ALTERNATE DRAFT **Agenda ID #3806**
Alternate to Agenda ID #3366
Ratesetting
9/2/04 Item 27a

Decision **ALTERNATE PROPOSED DECISION OF COMMISSIONER GEOFFREY F. BROWN (Mailed August 5, 2004)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company to Consolidate the Review of Pacific Gas and Electric Company's Expenditures in 1997 And 1998 to Enhance Transmission and Distribution System Safety and Reliability Pursuant to Section 368(e) of the California Public Utilities Code. (U 39 E)	Application 99-03-039 (Filed March 19, 1999)

DECISION RESOLVING PACIFIC GAS & ELECTRIC COMPANY'S SYSTEM SAFETY AND RELIABILITY ENHANCEMENT FUNDS BALANCING ACCOUNT

(See Appendix A for List of Appearances.)

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DECISION RESOLVING PACIFIC GAS & ELECTRIC COMPANY'S SYSTEM SAFETY AND RELIABILITY ENHANCEMENT FUNDS BALANCING ACCOUNT

I. Summary

Pacific Gas and Electric Company (PG&E) requests Commission review and approval of its expenditures in 1997 and 1998 to enhance transmission and distribution system safety and reliability. In Decision (D.) 96-12-077, the Commission authorized incremental base revenue for PG&E of $164.231 million for 1997, and $241.614 million for 1998, for system safety and reliability enhancements above those already authorized in base revenues, pursuant to Pub. Util. Code § 368(e).[1] PG&E states that in 1997 it overspent the authorized amount by $19.012 million, and that in 1998 it underspent the authorized amount by $2.875 million.

In this decision, we find that PG&E is entitled to reimbursement of most costs incurred pursuant to § 368(e) other than $29.1 million in flood and storm-related costs that we order deferred to a separate Catastrophic Events Memorandum Account (CEMA) application. This proceeding is closed.

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[1] Unless otherwise noted, all statutory references are to the Public Utilities Code.

II. Background

Section 368 required PG&E to propose plans to recover increased system safety and reliability costs associated with the transition to a deregulated environment and, if the plans met certain criteria, directed the Commission to authorize the plans. Section 368 also required that PG&E's plan provide for an increase in base revenues in 1997 and 1998 equal to the consumer price index plus 2%. The statute restricted PG&E's use of the additional revenues to " . . enhancing its transmission and distribution system safety and reliability, including, but not limited to, vegetation management and emergency response." Section 368 also mandated our ratemaking treatment of such increased revenues not expended for system safety and reliability:

> To the extent the revenues are not expended for system safety and reliability, they shall be credited against subsequent safety and reliability base revenue requirements. Any excess revenues carried over shall not be used to pay any monetary sanctions imposed by the commission. (§ 368(e)(2).)

Taken together, the § 368 requirements were intended to effectuate a rate freeze or reduction and permit PG&E to enhance transmission and distribution system safety and reliability.

The Commission authorized PG&E's cost recovery plans for 1997 and 1998 in December 1996. (See D.96-12-077 [70 CPUC2d 207], rehearing denied in D.98-12-094.) Specifically, the Commission authorized incremental base revenue increases for PG&E of $164.231 million for 1997, and $241.614 million for 1998, for system safety and reliability enhancements. PG&E overspent the authorized amount by $19.012 million in 1997 and underspent the authorized amount by $2.875 million in 1998.

For context, it is helpful to remember that the § 368(e) authorized revenues are an increase above the amounts authorized by the Commission in PG&E's 1996 General Rate Case (GRC) for transmission and distribution system safety and reliability. The table below summarizes the authorized revenues and expenditures.

Transmission and Distribution System Safety and Reliability Revenues[2]

	1997	1998
	(millions of dollars)	
GRC-Authorized[3]	$326.462	$320.891
§ 368(e)-Authorized[4]	$164.231	$241.614
Total Authorized	$490.693	$562.505
Company Expenditures[5]	$509.705	$559.63
Over/Under Authorized	-$19.012	$2.875

We also directed PG&E to establish a one-way balancing account, the System Safety and Reliability Enhancement Funds Balancing Account (SSREFBA), to track PG&E's expenditures, and ensure that any funds collected and not used are appropriately credited as required by § 368(e)(2). In D.96-12-077, we took the rather unusual step of specifying the sub-accounts. We said at the time that the high degree of specificity was required to enable us

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2 The accounts that were totaled to arrive at these figures are the same accounts identified by the Commission in Attachment A to D.96-12-077.

3 *See* D.95-12-055 (63 CPUC2d 570), PG&E's 1996 GRC Decision.

4 *See* D.96-12-077 and Advice Letters 1612-E-B and 1703-E, and Resolution E-3251.

5 The amounts noted here reflect adjustments PG&E recorded that were described in this application. (*See* Application, pp. 3-4, filed March 19, 1999.)

to perform our future ratemaking duties and confirm that the funds expended in the balancing account were in fact incremental to the funds authorized for safety and reliability in the 1996 GRC decision, D.95-12-055, (63 CPUC2d 570).

In addressing an application for rehearing of D.96-12-077, we determined that D.96-12-077 properly applied § 368(e) to PG&E and that § 368(e) funds may be used for on-going activities – rather than just new activities - that enhance the safety and reliability of PG&E's transmission and distribution system. We further determined that § 368(e) specifically allows PG&E to devote the funds to vegetation management activities, such as tree-trimming, for the purpose of improving the safety and reliability of PG&E's transmission and distribution system. (*See* D.98-12-094.)

Briefs were filed on March 10, 2000.

III. Scope of Proceeding

The scope of this proceeding was described in *Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge*, issued on June 24, 1999. The fundamental questions we need to resolve are: (1) whether the incremental revenues PG&E recorded in the balancing account during 1997 and 1998 were spent on the kinds of transmission and distribution system safety and reliability activities authorized in § 368(e), D.96-12-077, and D.98-12-094; and (2) whether they were reasonably incurred.

IV. Standard

Section 368(e) directs PG&E to restrict its expenditures to those that enhance[6] transmission and distribution system safety and reliability. The parties do not dispute that in D.96-12-077, we interpreted the code to require these expenditures to be incremental to expenditures authorized in PG&E's 1996 GRC. Nor do the parties dispute the specific accounts at issue, as laid out in D.96-12-077, Attachment A. The parties agree that in D.98-12-094, we interpreted "enhance," in the context of § 368(e), as not restricting PG&E's expenditures to only new activities.

