

2.3 PROJECT SETTING AND BACKGROUND

2.3.1 INTRODUCTION

On December 19, 1997, SDG&E filed an application (Application No. 97-12-039) with the CPUC to sell (divest) its electric generation facilities, a refueling facility, and long-term power supply contracts through a competitive auction process. Specifically, SDG&E proposes to sell its two fossil-fueled power plants (the Encina and South Bay Power Plants), 17 additional CTs, the 24th Street Terminal Refueling Facility, its 20 percent interest in SONGS, and 11 long-term power supply contracts. The power plants, the CTs, and the 24th Street Terminal Refueling Facility are tangible assets wholly owned by SDG&E, operated by and within the discretionary control of SDG&E. SDG&E's ownership interest in SONGS and the long-term power supply contracts are intangible assets in that the discretionary operational control of these generating assets does not reside with SDG&E and in that SDG&E holds no ownership interest in the QFs or out-of-state utilities that produce electricity under the power supply contracts and only a passive ownership interest in SONGS. The locations of SDG&E's tangible and intangible assets being divested are shown in Figures 2.1 and 2.2, respectively. By selling these assets, SDG&E would divest itself of approximately 2,736 MW of its combined generating capacity and firm capacity guaranteed from its ownership interest in SONGS and long-term power supply contracts. The CPUC has discretionary approval authority over the general terms of the Asset Sale Agreement, the Operation and Maintenance (O&M) Agreement, and the Bidding Contract of each proposed sale.

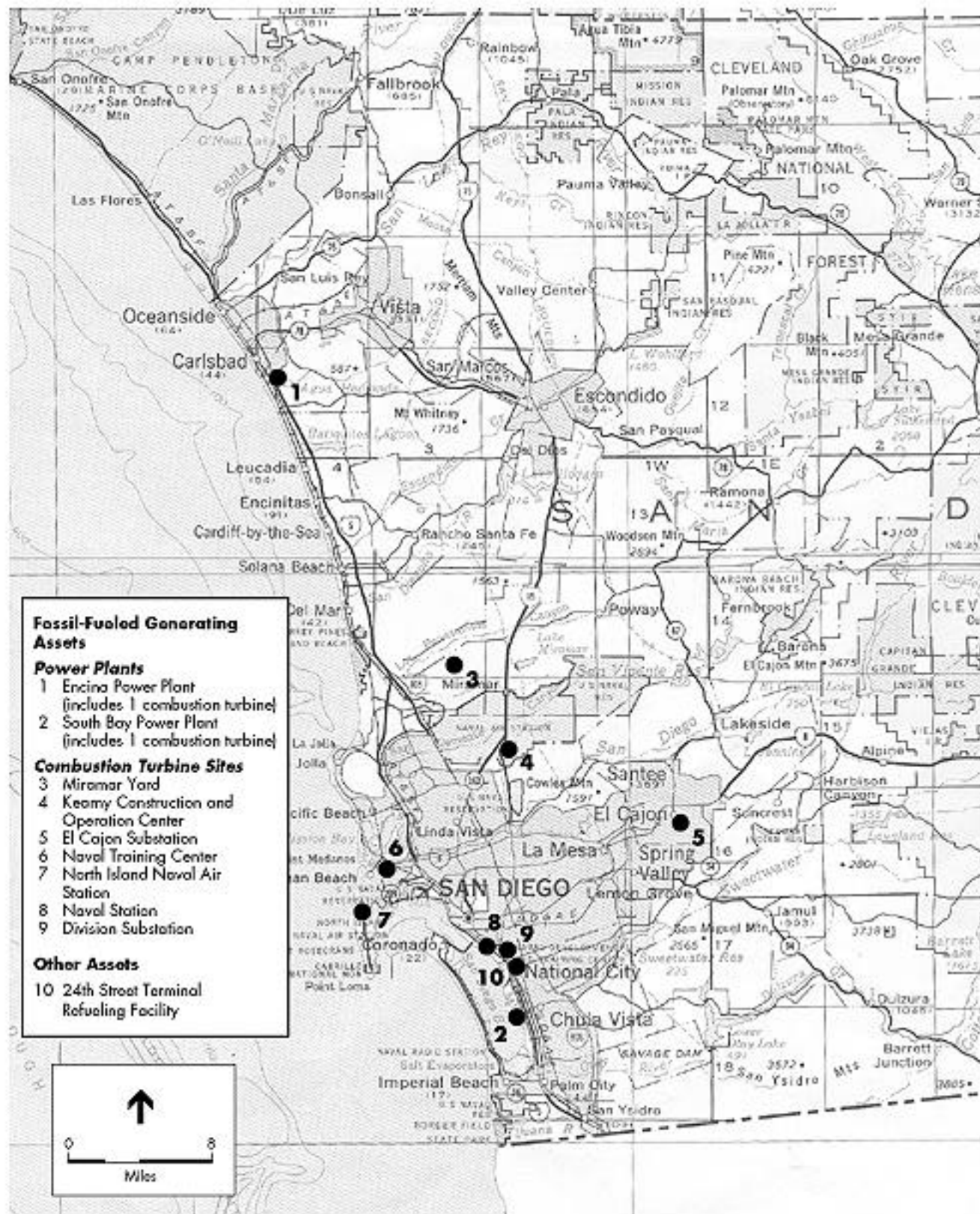
The Independent System Operator (ISO), the entity responsible for the operation and control of the statewide transmission system, has designated SDG&E's Encina and South Bay Power Plants and all 17 additional CTs as "must-run" generating facilities needed to ensure local load reliability and to maintain the rating of regional transmission facilities.⁴ The new owner would be assigned SDG&E's "must-run" contracts with the ISO to ensure the availability of these generating facilities.

