

Decision **DRAFT DECISION OF ALJ HALLIGAN** (Mailed 11/15/2005)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Pacific Gas and Electric Company for Authority, Among Other Things, To Increase Revenue Requirements for Electric and Gas Service and to Increase Rates and Charges for Gas Service Effective on January 1, 2003. (U 39 M)

Application 02-11-017  
(Filed November 8, 2002)

Application of Pacific Gas and Electric Company Pursuant to Resolution E-3770 for Reimbursement of Costs Associated with Delay in Implementation of PG&E's New Customer Information System Caused by the 2002 20/20 Customer Rebate Program. (U 39 M)

Application 02-09-005  
(Filed September 6, 2002)

Investigation on the Commission's Own Motion into the Rates, Operations, Practices, Service and Facilities of Pacific Gas and Electric Company. (U 39 M)

Investigation 03-01-012  
(Filed January 16, 2003)

**O P I N I O N****Summary**

On July 13, 2005, Pacific Gas and Electric Company (PG&E) filed a Petition to Modify Decision (D.) 04-05-055, which established the Test Year (TY) 2003 revenue requirement for PG&E. D.04-05-055 denied PG&E's request for a \$128.6 million pension contribution, finding that the funding status of the plan

did not justify a \$128.6 million annual contribution in TY 2003. On July 13, 2005, PG&E filed a Petition to Modify (Petition) D.04-05-055 regarding the issue of annual contributions to PG&E's retirement plan trust. This decision denies PG&E's Petition for Modification of D.04-05-055.

### **Background**

D.04-05-055 approved two comprehensive settlement agreements filed by the majority of the parties in the PG&E's TY 2003 General Rate Case (GRC), resulting in a 10.44% increase in electric distribution revenues, a 5.90% increase in gas distribution revenues, and a 4.35% increase in generation revenues for PG&E. The terms of the settlements included the agreement that PG&E would not file its next GRC application until late 2006, for a TY 2007 GRC, resulting in a GRC term that is one year longer than the typical three-year GRC term. In adopting the settlements, the Commission noted that although the settlements represent somewhat of a "black box" approach that does not identify a detailed forecast for each specific account, the settlements as a whole were in the public interest and should be approved.

In its Petition, PG&E requests an opportunity to show that it is prudent for the Commission to approve ratepayer funding for pension contributions beginning January 1, 2006. PG&E claims that the funded status of its retirement plan trust is estimated to be approximately 98.1 percent at January 1, 2005 and is projected to decline to 86.0 percent in 2010 unless contributions resume. PG&E requests that we authorize it to file an application, prior to and separate from its TY 2007 GRC application, for a revenue requirement increase of approximately \$185 million per year for the four year period from 2006 through 2009 to fund contributions to the pension fund trust.

If the Commission grants the Petition, PG&E will file an advice letter making the revenue requirement increase effective in rates on January 1, 2006, subject to the condition that if the revenue requirement increase is not approved in the Commission's decision on the merits of PG&E's application, any funds collected would be credited back to PG&E's ratepayers. PG&E further states that if the Commission grants PG&E the authority to file such an application before December 1, 2005, then the Commission should consider the issue of pension contributions for the period through 2009 in that application and not in PG&E's TY 2007 GRC.

If the Commission does not grant the instant petition, PG&E plans to include its pension contribution showing in its December 1, 2005, TY 2007 GRC application. PG&E states that, in this case, the increase requested in the TY 2007 GRC application is anticipated to be approximately \$250 million per year for the three year period from 2007 to 2009.

PG&E argues that the Petition is consistent with the Distribution and Generation Settlements approved in D.04-05-055 because the settlements did not address the pension contribution issues. PG&E also argues that its request is consistent with D.96-12-066, which denied PG&E's request for an increase for a mid-cycle increase in the base revenues adopted for TY 1996, because the revenue requirement will have been in effect for three years regardless of the outcome of the Petition. PG&E further states that the Petition is compatible with D.96-12-066 because the "unlike the types of costs at issue in D.96-12-066, the Commission treats pension contributions in their own cost category and does not

expect PG&E to shift dollars from operations to fund the retirement plan trust.”<sup>1</sup> Finally, PG&E maintains that its request will create minimal additional work for interested parties.

