast. December 1 applications, such as the application before us, are to address the reasonableness of its energy resource contract administration, least-cost dispatch, and ERRA.

III. Discussion

SDG&E tendered testimony as part of its application to substantiate the reasonableness and prudence of its contract administration, least-cost dispatch, and ERRA for the period January 1, 2003 through September 31, 2003. Portions of SDG&E's data and testimony deemed commercially sensitive because it provided nonpublic market information regarding SDG&E's power procurement activities which included individual prices and terms of power purchase agreements between SDG&E and certain generating facilities, and detailed discussion of SDG&E's development load forecasts, operating characteristics of certain generating facilities and market indices relied upon in its procurement strategy were tendered under seal, pursuant to General Order 66-C. All such information deemed commercially sensitive was placed under seal pursuant to an Administrative Law Judge (ALJ) ruling at the January 28, 2004 prehearing

conference and June 8, 2004 evidentiary hearing. The specific confidentiality claims, on our review of them, outweighed the public interest in disclosure. Due to the commercially sensitivity of the information all information placed under seal should remain sealed for a period of one year from the effective date of this order except upon further order or ruling of the Commission or ALJ then designated as the Law and Motion Judge.

The Office of Ratepayer Advocates (ORA) conducted an independent review of SDG&E's energy procurement activities to assess the prudence and reasonableness of those activities.

A. Contract Administration

SDG&E administers its power purchase agreements through its contract administration section which also has responsibility for negotiating and executing new agreements with renewable and Qualifying Facilities (QF) developers. That section also monitors various obligations supplemental to the power purchase agreements, such as the compliance of cogenerators with operating and efficiency standards of the Federal Energy Regulatory Commission (FERC), monitoring the comprehensive general liability insurance coverage of each QF, and monitoring those QFs' that may be ultimately responsible for the Contributions in Aid of Construction tax imposed on SDG&E as a result of QF interconnection arrangements. In addition, the contract administration section provides limited administrative support to the California Department of Water Resources (CDWR) for the ten agreements allocated to SDG&E in accordance with the February 2003 Operating Agreement between SDG&E and CDWR.

SDG&E's electricity portfolio consists of both Utility Retained Generation (URG) and various sources under contract with CDWR.

Approximately 48% of SDG&E's resource requirements are satisfied through the CDWR agreements. The URG portion of the portfolio is comprised of a combination of Renewable, QF, and Bilateral agreements. SDG&E's only generation resource during the record period is its twenty percent ownership in San Onofre Nuclear Generation Station (SONGS). Details of its contract administration and energy purchases are set forth in its testimony and exhibits accompanying the application.

ORA applied a "reasonable manager" standard to assess the reasonableness of SDG&E's contract administration. Components of this standard used by ORA are set forth in Appendix A to this decision. Based on its detailed review and analysis of SDG&E's application, testimony, workpapers, data responses, and written description of SDG&E's contract administration procedures and purchase contracts, ORA concluded that SDG&E's management of its purchase contracts was reasonable.

However, ORA did recommend that SDG&E include the following information as part of future ERRA filings to assist the Commission and its staff in reviewing contract management:

- Detailed description of each contract applicable to the record period.
- Detailed description of the contract administration procedures.
- Summary of all amendments and copies of the amendments.
- Summary of all contract disputes and litigation.
- Economic impacts and analysis of settlements and agreements resolving contract disputes.
- Copy of the current contract manual.

ORA clarified at the evidentiary hearing that it would work with SDG&E in incorporating this additional information into a master data request. ORA also explained that it would change that master data request from time to time as different information becomes relevant and other information becomes irrelevant. With that clarification, the issue of whether the additional information should be incorporated into SDG&E's future ERRA applications is moot and need not be addressed further in this decision.