As described in its application, SDG&E proposes to sell its tangible assets in the following three packages:

- Encina Power Plant (includes one CT)
- South Bay Power Plant (includes one CT) and the 24th Street Terminal Refueling Facility
- Remaining 17 CTs at seven locations

One or more buyers may purchase these tangible asset packages. No other bundling of assets is proposed. One or more buyers may also purchase SDG&E's intangible assets (SONGS ownership interest and 11 long-term power supply contracts).

⁴ A "must-run" unit is a generating unit that is subject to an agreement between the unit owner and the ISO under which, in return for certain payments, the ISO is entitled to call upon the owner to run the unit or to provide ancillary services when required by the ISO to maintain electrical system reliability.

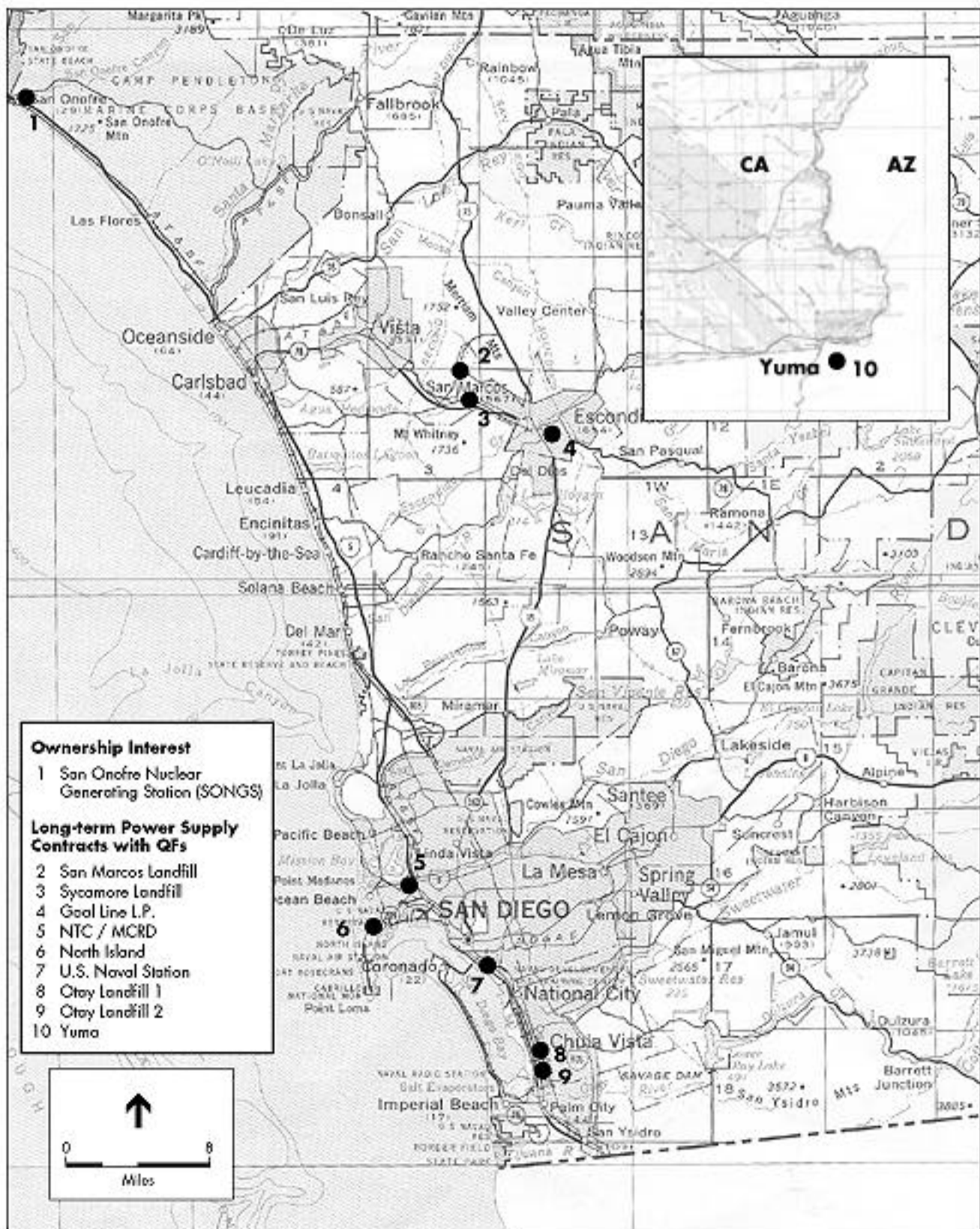


Note: SDG&E's long-term power supply contracts with non-qualifying energy suppliers (i.e., Portland General and PNM) are not shown here.

SOURCE: U.S.G.S., Environmental Science Associates

Divestiture of Assets by SDG&E / 980084 ■

Figure 2.1
SDG&E's Tangible Assets to Be Divested



Note: SDG&E's long-term power supply contracts with non-qualifying energy suppliers (i.e., Portland General and PNM) are not shown here.

SOURCE: U.S.G.S.; Environmental Science Associates

Divestiture of Assets by SDG&E / 980084 ■

Figure 2.2
SDG&E's Intangible Assets to Be Divested

Subsequent to the filing of Application No. 97-12-039, SDG&E and the San Diego Unified Port District (Port District) announced an agreement whereby SDG&E would transfer ownership of the South Bay Power Plant, the 24th Street Terminal Refueling Facility and other SDG&E lands to the Port District through a negotiated sale and donation rather than selling those facilities through an auction process. The assets that would be transferred to the Port District under the negotiated agreement by SDG&E include:

- the personal property, improvements, equipment and fixtures at the South Bay Power Plant, including the plant and all related operating equipment;
- the South Bay Power Plant site, including the land upon which the switchyard is located, consisting of approximately 116 acres;
- the 24th Street Terminal Refueling Facility;
- the former liquefied natural gas (LNG) site adjacent to the southern boundary of the South Bay Power Plant site, consisting of approximately 33 acres; and
- additional land owned by SDG&E (and used by SDG&E for transmission purposes), which is located immediately to the north of the South Bay Power Plant between J and F Streets, consisting of approximately 16 acres.