PG&E argues that § 368(e), D.96-12-077, and D.98-12-094 only require it to do three things to be assured recovery from ratepayers of the § 368(e) revenues it spent: (1) establish the balancing account; (2) detail the accounting used to track the incremental funds authorized in § 368(e) in a manner distinct from funds authorized in the 1996 GRC; and (3) incorporate specific tariff language and the specific accounts and capital programs set forth in Attachment A of D.96-12-077.

PG&E argues further that it need not independently demonstrate that expenditures made in compliance with the statute, our decisions and our orders enhance system safety and reliability. In support of this position, PG&E notes that in D.96-12-077 we rejected the Office of Ratepayer Advocates' (ORA) and The Utility Reform Network's (TURN) request that PG&E be required to describe in detail the intended uses of the revenue increases and how the revenues will be applied to enhancements to system safety and reliability. In D.98-12-094, upon

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[6] See: *The American Heritage Dictionary of the English Language, New College Edition* 1980; Enhance is "to increase or make greater, as in value, cost, beauty or reputation; augment." It is also a synonym for "improve."

consideration of rehearing of D.96-12-077, we clarified our position in the course of dealing with objections raised by TURN:

> TURN asserts that it would be unfair to PG&E's ratepayers, and contrary to AB 1890 and to the rate-making principles pronounced previously in D.96-12-066, to allow the §368(e) funds to cover cost overruns for previously forecasted T&D activities. PG&E, TURN argues, should not be able to use the funds to bail itself out of cost overruns for activities required to simply maintain the system at the levels forecast in the GRC.
>
> However, the legislature clearly did not intend to maintain traditional regulatory practices. On the contrary, pursuant to the §368 legislation, the utilities are instructed to submit cost recovery plans so that they can recover certain costs that would otherwise be rendered unrecoverable by the move from regulation to competition in the electric utility industry.
>
> TURN would preclude PG&E from spending §368(e) funds on additional tree trimming, faster or more focused storm response and other such activities which are integral to the reliability and safety of the T&D system. There is no indication that the Legislature intended to encourage such a restriction. Quite the contrary, the language of §368(e)(2) specifically allows PG&E to devote the funds to vegetation management activities, such as tree trimming, with the purpose of improving the safety and reliability of PG&E's T&D system. TURN's interpretation would work against that purpose.[7]

Thus, in D. 98-12-094, we expressly rejected TURN's argument that Section 368(e) funds could only be used for new activities and could not be used for activities that "simply maintain" PG&E's transmission and distribution system. In so doing, we confirmed that the requirements for recovery specified in Decision 96-12-077 are consistent with the express language and legislative intent of Section 368(e).

Notwithstanding its objections to being required to make a separate showing of system enhancement, PG&E introduced evidence at the hearings and

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[7] D.98-12-094, p. 8

in its briefs responsive to this issue. Accordingly, our consideration of whether the incremental revenues were spent on authorized activities includes consideration of whether:

(1) costs recorded were *incremental* to the costs authorized in the 1996 GRC; and

(2) the activities *enhanced or improved* transmission and distribution system safety and reliability.

Section 368(e) does not state that the base revenue increases authorized therein should be subject to reasonableness review. Nevertheless, both ORA and TURN requested in their protests to Advice Letter 1612-E that PG&E's Section 368(e) expenditures be subject to reasonableness review. In Decision 96-12-077, we agreed that we would "confirm through an audit procedure that the funds expended in the [SSREFBA] are in fact incremental to the funds authorized for safety and reliability in the 1996 GRC decision,"[8] but we did not state that this "audit procedure" would constitute a reasonableness review.

In its protest of PG&E's Section 368(e) application, ORA requested that the scope of issues in this proceeding be expanded to include the reasonableness of PG&E's costs.[9] PG&E opposed this request on the basis that neither Section 368(e) nor Decision 96-12-077 requires *post facto* reasonableness review.[10] The

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8 D.96-12-077, p. 30.

9 "Protest of the Office of Ratepayer Advocates to the Application of Pacific Gas and Electric Company for Review and Approval of PG&E's 1997 and 1998 Expenditures Pursuant to Section 368(e) of the California Public Utilities Code" (filed April 23, 1999 in A.99-03-039).

10 *See* "Reply of Pacific Gas and Electric Company to Protest of the Office of Ratepayer Advocates" (filed May 3, 1999, in A.99-03-039); *see also* Prehearing Conference Tr. pp. 8–9 (PG&E, Kim).

Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge, issued June 24, 1999, granted ORA's request on the basis that "[n]othing in §368(e) changes the Commission's longstanding obligation to ensure that the rates are just and reasonable (§451)."

PG&E does not dispute that it bears the burden of proof in this proceeding. As discussed above, PG&E maintains that its Section 368(e) expenditures complied with the requirements and conditions of Section 368(e) and of Decision 96-12-077, as confirmed by Decision 98-12-094. In compliance with the statute and these decisions, PG&E filed two reports summarizing its entries into the SSREFBA and detailing on an account-by-account basis PG&E's expenses and, on a major work category basis, PG&E's capital additions and related revenue requirements. PG&E has also provided detailed workpapers and access to its accounting system to ORA to permit examination of individual accounting entries and evaluation of PG&E's financial models.[11] To the extent third parties have submitted data requests regarding specific expenditures, PG&E has responded to such data requests.[12] PG&E's showing in this proceeding is therefore consistent with the showings made in "traditional" reasonableness proceedings.[13]

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[11] *See* notes 11–14, *supra*, and accompanying text.

[12] *See, e.g.*, Exhs. 6, 7, 9, 11, 13, 16, 18, 19, 20, 23, 28.

[13] *See* Tr. pp. 147–149 (PG&E, Frazier-Hampton) (in ECAC reasonableness cases, the utility provides information to support the costs it has incurred, provides the showing to the Commission, and allows other parties the opportunity to review and submit data requests on the utility's showing); *see also* Excerpt from *PG&E's Resource* (Exh. 14) (defining "reasonableness").