B. Least-Cost Dispatch

SDG&E has resumed the role of electric procurement for its customers pursuant to Ordering Paragraph 5 of D.02-09-053. That same decision provided some guidance on how SDG&E should carry out those procurement activities. As a result SDG&E adopted two principles for the least cost dispatch of its combined SDG&E and DWR portfolio. The first principle is to provide the total requirements of the energy and ancillary services requirements for its customers at a reasonable cost, consistent with competitive market conditions. The second principle is to integrate SDG&E and DWR resources into a joint portfolio that is dispatched based upon variable, least cost economics subject to market and operational constraints, and without preference to URG resources. Details of SDG&E's least-cost dispatch are set forth in its testimony and exhibits.

ORA's independent examination of SDG&E's least-cost dispatch consisted of a review of the application and prior commission decisions guiding the least cost dispatch process. Based on that review, ORA compared the process SDG&E used to implement its least-cost dispatch strategies with guidelines set forth by the Commission in its decisions. ORA concluded from its independent examination that SDG&E prudently performed its least-cost dispatch for the period January 1, 2003 through September 31, 2003.

C. Energy Recovery Account (ERRA)

SDG&E established its ERRA effective January 1, 2003 to track its forecasted fuel and purchase power revenues against actual recorded costs. This balancing account was modeled after the Energy Cost Adjustment Clause balancing account. Included in its ERRA account is SDG&E's share of revenue from the sale of surplus energy and adjusted Electric Energy Commodity Cost (EECC) rate schedule. Adjusted from the ERRA account is CDWR revenues for CDWR energy provided to SDG&E customers and related SDG&E bond payments.

SDG&E compared its energy procurement costs with the revenue from Schedule EECC, excluding CDWR revenue and bond payments on a monthly basis. Interest was applied to any resulting over or under-collection balance at the three-month commercial paper rate. Details of its ERRA for the nine-month period beginning January 1, 2003 and ending September 30, 2003 were set forth in Appendix B to its prepared testimony.

SDG&E had an $83.3 million overcollected ERRA balance at September 30, 2003, excluding an overcollected balance of approximately $92 million being refunded to its large customers pursuant to its November 21, 2003 Advice Letter No.1539-E**.** Although the overcollected balance exceeds SDG&E's 5% threshold amount of $26.8 million for 2003, SDG&E does not propose to refund any overcollections at this time because this application covers only the first nine months of SDG&E's ERRA.[1]

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[1] Decision 02-10-062, which established an ERRA trigger mechanism, precludes the trigger mechanism from being activated to refund overcollections until the ERRA has been in operation for a full twelve months.

Consistent with Ordering Paragraph 19 of D.02-12-074, SDG&E submitted monthly reports to the Commission's Energy Division for the nine-month period this application covers. The monthly reports included supporting source documents to substantiate the monthly activity in SDG&E's ERRA balancing account. SDG&E represents that the Energy Division has indicated by letter to SDG&E that the Energy Division has verified all ERRA original source documents exceeding $100. Therefore, SDG&E seeks Commission approval and determination of reasonableness of its ERRA entries and calculations for the period January 1, 2003 through September 30, 2003.

ORA's independent examination of SDG&E's ERRA for the time period subject to this application included a review and analysis of prior Commission ERRA decisions and tariffs, SDG&E supporting source documents, and SDG&E's working papers previously reviewed by the Energy Division. ORA also conducted interviews with SDG&E's witnesses, issued data requests, and conducted selective substantive testing. ORA concluded from its independent examination that SDG&E's ERRA entries and calculations for the nine-month period were reasonable.

IV. Conclusion

As addressed in this order, SDG&E provided detailed exhibits and testimony on its administration of power purchase agreements, procurement of least-cost dispatch power activities, and procurement-related revenue and expenses recorded in its ERRA for the period beginning January 1, 2003 and ending September 30, 2003. In addition, ORA provided testimony on the results of its independent examination of SDG&E's administration of power purchase agreements, procurement of least-cost dispatch power activities, and ERRA activities that affirmed the reasonableness and prudence of SDG&E's application.