On August 12, 2005, the Office of Ratepayer Advocates (ORA) filed a response to PG&E’s Petition, asking the Commission to deny PG&E’s request. ORA notes that PG&E is free to make contributions to its pension trust at any time, without Commission approval. ORA points out that San Diego Gas and Electric Company recently made a contribution to its pension plan that was not funded in rates. ORA also points out that PG&E’s request would require parties to review PG&E’s revenue requirement requests in two proceedings, the TY 2007 GRC and the separate pension application, creating an undue burden on all parties and the Commission. The California Coalition of Utility Employees filed a response supporting PG&E’s request. PG&E filed a reply to ORA’s Response on August 22, 2005.

### **Analysis**

In this Petition, PG&E is seeking to modify the portion of D.04-05-055 and the associated settlements calling for a four-year GRC cycle, thereby having the opportunity to request a revenue requirement increase prior to the TY 2007 GRC. Under the normal three-year GRC schedule adopted in the Commission’s Rate Case Plan<sup>2</sup>, the TY 2003 cycle would have been 2003 through 2005, with PG&E’s next GRC application to have been filed in late 2004. However, in the Distribution and Generation settlements, the parties agreed to extend the TY

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<sup>1</sup> PG&E Petition at pg. 7.

<sup>2</sup> The Commission’s Rate Case Plan is set forth in D.89-01-040.

2003 GRC to four years, through 2006, with the TY 2007 GRC planned for filing on December 1, 2005.

PG&E now finds the four-year cycle it agreed to unacceptable. PG&E seeks permission to request an interim increase in its revenue requirement for the year 2006 to fund a contribution to the retirement plan trust. In D.04-05-055, the Commission denied PG&E's request for a TY 2003 forecast contribution to the retirement plan trust because PG&E had not provided sufficient evidence demonstrating that its requested \$128.6 million contribution to the retirement plan trust was necessary based on the funding status of the retirement plan trust. The fact that PG&E now believes it can adequately support a request for a pension contribution is not sufficient justification to reopen PG&E's TY 2003 revenue requirement.

The four-year GRC cycle at issue here was approved in D.04-05-055, as part of a settlement that was the "result of compromises to accommodate and balance the interests of all the parties and the public." PG&E agreed to the settlements with the full knowledge that the Commission could either approve or deny PG&E's request for a pension contribution. Allowing the utility to back out of one of the terms of settlement when it becomes inconvenient would not only create a strong disincentive for future settlements, but it would violate one of the fundamental tenets of forecast test year ratemaking.

That tenet is that the utility retains the discretion between the test years to manage its revenues and activities as it sees fits, consistent with the obligation to provide safe, reliably, environmentally sound utility service. The utility is not expected to spend the authorized amount or refund excess revenues in areas where its expenses were less than its adopted revenue requirement nor is it permitted to request additional funding for expenses that exceed its forecast.

This relationship represents a balance of regulatory risk, providing utility management with the discretion to operate its business without the Commission micromanaging each expenditure, while providing ratepayers with the assurance that the utility will attempt to prudently manage its costs, because it is not permitted to come back to the Commission for additional funding absent extraordinary events.

The Commission described the nature of this regulatory relationship in D.96-12-066 (citing D.85-03-042), where it stated:

“Ratemaking is not, nor has it ever been an exact science that guarantees perfect results from all perspectives. Ratemaking, whether in a general rate proceeding, or by an attrition mechanism, is essentially the art of estimating future events based on judgment that it as fully informed as possible. We know in prospective test year ratemaking that our adopted estimates of revenues and expenses may be at variance with actual hindsight experience. But we do not view this as a problem, because we are extending to the utility management an incentive to find ways to conduct operations for less than projected. When it can do this it flows the benefit to the utility’s bottom line, which means profit. In the short-term, between general rate proceedings, the shareholders benefit when the company’s management can ‘do it for less,’ and correspondingly, ratepayers ultimately benefit because the productivity improvement will be reflected periodically when there is a comprehensive review of the utility’s revenue requirements. Keeping this incentive for utility management is a cornerstone of ratemaking, which leads us to look askance at proposals for immediate ‘give backs’ of all cost savings to ratepayers.”<sup>3</sup>

D.96-12-066 further stated that “just as it is inconsistent with this ratemaking philosophy to reduce the base revenue requirement between rate

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<sup>3</sup> D.96-12-066 69 CPUC 2d 693, 694.

cases when costs go down, it is inconsistent (and counterproductive) to selectively grant the utility interim increases in areas where it finds its costs may be going up.”<sup>4</sup>

In D.96-12-066, the Commission was responding to PG&E’s request for a waiver of the Rate Case Plan and an increase in the revenue requirement based on the assertion that there were extraordinary circumstances that warranted an interim increase. The Commission rejected PG&E’s request, finding that granting PG&E’s request would enable PG&E to escape its part of the regulatory contract. The Commission also found that the activities for which PG&E sought an increase were a normal part of its ongoing business and did not warrant extraordinary relief.