The procedural questions raised by this history are: (a) Did PG&E make a prima facie case of entitlement to reimbursement for reasonable expenditures? (b) Were the reasonable expenditures incremental to costs authorized in the 1996 GRC? (c) Which party had the burden of going forward with evidence on the issue of the allowability of specific expenses? We conclude that PG&E made a prima facie showing of entitlement to reimbursement for reasonable incremental expenditures by complying with the statutory requirements and the detailed accounting instructions we gave it in D.96-12-077 and D. 98-12-094. Thereafter the burden of demonstrating that specific expenditures identified by PG&E in its compliance reports and its application were reasonable and incremental fell to PG&E, as is standard in traditional ratemaking proceedings and required by Section 451. We conclude that, for the most part, PG&E carried this burden with regard to the expenses at issue in this case and we therefore allow PG&E to recover most of the expenses disputed by ORA and TURN.

We allow:

1. $27 million for administrative and general (A&G) expense in 1997 and 1998;
2. $450,000 for advertising expenses in 1998;
3. $5.6 million in 1997 and $13.9 million in 1998 for common plant capital expenditures;
4. $7.01 million in 1997 and $ 6.3 million in 1998 for Distribution and Customer Service Support (DCSS) expenses; 4. $940,000 in 1998 expenses and $1.46 million in 1998 capital expenditures for Year-2000 compliance; and
5. $940,000 in 1998 expenses and $1.46 million in 1998 capital expenditures for Year-2000 compliance; and

We disallow:

1. $499,295 in automatic meter reading (AMR) costs in 1998; and
2. $929,000 in 1998 capital expenditures for meter reading vehicles.
3. $2.06 million in 1997 restructuring-related expenses;

We direct PG&E to file a separate CEMA application to recover $5.406 million in catastrophic event related costs for 1997 and $15.312 million in catastrophic event related costs for 1998.

We defer consideration of $2 million in 1998 pole treatment expenses to an advice letter filing.

We reject ORA and TURN's proposed prior-period adjustments for cash accounting by PG&E for various tree-trimming expenses.

V. Specific Expenditures

In its 1997 and 1998 Audit Reports (Exhibits 4 and 5, and errata filed November 8, 1999), ORA recommended numerous adjustments to the amounts PG&E recorded in the balancing account.[14] ORA recommended $56.6 million in adjustments for expense-related items and $19.6 million in capital-related items recorded in calendar year 1997. It recommends $41.132 million in adjustments for expense-related items and $3.354 million in capital-related items recorded in 1998. Separately, TURN has recommended approximately $14 million in adjustments for expenditures recorded in 1997 and 1998. PG&E agreed, in some instances, to make the adjustments. PG&E agreed that $10.53 million was

[14] In neither its audit reports nor its testimony does ORA assert that PG&E imposed any inappropriate limitations on the scope of ORA's review. ORA was apparently able to determine and pursue the level of review it deemed necessary.

incorrectly recorded in the § 368(e) accounts. (*See Summary Table of Resolved Issues,* Appendix B, PG&E Opening Brief.) We discuss the disputed expenditures below.

1. Administrative and General ($27 Million)

ORA recommends certain reductions in the authorized expenditures because PG&E reclassified A&G expenditures and recorded them in sub-accounts to which the § 368(e) enhancement applies. ORA recommends an $15.1 million reduction to reflect the impact of reclassification of A&G costs into operations and maintenance (O&M) costs recorded in 1997. One category of costs that were reclassified is "chargebacks," charges made by one company department to another for internal services. ORA recommends that A&G chargebacks totaling $15.1 million composed of $3.9 million, recorded in 1997, and $11.9 million, recorded in 1998, not be authorized as § 368(e) expenditures.

The O&M chargeback reclassification occurred when PG&E implemented a new accounting system that employed a different chart of accounts. Although total dollars charged to the system remain unchanged, PG&E now charges to O&M expense accounts certain chargebacks previously charged to A&G accounts and vice-versa. PG&E's application compares the lump sum total amounts spent in all the specified accounts for each year with the total amount spent in 1996. ORA argues that as a result of this accounting change, it cannot verify that the funds expended are incremental to those authorized in the 1996 GRC accounts.

Aside from ORA's general concerns about the incremental nature of PG&E's Section 368(e) expenditures, the only costs specifically challenged on incremental grounds are PG&E's so-called "reclassified A&G" and "A&G chargeback" costs.[15] Regarding the "reclassified A&G" costs, PG&E Witness Frazier-Hampton explained at hearings that PG&E's new accounting system was implemented in May or June of 1996, several months *before* the Commission issued Decision 96-12-077.[16] As a result of implementing the new accounting system, PG&E was able to "better identify where . . . costs should be recorded."[17] PG&E has made a showing that the "reclassified A&G" and "A&G chargeback" costs were incremental, although due to its change of accounting systems it is not entirely clear whether the requested amounts are entirely accurate.

In its rebuttal testimony, PG&E also explained that computer and telecommunications support functions and facilities costs — which comprise all of the "A&G chargeback" costs at issue in this proceeding — enhance PG&E's T&D system safety and reliability through "better maintenance continuity, analyzing and resolving recurring problems through the use of various computer software systems, and advanced phone capabilities" and by housing employees and equipment.[18] PG&E showed that computer and telecommunications support functions and facilities costs are essential to enable PG&E's distribution and transmission personnel to perform their safety and reliability-related work, and that these costs are therefore reasonable for Section 368 recovery purposes. Therefore, we allow recovery of A&G chargeback and reclassified A&G costs.

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[15] *See* ORA's 1997 Audit Report (Exh. 4), pp. 2-4, 3-5 to 3-8; ORA's 1998 Audit Report (Exh. 5), pp. 2-3 to 2-4, 3-4 to 3-5.

[16] Tr. pp. 136–137 (PG&E, Frazier-Hampton).

[17] Tr. p. 50, ll. 27–28 (PG&E, Frazier-Hampton).

[18] PG&E's Rebuttal Testimony (Exh. 3), p. 1-15.