With no opposition to SDG&E's application and a record that affirms the reasonableness and prudence of SDG&E's contract administration, least-cost dispatch, and ERRA activities, we concur that SDG&E was prudent in its procurement-related activities for the period January 1, 2003 through September 30, 2003 and that its $83.3 million ERRA overcollected balance at September 30, 2003 was reasonable and prudent.

V. Procedural Matters

SDG&E requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3125, dated December 18, 2003, the Commission preliminarily determined that this was a ratesetting proceeding and that hearings may be necessary. The assigned Commissioner's February 13, 2004 Scoping Memo and Ruling affirmed that this proceeding is a ratesetting proceeding.

Notice of the application appeared in the Commission's December 11, 2004 Daily Calendar. There is no objection to the ratesetting categorization. An evidentiary hearing was held on June 8, 2004. This matter was submitted at the conclusion of that evidentiary hearing.

VI. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

VII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Michael J. Galvin is the assigned Administrative Law Judge and principal hearing officer in this proceeding.

Findings of Fact

1. The application was filed on December 1, 2003, and appeared in the Commission's Daily Calendar on December 11, 2003.

2. There is no opposition to this application.

3. SDG&E provided detailed exhibits and testimony on its administration of power purchase agreements, procurement of least-cost dispatch power activities, and procurement-related revenue and expenses recorded in its ERRA for the period beginning January 1, 2003 and ending September 30, 2003.

4. ORA provided testimony on the results of its independent examination of SDG&E's administration of power purchase agreements, procurement of least-cost dispatch power activities, and ERRA activitiies affirming the prudence of SDG&E's application.

Conclusions of Law

1. The application should be granted.

2. Information placed under seal should remain sealed, because if disclosed, it would provide competitors an insight of SDG&E's nonpublic market information regarding SDG&E's power procurement activities.

3. This decision should be effective today, in order to allow the docket to be closed expeditiously.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company's (SDG&E) administration of its power purchase agreements and procurement of least-cost dispatch power activities for the period beginning January 1, 2003 and ending September 30, 2003 were reasonable and prudent.

2. SDG&E's $83.3 million Energy Resource recovery Account (ERRA) overcollected balance at September 30, 2003 and its procurement-related revenue and expenses recorded in its ERRA from January 1, 2003 through September 30, 2003 were reasonable and prudent.

3. All information placed under seal shall remain sealed for a period of one year from the effective date of this order except upon further order or ruling of the Commission or Administrative Law Judge then designated as the Law and Motion Judge. If SDG&E believes that further protection of sealed information is needed beyond two years after the effective date of this order it may file a motion stating the justification for further withholding of the sealed information from public inspection, or for such other relief as the Commission may provide. This motion shall be filed no later than 30 days before the expiration of this ordering paragraph.

4. Application 03-12-010 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX A

THE OFFICE OF RATEPAYER ADVOCATES REASONABLE MANAGER STANDARD

- Utilities are held to a standard of reasonableness based upon the facts that are known or should have been known at the time.
- The act of the utility should comport with what a reasonable manager of sufficient education, training, experience and skills using tools and knowledge at his disposal would do when faced with a need to make a decision and act.
- The commission, as the agency charged with oversight and economic regulation of the monopoly utilities, has a legitimate concern not only with the outcomes of the utilities' decisions, but also with the process employed to arrive at a particular decision.
- The reasonable and prudent act is not limited to the optimum act, but includes a spectrum of possible acts consistent with the utility system need, the interest of the ratepayers, and the requirements of government agencies of competent jurisdiction.
- The action taken should logically be expected at the time the decision is made, to accomplish the desired result at the lowest reasonable cost consistent with good utility practices.
- The greater the level of money, risk and uncertainty involved in a decision, the greater the care the utility must take in reaching that decision.
- The burden rest heavily upon a utility to prove with clear and convincing evidence, that it is entitled to the requested rate relief and not upon the Commission, its staff, or any interested party to prove the contrary.

(END OF APPENDIX A)