These latter two properties, totaling approximately 49 acres, were not proposed by SDG&E to be sold through the auction process. Pursuant to the agreement between SDG&E and the Port District, SDG&E will refrain in the near term from offering the South Bay plant for sale by auction. If the details of the negotiated sale are not finalized by November 30, 1998, 60 days after the signing of the agreement, then the agreement between SDG&E and the Port District will terminate and SDG&E would recommence the auction of the South Bay Power Plant as originally proposed in its divestiture application. Regardless of the manner in which the sale of the South Bay Power Plant is conducted (i.e., auction or negotiation) or the identity of the purchaser, the transfer of ownership would be subject to approval by the CPUC. In order fully to account for and evaluate the impacts of the transfer of the South Bay assets, this Initial Study addresses as the project both the potential negotiated sale to the Port District and the potential sale through an auction process to an unidentified party, which would involve identical physical facilities but less real property.

Regardless of the mechanism of sale, as to both the Encina and South Bay Power Plants, SDG&E would retain ownership of certain facilities and equipment located on the land, such as the switchyards, interconnection facilities, grid-related switching equipment, communication equipment and facilities, and proprietary computer software and hardware, that relate to electricity transmission and distribution. In addition, SDG&E would reserve to itself easements over such lands to enable SDG&E to access, operate, maintain and upgrade such facilities and equipment, and to perform its environmental remediation obligations. SDG&E also proposes to retain the land owned by SDG&E associated with the CTs, except those associated with the Encina and South Bay Power Plants. The four CTs located at North Island, the Naval Station, and the Naval Training Center are located on land owned by the United States Navy. SDG&E's access rights to the Navy property are provided through a service agreement between SDG&E

and the Navy. The current agreement was extended at the end of September 1998 for 30 months. Access rights to the Navy property held by SDG&E would be transferred to the selected buyer. The remaining CTs are located on SDG&E property that must be retained for transmission, distribution and other purposes. SDG&E would provide the buyer with long-term leases and related easements to these properties.