While PG&E has readily admitted that some of the costs now recorded in the SSREFBA's O&M accounts had been recorded in A&G accounts under the former accounting system, the reverse is also true.[19] In the words of ORA's attorney, "it's PG&E's position that the Commission can safely assume that the inaccuracies end up as a wash; in other words, inaccuracies of what's in the accounts would be offset by the inaccuracies of what should have been in the accounts but isn't."[20] At hearings, PG&E Witness Frazier-Hampton stated that PG&E had identified at least $31 million in O&M-type costs not included in PG&E's SSREFBA, as compared to the approximately $27 million in A&G-type costs identified by ORA.[21] ORA Witness Ayanruoh admitted at hearings that, if the Commission were to adopt his recommendation to remove A&G-type costs from Section 368(e) recovery, PG&E should also be permitted to recover O&M-type costs that it had *not* included in its SSREFBA.[22] However, PG&E has made no showing regarding $ 31 million (or any other amount) of O&M – type costs not included in PG&E's SSREFBA; we cannot allow recovery as reasonable costs which have not even been identified in the record. Instead we will allow only the $27 million identified by PG&E.

2. Advertising Expenses ($450,000)

ORA recommends that $450,000 in expenses described by PG&E as "advertising expenses" that were recorded under § 368(e) in 1998 should be

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19 *Id.*; Tr. pp. 130–131 (PG&E, Frazier-Hampton).

20 Tr. p. 130, ll. 6–10 (ORA, Bromson).

21 Tr. p. 131, ll. 3–11 (PG&E, Frazier-Hampton).

22 *See* Tr. p. 254, ll. 5–20 (ORA, Ayanruoh).

disallowed. ORA acknowledges that PG&E later explained that the description assigned to the charges was in error and that they should have been described as charges associated with providing information to customers about system emergencies. ORA recommends removal because it believes that the costs should have been recorded in a different account, Account 909.

PG&E Witness Frazier-Hampton explained why such costs were recorded in an account other than FERC Account 909:

> These particular expenses identified as Item 3 advertising expenses on this page are different from the informational and instructional advertising expenses reflected in this Account 909. These expenses on page 1-16 of my testimony were explicitly performed to inform customers of emergency types of situations.[23]

We agree with PG&E's reasoning. PG&E is thus entitled to recover such costs under Section 368(e), which is intended to enhance T&D system safety and reliability.

3. Automatic Meter Reading (AMR) Costs ($499,295)

TURN argued that PG&E's AMR costs should not be recovered under Section 368(e) because they are "not sufficiently related" to T&D system safety and reliability.[24] PG&E Witness Carruthers explained at hearings that AMR could be used "to send signals to an outage information system to let PG&E know that groups of customers are out of power [which]…would facilitate our diagnosis of the distribution system relative to where an outage may have

[23] Tr. p. 65 (PG&E, Frazier-Hampton).

[24] TURN's Opening Brief, p. 11. The "sufficiently related" standard is not found in the plain language of Section 368(e), in either Decision 96-12-077 or 98-12-094, or in TURN's own filed testimony.

occurred."[25] PG&E concedes that the AMR project also produced benefits to its billing system. However, the fact that a project could produce *other* benefits aside from enhancing T&D system safety and reliability does not render the costs of such project unrecoverable under Section 368(e). The issue here is similar to the issue of vehicle purchases which we discuss below. In both cases, the question is whether the expenses are reasonably related to enhancing system safety and reliability. Each case calls for a balanced judgment about the relative contribution of the expenditure to system safety and reliability as compared with other uses of the equipment or services purchased. The statute does not require and we do not believe that there is a minimum amount of system safety and reliability that the expenditures have to produce. At the same time, we believe that an expenditure that produces only a remote and insignificant benefit to system safety and reliability is better dealt with in a GRC than in this proceeding.

On balance, with regard to automatic metering, we believe the testimony establishes that although there is a benefit to system safety and reliability derived from automatic metering, the benefit is too remote and insignificant to qualify as a reasonable use of Section 368 funds and we will not allow it.

4. Common Plant "Unbundling" ($19.5 Million)

In its filed testimony, TURN argued that PG&E's expenditures for capital programs should be "unbundled" to remove gas, electric generation, and electric transmission costs after April 1, 1998.[26] In its rebuttal testimony, PG&E explained that the two common plant programs identified in Attachment A to

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[25] PG&E's Opening Brief, p. 15, *quoting* Tr. P. 33, ll. 11–19 (PG&E, Carruthers).

[26] *See* TURN Testimony (Exh. 24), pp. 5–7.

Decision 96-12-077 (Program 902 — Fleet, Equipment, and Tools, and Program 904 — Telecommunications Equipment) were not unbundled in the 1996 GRC.[27] In order to do an "apples to apples" comparison, as required by the accounting procedures discussed in Decision 96-12-077 and Advice Letter 1612-E-B, PG&E compared the total unbundled common plant cost for Programs 902 and 904 authorized in the 1996 GRC against the total actually incurred in 1997 and 1998 to determine the proper increment that would be eligible for Section 368(e) recovery.

For purposes of determining the annual base revenue increases for 1997 and 1998, however, PG&E's common plant capital costs *have* been unbundled. In calculating the base revenue increase for 1997, PG&E used its 1996 GRC *electric* base revenue requirement, which reflects an allocation of common plant capital costs between gas and electric.[28] Moreover, in calculating the base revenue increase for 1998, PG&E, at the Commission's direction, further reduced its total electric base revenue requirement (not just the common plant portion) to reflect costs related to the transmission department after March 31, 1998.[29]

As PG&E Witness Winn testified at hearings, however, "in the advice letter filing approving PG&E's tariff sheets for the establishment of the

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27 PG&E's Rebuttal Testimony (Exh. 3), pp. 4-1 to 4-2.

28 *See* PG&E's Advice Letter 1612-E-B, Attachment I, Revised Cal. P.U.C. Sheet 14289-E (indicating that the base revenue amount would be calculated based on the "GRC Result of Operations" amount of approximately $3.25 billion); *see also* D.95-12-055 (PG&E's 1996 GRC decision), Appendix D (showing a GRC result of operations figure for the *electric department* of approximately $3.25 billion and a GRC result of operations figure for the *gas department* of approximately $1.1 billion).

29 *See* Resolution E-3516.

[SSREFBA]…the Commission specifically said that the adopted amounts to be used from the '96 GRC were the *total* common costs approved for those programs, and they would include gas services as well as electric services."[30] Under the accounting procedures of Decision 96-12-077, PG&E had to compare the total common plant capital costs for Programs 902 and 904 authorized in the 1996 GRC against the total actually incurred in 1997 and 1998.