In the instant Petition, PG&E claims that an interim increase in the revenue requirement for pension contributions is warranted because the pension issue was not part of the Distribution and Generation settlements approved in D.04-05-055. As noted above, however, PG&E agreed to the settlements with the full knowledge that they would not be allowed to file for a revenue requirement increase until TY 2007. It would be unfair and unreasonable to allow PG&E to request a revenue requirement increase for one category where it asserts additional revenues are needed without requiring PG&E to show whether or not there are offsetting revenues produced that should be or should have been used to mitigate the ratepayers responsibility for the pension funding. As we stated in D.96-12-066, “if we were to give the utility more revenue whenever it discovered that some costs were higher than expected, the utility would lose much of its

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<sup>4</sup> *Id.* 694.

incentive to keep rates down. It would also lack incentive to ensure that it undertakes the studies and collects the data needed to forecast its test year expenses as accurately as possible.”

Regardless of the length of the GRC cycle, allowing for out-of-cycle increases to the revenue requirement would require the Commission and other parties to dedicate limited resources to reviewing PG&E’s request in two proceedings simultaneously. In this case, even if we were to find that the funding status of PG&E’s pension trust is indeed at a level of less than 100%, we would still need to determine whether a revenue requirement increase is necessary for the year 2006, considering the entirety of PG&E’s base revenues and expenses. We cannot consider PG&E’s request for an increase in funding for pension contributions in isolation, without considering the rest of PG&E’s revenues, expenses, and earnings. Therefore, such a review would be tantamount to conducting a mini-GRC at the same time as PG&E’s TY 2007 GRC.

Finally, in our view, the potential difference between the two approaches, an estimated \$65 million, the difference between a \$185 million contribution for four years, versus a \$250 million contribution for three years is too speculative to warrant the certain additional cost and negative consequences of conducting duplicate proceedings, simply to grant PG&E the opportunity to change its rates whenever it is unhappy with them.

For all of these reasons, we decline to grant PG&E’s request. PG&E’s entire revenue requirement, including pension contributions, will be before the Commission in the TY 2007 GRC, and will be thoroughly addressed there.

### **Comments on Draft Decision**

The draft decision of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and

Rule 77.7 of the Rules of Practice and Procedure. PG&E and ORA filed opening comments on the Draft Decision on December 5, 2005. Reply comments were filed on December 12, 2005. PG&E states that the Draft Decision errs by finding that granting PG&E's petition would require the Commission to litigate the pension funding issues twice. In support of its position, PG&E claims that the Commission treats pension contributions in their own cost category, and does not expect PG&E to shift funds from other areas to fund the Retirement Plan trust. PG&E is incorrect. Determination of a test year revenue requirement requires budgeting on the part of the Commission; identifying the amount necessary to conduct the business of the utility safely and reliably at a reasonable cost for ratepayers. Ratepayer funds are not unlimited; therefore, the Commission must balance the competing needs of the utility operations with the available funds. Funding of the Retirement Plan Trust is simply one of the competing needs of operating the utility business. PG&E's comparison of the pension issue to the Cost of Capital proceedings and PG&E's application for advanced metering infrastructure (A.05-03-016 and A.05-06-028) is also incorrect. While the Commission can consider a utility's pension funding separately from the rest of the GRC issues, the Commission has not chosen to do so, because to do so would require conducting a mini-GRC to balance the cost of pension contribution against the rest of the day to day costs of running a safe and reliable electric and gas utility.

**Assignment of Proceeding**

Michael R. Peevey is the Assigned Commissioner and Julie M. Halligan is the assigned ALJ in this proceeding.

**Findings of Fact**

1. PG&E has not demonstrated that the Commission should modify D.04-05-055 to allow for the selective reexamination of the revenue requirement for the pension contributions.

2. PG&E's Petition would require the Commission, and other interested parties to litigate the reasonableness of PG&E's revenue requirements in two proceedings simultaneously.

**Conclusion of Law**

PG&E's Petition to Modify D.04-05-055 should be denied.

**O R D E R**

**IT IS ORDERED** that Pacific Gas and Electric Company's Petition to Modify Decision 04-05-055 is denied.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.