Where applicable, SDG&E is proposing a two-step process for its auctions, similar to the processes approved by the CPUC for recent divestiture applications from Edison (Application No. 96-11-046) and PG&E (Application Nos. 96-11-020 and 98-01-008). In the first step, SDG&E requests the CPUC to issue an interim decision approving SDG&E's proposed auction process, proposed contracts, and proposed ratemaking. In the second part of the process, SDG&E would conduct the proposed auctions. If SDG&E were to receive satisfactory bids for some or all of its generating assets being divested, it would then negotiate final contracts with the winning bidder(s) and submit the final contracts to the CPUC for approval.

Specifically, SDG&E's Application No. 97-12-039 seeks the following from the CPUC:

1. A determination that SDG&E's fossil-fueled power plants, CTs, SONGS ownership interest, and long-term power supply contracts are no longer necessary or useful in the performance of SDG&E's duties to the public, or alternatively, that SDG&E's proposed divestiture of these assets is in the public interest;
2. A determination that SDG&E's proposed divestitures are reasonable and would not impair the reliability of the electric supply;
3. Approval of SDG&E's proposed auction process;
4. A determination that SDG&E's proposed auction process would establish the fair market value of the auctioned assets;
5. A determination that SDG&E need not entertain post-auction overbids;
6. Approval of SDG&E's proposed ratemaking for the sales;
7. Approval of SDG&E's proposed auction-related contracts, including sales agreements and O&M contracts;
8. Authorization to obtain recovery of its estimated future generation-related environmental clean-up costs in a subsequent application.
9. A determination that: (1) SDG&E's proposed generation divestitures are not subject to CEQA because they do not constitute a "project" within the meaning of CEQA; (2) that CEQA does not apply to SDG&E's divestitures because they fall within a categorical exemption to CEQA; or, alternatively (3) that a Negative Declaration under CEQA is appropriate because SDG&E's divestitures will not cause one or more significant effects on the environment.

Final CPUC approval is a condition to the closing of each sale, whether the sale is negotiated (as with the Port District) or conducted by auction. Approval by the Nuclear Regulatory

Commission is also required for the transfer of SDG&E's SONGS ownership interest, and by the Federal Energy Regulatory Commission (FERC) for transfer of the long-term power supply contracts.

In a motion filed with the CPUC on April 1, 1998, the Office of Ratepayer Advocates (ORA) and SDG&E requested that the CPUC adopt a revised schedule for SDG&E's proposed divestiture. The revised schedule bifurcates the CPUC's consideration of SDG&E's divestiture of its tangible assets (fossil-fueled generating assets and refueling facility) and intangible assets (SONGS ownership interest and long-term power supply contracts) described in Application No. 97-12-039. SDG&E's application initially sought a single auction and regulatory approval track for all of its assets being divested. SDG&E now proposes to hold two separate auctions, one for its tangible assets and one for its intangible assets (SDG&E and ORA, 1998). Pending the completion of this environmental review, it is anticipated that the auction of the tangible assets will be held before the end of 1998. The auction of the intangible assets is likely to occur sometime in 1999.

2.3.2 TERMS OF THE PROPOSED SALES

As summarized in SDG&E's PEA (SDG&E, 1997b), SDG&E's Application No. 97-12-039 seeks authority to sell its fossil-fueled generating assets, 24th Street Terminal Refueling Facility, SONGS ownership interest, and long-term power supply contracts under the following terms and conditions:

1. The fossil-fueled generating assets (including the South Bay Power Plant if the sale to the Port District does not occur) would be offered for sale through an auction process to qualified bidders to ensure that the power plants and the CTs sold through the auction would continue to operate when needed to protect system reliability, and, when no longer needed, would be decommissioned in accordance with applicable laws.
2. SDG&E would retain ownership and control of certain transmission-related facilities associated with the generating assets being divested.
3. Subject to applicable federal, state, and local laws and regulations, SDG&E and the new owner(s) would apportion the respective liability and responsibility for conducting any necessary remediation of any environmental conditions at the power plants, CTs, or the 24th Street Terminal Refueling Facility, as required by any governmental agency having jurisdiction over such laws and regulations.
4. The power plants and CTs have been determined by the ISO to be "must-run" generating facilities. Accordingly, the new owner(s) of such facilities would be assigned of SDG&E's "must-run" contract with the ISO to ensure that electric power would be available when needed for reliability, to maintain transmission ratings, and to prevent price manipulation during times when market power exists, for as long as such facilities remain "must-run" facilities.
5. SDG&E would operate the Encina and South Bay Power Plants and the CTs on behalf of the new owners for at least two years following their sale pursuant to a contract with the new owner, in accordance with Public Utilities Code §363.