To require PG&E to again unbundle its common plant capital costs incurred in 1997 and 1998 would be inconsistent with our requirements and would result in an unfair undercollection of PG&E's costs. For example, if the electric-to-gas allocation in the 1996 GRC was 70:30 and PG&E were also to allocate its common plant capital costs incurred in 1997 and 1998, as TURN suggests, PG&E would recover only 49% of its total common plant capital costs (70% of 70%), rather than the 70% to which it is entitled. Such an outcome is neither required by nor consistent with Section 368(e) or the Commission's implementing decisions.

5. Distribution and Customer Service Support (DCSS) Costs ($13.31 Million)

At issue is whether DCSS Account Expenditures for clerical support services for electric distribution system operations, maintenance and construction personnel that are recorded in the DCSS expenses should be excluded from recovery because they do not directly enhance system safety and reliability. ORA does not dispute that DCSS expenses are necessary to maintain

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[30] Tr. p. 164, ll. 15–24 (PG&E, Winn) (emphasis added). *See also* PG&E's Advice Letter 1612-E-B, Attachment I, Original Cal. P.U.C. Sheet No. 14314-E, n.1 ("The capital additions included in the adopted 1996 rate base are as follows:…Program 902 -- $45.534 million; Program 904 -- $26.034 million.")

service at existing levels. In its 1998 report, ORA argued that DCSS costs "are normal operating costs, essential for PG&E to maintain the same standard or level of performance, and do not enhance the safety and reliability of operations."[31] In its rebuttal testimony, PG&E explained that "for PG&E's operations, maintenance and construction personnel to work, they must have the necessary support. PG&E's DCS support personnel work together with operations, maintenance and construction personnel to provide a safe and reliable system."[32] PG&E Witness Carruthers confirmed this at hearings.[33]

Indeed, ORA Witness Ayanruoh agreed that these DCS support costs are "essential for PG&E to maintain the same standard or level of performance."[34] ORA is mistaken in contending that activities that "simply maintain" the T&D system are not recoverable under Section 368(e); we expressly rejected such a narrow interpretation of Section 368(e) in Decision 98-12-094. Accordingly, we approve these expenses.

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[31] ORA's 1998 Audit Report (Exh. 5), pp. 3-9 to 3-10.

[32] PG&E's Rebuttal Testimony (Exh. 3), p. 3-5.

[33] Tr. p. 15, ll. 6–17 (PG&E, Carruthers).

[34] ORA's 1998 Audit Report (Exh. 5), pp. 3-9 to 3-10; *see also* Tr. p. 265, ll. 1–23 (ORA, Ayanruoh) (agreeing that it would be correct to paraphrase ORA's statement as "ORA believes that the DCS support costs are normal operating costs, absolutely necessary for PG&E to maintain the same standard or level of performance.").

6. Electric Industry Restructuring Costs ($2.06 Million)

ORA contends that $3.9 million of costs incurred in 1997 relating to electric industry restructuring implementation should be excluded from § 368(e) recovery. PG&E describes these costs as including labor and expenses associated with the design, development, and implementation of Independent System Operator (ISO) operational systems, physical facilities, business systems, business rules and protocols. PG&E also describes these costs as transmission reliability-related costs. PG&E has agreed that $1.84 million of these costs should be removed since recovery of them was requested and granted in two other proceedings, leaving recovery of $2.06 million contested.[35]

Like the CEMA costs discussed elsewhere, ORA argues that these costs did not enhance system safety and reliability and should have been included in PG&E's application to recover electric restructuring costs pursuant to § 376.[36] ORA asserts that these costs would not have been incurred if electric industry restructuring had not been implemented. ORA maintains that costs incurred to implement restructuring that are not funded in the 1996 GRC may be recovered under § 376. ORA claims that prior to the settlement, PG&E had carefully detailed where costs associated with electric industry restructuring implementation were being recovered but made no mention of its effort to recover such costs in this proceeding. ORA concludes that as long as such costs

[35] Specifically, PG&E states that $1.34 million was included in the Annual Transition Cost Proceeding (Application (A.) 98-09-003) and $0.49 million was included in its § 376 proceeding (A.98-05-004).

[36] That application, A.98-05-004, was concluded in a settlement that was approved by the Commission in D.99-05-031.

were properly included in PG&E's § 376 application, regardless of whether the Commission approved their recovery in adopting the settlement, they are ineligible for recovery under § 368(e). Without stating it explicitly, ORA seems to be concerned that PG&E is attempting to recover electric restructuring costs above and beyond the recovery of such costs recommended in the settlement and ultimately approved in D.99-05-031, in conflict with the settlement adopted in that decision.

TURN again points out that the mechanism for recovery – pursuant to § 368(e) vs. § 376 – is important. TURN argues, and PG&E does not appear to contest, that the costs recorded were entirely devoted to the development and implementation of the ISO, and are, therefore, transmission expenses. Recovery here, TURN explains, would allocate these transmission expenses on a distribution-EPMC basis. TURN argues that this outcome is contrary to the settlement equal percentage of marginal costs (EPMC) approved in D.99-05-031, which stated that costs such as these would be categorized as "internally managed restructuring costs" and be recovered through a one-time debit to the Transition Revenue Account (TRA). TURN states that although the Commission is presently considering proposals to change the allocation, none of the proposals would assign as high a proportion of these costs to small consumers as would allowing recovery of them in this proceeding. [37]

PG&E claims that the electric restructuring costs at issue here were not included in its § 376 application. It argues that § 376 is not the exclusive means of recovering electric restructuring costs, and that these costs were not required

[37] The allocation methodology issue that was pending while this proceeding was in active litigation is moot, because we adopt the disallowance.

to be included in PG&E's § 376 application. They were not included, argues PG&E, because contrary to ORA's assertions, the standard for recovery under § 376 differs from that under § 368(e). PG&E claims that § 376 cost recovery was limited to costs incurred to perform tasks different from the tasks funded in the 1996 GRC, and that the costs must be one-time only type costs. PG&E states that the restructuring costs at issue here are costs that it would incur regardless of electric industry restructuring.

