DATE ISSUED: August 6, 2004 REPORT NO: 04-185

ATTENTION: Honorable Mayor and City Council
Docket of August 9, 2004

SUBJECT: California Public Utilities Commission's (CPUC) permanent cost allocation of energy contracts purchased by the State's Department of Water Resources during the recent energy crisis

SUMMARY:

Issues - 1) Should the City Council adopt a resolution opposing the proposed and alternate CPUC decisions in the allocation of the Department of Water Resources (DWR) revenue requirement proceeding A.00-11-038? 2) Should the City Council adopt a resolution recommending the total percentage allocation of costs adopted in previous CPUC annual allocations remain in effect for the remaining contract terms?

Manager's Recommendations - 1) Oppose the CPUC proposed and alternate decisions in the allocation of the Department of Water Resources contracts.
2) Recommend to the CPUC that the total percentage allocation of costs adopted in previous annual DWR allocations remain in effect for the remaining contract terms.

Fiscal Impact - If either the proposed or alternate decisions in the allocation of the Department of Water Resources is adopted the total energy cost for all service provided by San Diego Gas & Electric (SDG&E) may increase by an estimated $1 billion over an eight year period. This will increase the cost of energy purchased from SDG&E for all City accounts.

BACKGROUND

During the energy crisis of 2000 and 2001, the State Legislature created law (AB 1x) authorizing the State Department of Water Resources (DWR) to enter into long-term power purchase contracts with electricity generators to relieve credit-impaired utilities from having to purchase power on the dysfunctional spot market and to provide for the electric needs of California consumers. As a consequence of these long-term contracts, the CPUC became responsible for allocating the costs of these energy contracts among the customers of the State's three regulated utilities.

The CPUC has previously established allocations for the DWR revenue requirement for 2001-2002 (D.02-02-052), and for 2003 (D.02-12-045). For 2004, on an interim basis, the CPUC continued to use the 2003 allocation methodology. In this current proceeding, the CPUC is considering adopting an allocation methodology applicable to 2004, but also applicable for the remaining term of the DWR power purchase contracts.

DISCUSSION

As part of the CPUC proceeding A.00-11-038 the DWR was required to provide annual revenue requirements for the energy contracts purchased during the energy crisis that would then be allocated to each of the utilities. The allocation of the DWR contract revenue requirements to each utility area was accomplished through a process that matched projected power needs to contracts purchased by DWR. The process did not assign the cost of each contract when allocating resources, but assigned costs based on each utility's overall percentage of total statewide load. This method was used because DWR had purchased energy to meet the aggregate net short position of all the utilities. Previous annual allocation decisions assigned SDG&E responsibility for approximately 12.5 % of the total contract costs. In the current 2004 cost allocation process the CPUC will determine cost allocation for all remaining years of the contracts.

SDG&E has submitted a proposal to maintain the existing methodology that allocates the costs of the DWR contracts based on the use percentages adopted in previous decisions. Subsequently, a proposed settlement agreement to permanently allocate the DWR revenue requirement was developed by Southern California Edison (SCE), Pacific Gas and Electric (PG&E), and The Utility Reform Network (TURN) that recommended the cost of each contract follow to the utility assigned each contract. This method would have resulted in significant shift of costs to electricity customers in the San Diego and South Orange County region.

After considering the testimony and the proposed settlement, Administrative Law Judge (ALJ) Peter Allen and Commissioner Loretta Lynch respectively developed a Proposed Decision (PD) and an Alternate Proposed Decision (AD) which rejected the SCE, PG&E and TURN proposed settlement as not representing a fair distribution of cost. The decisions proposed by the ALJ and Commissioner Lynch reviewed the positions of all parties submitting testimony and created a new allocation. This method shifts less burden than the one contained in the rejected settlement but still could add approximately 2.5% to SDG&E's portion of the current allocation, without any corresponding benefit.

Although the PD and AD attempt to address the long-term allocation of DWR contract costs and have proposed reductions in the State's total DWR costs, they do not recognize or address the impact that the new cost allocation will have on San Diego and Southern Orange County consumers and their electricity rates. SDG&E indicates that this diversion from the previous methodology of the prior decisions results in a cost shift of nearly $1 billion to SDG&E customers over the next eight years.

CONCLUSION

Both decisions being considered for the allocation of DWR contract costs will increase the cost allocation to the SDG&E region without regional customers receiving any corresponding benefit from the DWR contracts. This can impact the economic climate in the region and allocate additional DWR costs to SDG&E. A resolution urging the CPUC to maintain the current allocation methodology would be in the best interest of the City of San Diego and its residents and businesses.

ALTERNATIVE

1) Do not adopt the resolution to oppose the allocation decisions.

2) Do not recommend previous total cost allocations remain in effect for the remaining term of the DWR energy contracts.

Respectfully submitted,

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