In D.99-05-031, the Commission stated that costs eligible for § 376 treatment must be incremental to those costs (1) covered in current rates, and (2) that relate to ongoing utility business. (D.99-05-031, p. 20.) In that decision, the Commission also adopted guidelines regarding § 376 treatment and cost recovery issues, including the following:

1. Identification and recovery of <u>all</u> restructuring implementation costs shall be addressed in this proceeding. Restructuring-related costs other than restructuring implementation costs, shall be recoverable from customers.
2. Only those costs expended to accommodate implementation of the ISO, Power Exchange, and direct access until December 31, 1998 shall receive § 376 treatment. Therefore, costs incurred after 1998 are not eligible for § 376 treatment and the costs of operating these programs on an ongoing basis are not eligible for § 376 treatment.
3. Restructuring implementation costs shall be recovered through a debit entry to the TRA and shall not be assigned to separate cost categories such as transmission, distribution, etc. (*Id.*, pp. 23-24, emphasis added.)

Moreover, the Commission found that costs incurred to establish the new market structure, "i.e., accommodate the implementation of the ISO" are eligible for recovery through § 376. (*Id.*, p. 19.)

The specific costs at issue here were described in Exhibit 11, which includes PG&E's descriptions of the work orders associated with the costs. As TURN pointed out, all of the activities were related to the development and implementation of the ISO. For example, labor and expenses associated with the ISO's physical facilities in Folsom, California; preparation of functional diagrams and vendor bid documents for the ISO's settlement and billing systems; and stakeholder discussions on how the ISO's operation systems should function. All of the activities and the associated costs are restructuring implementation costs specific to development and implementation of the ISO.

At a minimum, PG&E should have identified these costs in its § 376 application. In D.99-05-031, the Commission clearly stated that all restructuring implementation costs were to be identified in that proceeding. In fact, parties supporting the settlement argued that the settlement was in the public interest precisely because it identified and addressed the overlap issues with other proceedings and provided a clear roadmap for their resolution. Apparently other parties believed PG&E had identified <u>all</u> restructuring implementation costs, and the settlement struck among those parties was, at least in part, predicated on that assumption. In D.99-05-031, the Commission summarized the following understanding:

> PG&E expects to incur $114.3 million in restructuring implementation expensed costs and $11.6 million in capital costs, for a total of $125.9 million. Out of this total, PG&E has subtracted $13.6 million for which it expects to seek recovery in other forums, externally managed costs of $62.2 million for 1997 and 1998, and a settlement reduction of $10 million.

PG&E did not make an exception for recovering some restructuring costs in § 368(e).

PG&E cannot now credibly come to the Commission and state that it did not include all restructuring implementation costs in the § 376 proceeding. PG&E's statements to that effect undermine its § 376 settlement. We will not allow recovery here of the electric restructuring implementation costs that PG&E failed to bring to our attention in A.98-05-004 et al. To do so would undermine the Commission's settlement process.

Further, given how PG&E defines costs eligible for § 376 recovery, we cannot conclude that the costs at issue were ineligible for recovery in its § 376 application. Performing the task of, for example, designing and developing the physical facilities for the ISO in Folsom is different from the tasks funded in the 1996 GRC, and the costs incurred to perform that function are one-time only type costs. These costs are clearly unrelated to enhancing system safety and reliability. Therefore, we find that PG&E should not be allowed to recover the remaining $2.06 million in contested electric industry restructuring costs under § 368(e) and that these costs should be excluded from 1997 expenses.

7. Pole Test & Treat Costs ($2 Million)

TURN argues that PG&E should not be allowed to recover amounts for the pole test and treat program, which should be the responsibility of the joint owners of the poles, primarily the telecommunications utilities. It argues that in 1996 and 1997, PG&E recovered $2.22 million and $2.023 million, respectively, from joint owners. TURN contends that it would be unreasonable for the Commission to assume for ratemaking purposes that the telecommunications utilities will "get off the hook" for their traditional responsibility to maintain joint poles. (Ex. 24, TURN / Marcus, p. 4.) TURN proposed two remedies:

(1) deduct $2 million in imputed revenues from the amount PG&E is allowed to recover under § 368(e), or, (2) in the alternative, direct PG&E to establish an accounting mechanism that will ensure that ratepayers receive the full benefit of any reimbursement ultimately made to PG&E by its joint pole owners.

PG&E argues that no party questions that pole test and treat costs enhance transmission and distribution system safety and reliability, or that they satisfy the requirements for § 368(e) recovery. PG&E does not object to establishing a memorandum account to track any reimbursements PG&E may receive for pole maintenance. PG&E points out, however, that Pacific Bell Telephone Company (Pacific Bell),[38] the predominant joint owner of its poles, has stated that it is not bound by General Order (GO) 165 and, therefore did not anticipate participating financially in the pole test and treat program. PG&E states that "[w]hile TURN and PG&E [the utility] may disagree with this interpretation of GO 165, the fact remains that Pacific Bell has not reimbursed [the utility] for test and treat work done on joint poles in 1998." (Ex. 3, PG&E Co / Carruthers, p. 3-8.)

The test and treat program is conducted to comply with GO 165. The purpose of GO 165 is to establish minimum requirements for electric distribution facilities inspection, condition rating, scheduling and performance of corrective action, record keeping, and reporting, in order to ensure safe and high-quality electrical service. We considered recovery by PG&E of costs associated with wood pole test and treat programs in the GRC. (D.00-02-046, pp. 164-165.) We disallowed PG&E's proposed forecast adjustment of $3,200,000 for its

[38] Pacific Bell is now known as SBC Communications, Inc.

supplemental pole test-and-treat costs on the grounds that it was not reasonable to charge ratepayer for a supplemental maintenance program *in the GRC*:

> PG&E has not shown that it is reasonable to charge ratepayers for this expense through this GRC. We support appropriate cost sharing for the costs of testing and treating jointly owned poles. However, this is not the appropriate proceeding to resolve alleged deficiencies in GO 165.

By contrast with the GRC, this case is an appropriate proceeding to deal with the pole test and treat issues for 1997 and 1998. Under Section 368(e), PG&E was granted base revenue increases to enhance T&D system safety and reliability in those years. It is undisputed that pole test and treat expenditures enhance T&D system safety and reliability and that they satisfy the requirements for Section 368(e) recovery.

In its filed testimony, TURN urged us to require PG&E to hold its SSREFBA open for the limited purpose of recovering and crediting to ratepayers any reimbursements for joint pole test and treat work.[39] We will keep open this proceeding and PG&E's SSREFBA for this sole purpose. PG&E should submit an Advice Letter detailing the current status of payments from joint pole owners for work performed in 1997 and 1998. We will defer a decision on recovery of the $2 million for pole recovery costs to the Advice Letter process. In the meantime, the extent that PG&E receives reimbursement from joint pole owners, such funds should be tracked in a memorandum account and credited to ratepayers. Further, PG&E should actively pursue such reimbursement from Pacific Bell and other joint pole owners.

[39] TURN Testimony (Exh. 24), p. 4.

8. Vehicles Used for Metering ($929,000)

PG&E included in its request $929,000 of common plant costs incurred to purchase vehicles used for metering. PG&E argues that the vehicles are "available for emergency response duties" and "could be used" as part of its response to emergencies on its transmission and distribution system. (Ex. 3, pp. 3-9 and Opening Brief of PG&E, pp. 15-16.) In support of characterizing these vehicle purchases as appropriate uses of Section 368 funds, PG&E argues that nothing in § 368(e) or the Commission's implementing decisions suggests that the funds "can only be used to purchase items that are actually used for specific purposes a certain percentage of the time." (Reply Brief of PG&E, p. 24.)

PG&E's witness testified that these emergency response duties would likely arise only during Class 3 and Class 4 emergencies; that during the last five years, PG&E has experienced no Class 4 emergencies, and approximately 10 Class 3 emergencies lasting from one to five days each.

We agree that it is appropriate for PG&E to utilize its available vehicle fleet as necessary in emergency response. PG&E is also correct that the statute and our implementing decisions do not include any "minimum use" criteria for evaluating whether a particular expenditure is eligible for recovery through § 368(e) funds. However, as with the issue of automatic metering, it is clear from this record that the metering vehicles have at best a remote and insignificant relationship with transmission and distribution system safety and reliability. Even though the metering vehicles are available for emergency response, they were not acquired for that purpose and have rarely been used in such situations. Accordingly it is an unreasonable use of Section 368 funds to purchase such vehicles and we disallow $929,000 incurred to purchase them.

9. Year 2000 Compliance Expenses ($2.086 million)

ORA recommends that $940,000 in 1998 expenses and $1.46 million in 1998 capital spending associated with year 2000 (Y2K) embedded system costs be excluded from recovery under § 368(e). ORA argues that PG&E cannot demonstrate that its Y2K spending has demonstrably enhanced transmission and distribution system safety and reliability

PG&E responds that its Y2K expenses were incurred for inventorying, assessing, testing, and remediation to embedded systems and applications associated with its distribution system.

We believe ORA is inappropriately applying a hindsight test to this expenditure. It is common knowledge that American companies, including utilities, spent billions of dollars testing and reconfiguring computer systems to avoid an anticipated melt-down at the turn of the millennium. This type of expenditure is exactly analogous to tree-trimming, in that it is designed to anticipate and forestall a future threat to system safety and reliability. We will approve it.

VI. Catastrophic Event Memorandum Account Costs

ORA claims that PG&E recorded $23.9 million in § 368(e) accounts for 1997 and $28 million in § 368(e) accounts for 1998 reflecting costs incurred to restore service after the 1997 New Year's flood and February 1998 storms. ORA argues that PG&E should seek recovery of these costs via a CEMA application pursuant to § 454.9, rather than in this § 368(e) proceeding.

PG&E argues that, from a ratepayer perspective, the mechanism through which these costs are ultimately collected is irrelevant, and that it will promptly file a request for recovery through CEMA following a decision in this proceeding. Further, PG&E argues that the amounts ORA identified as storm-and floor-related are overstated. PG&E states that it recorded storm- and flood-related expenditures of $5.406 million for 1997 and $23.683 million for 1998.

TURN disputes PG&E's assertion that ratepayers are indifferent to the mechanism used for recovery, arguing that the allocation of the underlying costs among various customer classes varies with the recovery mechanism. If these costs are recovered through CEMA, they may be recovered out of "headroom,"[40] or allocated by function to generation, distribution and transmission. If these costs are recovered in this proceeding, PG&E proposes to treat them as part of its distribution revenue requirement, which would result in the majority of them being recovered from residential and small commercial customers.

We agree with ORA and TURN that it is appropriate for PG&E to seek recovery of the storm-related costs in an application filed pursuant to § 454.9. PG&E acknowledges that the expenses and capital costs associated with restoring service after the 1997 New Year's flood and the February 1998 storms, are the kinds of expenses and costs that it would usually record to the CEMA. The costs and expenses eligible for recovery under § 368(e), on the other hand, are the types of costs that are usually included in base revenues, enhance or improve transmission and distribution system safety and reliability, and are incremental to the revenues authorized in a GRC. The revenues authorized in a GRC do not include the costs and expenses associated with declared disasters. Finally, we agree with TURN that choosing the correct mechanism for recovery is

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[40] At the time parties were litigating this proceeding the rate freeze imposed by AB 1890 was in effect. The Commission has since found in D.04-01-026 that the rate freeze ended on January 18, 2001.

not just an exercise in regulatory precision. The mechanism determines the method of calculation for sharing these costs among customer classes.

The following table summarizes the amounts in dispute:

Storm- and Flood-Related Costs
($ Millions)

Dollars In Millions					
	1997		1998		Total
	Capital	Expense	Capital	Expense	
PG&E	$0.000	$ 5.406	$ 8.371	$15.312	$29.089
ORA	$4.300	$19.600	$12.922	$15.312	$52.134
Disputed Amount	$4.300	$14.194	$ 4.551		$23.045

The costs in dispute are: (1) expenses related to the 1998 storms; and (2) expense and capital-related costs for the 1997 New Year's flood for which all expenses were offset by insurance proceeds received by PG&E in 1998.

As for the 1998 storm-related costs, PG&E and ORA agree that the capital-related figure is $15.312 million.[41] With respect to expenses, however, ORA claims that $12.922 million (as opposed to PG&E's figure of $8.371 million) should be excluded from Section 368(e) recovery. The difference between the two figures relates to straight-time labor costs. ORA cites two reasons for excluding straight-time labor costs from Section 368(e) recovery: (1) "It is impossible for PG&E to determine what the level of straight-time labor costs was

41 *Id.*, p. 27.

in the 1996 GRC in order to establish [w]hat the incremental level of expenses is"; and (2) "Straight-time labor costs and associated benefits do not enhance system safety and reliability."[42]

We established certain requirements to ensure that Section 368(e) expenditures are "truly incremental" to 1996 GRC funds and we conclude that PG&E has complied with these requirements.[43] As straight-time labor costs were part of the 1996 GRC adopted amounts for the accounts identified in Attachment A of Decision 96-12-077, straight-time labor costs associated with those accounts should also be included for purposes of determining the "incremental" amount above the 1996 GRC funds eligible for Section 368(e) recovery. Moreover, straight-time labor costs do enhance T&D system and reliability by ensuring that the necessary personnel are available to respond during storms and other emergencies. As noted in ORA's opening brief, PG&E excluded straight-time labor costs from its CEMA application.[44] Since PG&E has not recovered its straight-time labor costs related to the 1998 storms in the CEMA proceeding, there is no risk of double-recovering the costs in this proceeding.

As for the 1997 New Year's flood-related costs, ORA claims that there are $4.3 million in expenses and $19.6 million in capital-related expenditures, while PG&E states that there are no expenses and only $5.406 million in capital-related

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[42] *Id.*, p. 28.

[43] PG&E's Opening Brief, pp. 17–18.

[44] ORA's Opening Brief, p. 27.

expenditures.[45] As noted in PG&E's rebuttal testimony, PG&E's figures are supported by information presented to ORA in PG&E's CEMA proceeding.[46]

In opening brief, ORA raised the issue of PG&E's receipt of insurance proceeds in 1998 for the 1997 New Year's flood. ORA suggested that PG&E withheld this information and claimed that PG&E had not demonstrated that the insurance proceeds were credited to ratepayers.[47] To the contrary, PG&E has been forthcoming regarding the receipt of insurance proceeds in 1998 related to the 1997 New Year's flood. As PG&E Witness Frazier-Hampton noted in hearings, the workpapers to PG&E's 1998 Compliance Report show a credit in 1998 to Account 593 to remove expense dollars reflecting PG&E's receipt of insurance proceeds.[48] Ms. Frazier-Hampton further explained that by crediting the insurance proceeds to the O&M account, the costs to ratepayers was reduced.[49] Indeed, had PG&E not credited the O&M account with the insurance proceeds, the amounts recorded in the SSREFBA for these CEMA-related costs would have been approximately $4 million higher. To the extent ORA's recommendations regarding CEMA-related costs, including the level of costs, is adopted in this proceeding, PG&E would necessarily seek recovery in a CEMA application for the level of costs *actually* removed from Section 368(e) recovery.

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45 *Compare* ORA's 1997 Audit Report (Exh. 4), p. 1-5 *with* PG&E's Rebuttal Testimony (Exh. 3), p. 1-12.

46 PG&E's Rebuttal Testimony (Exh. 3), p. 1-12, *citing* Tables 9-1 and 9-2, Column C of PG&E's CEMA application (A.99-01-011).

47 ORA's Opening Brief, pp. 28–29.

48 Tr. p. 92 (PG&E, Frazier-Hampton).

49 *Id.*

Upon review of the entire record, we conclude that PG&E's allocation of storm-related costs is correct and we allow PG&E to seek reimbursement of $29,089 in a later CEMA application if it chooses to do so.

VII. Prior Period Transactions

Both ORA and PG&E agree that the proper accounting periods for this application, pursuant to § 368(e), are calendar years 1997 and 1998. ORA points out, and PG&E concedes, that PG&E recorded some transactions that occurred prior to January 1, 1997 as 1997 expenses, and some transactions that occurred prior to January 1, 1998 as 1998 expenses. ORA states that PG&E should have recorded transactions based on accrual accounting methods, and not the cash accounting method it applied, to match the transactions with the relevant accounting period.

ORA offered Exhibit 21 into evidence, which are excerpts from an accounting textbook. There, accrual accounting is defined as "relating the financial effects of transactions, events and circumstances having cash consequences to the period in which they occur rather than when the cash receipt or payment occurs." (Ex. 21, p. 34.) Recording the "financial effects" when the cash is received or payment is made is cash-based accounting. The authors state that "[b]ecause cash basis accounting does not attempt to match expenses against revenues, it is not in conformity with generally accepted accounting principles." (*See* Ex. 21, p. 35.)

PG&E states "accruals sometimes are not recorded for certain routine maintenance and operation expenses since they have little or no effect on the accuracy of the financial statements." (*See* Ex. 3, p. 2-2.) PG&E states routine tree-trimming and other miscellaneous distribution expenses typically involve thousands of invoices from numerous vendors, and a consistent level of expenditures between years. It argues that use of cash-based accounting for expenditures with these characteristics saves in processing time and produces annual expense levels that are approximately the same as annual expense levels produced under the accrual method. PG&E claims that it has never used the accrual method for recording tree-trimming expenses, and that the Commission's adopted expenses for 1996 tree trimming were developed using costs recorded on a cash basis. It also argues that neither § 368(e) nor the related implementing decisions require accrual accounting of incremental distribution expenditures.

This is not the proceeding to litigate the appropriate method of accounting for tree-trimming expenditures to arrive at the appropriate revenue requirement. The GRC is the traditional venue for that litigation. Upon review of the 1996 GRC decision, it is apparent that the accounting basis for the adopted revenues was not addressed. However, the Commission did adopt the estimated expenditures for tree-trimming recommended by PG&E. (63 CPUC2d 570, 604.)

While we believe that ORA has demonstrated that accrual accounting is the generally accepted accounting method for large companies to record expenses, we note that PG&E used cash accounting for tree trimming throughout the 1990's and the 1996 GRC adopted revenues for tree trimming were based on cash accounting. The revenues available for recovery here must be, among other things, incremental to the levels adopted in the 1996 GRC. For this reason, we will allow PG&E to recover these expenditures, as recorded on a cash basis, even though they include prior period transactions.

VIII. Crediting Unspent Funds

Section 368 (e)(2) specifies the treatment of funds not spent on system safety and reliability:

> To the extent the revenues are not expended for system safety and reliability, they shall be credited against subsequent safety and reliability base revenue requirements. Any excess revenues carried over shall not be used to pay any monetary sanctions imposed by the commission.

PG&E proposed (in 1999 when the application was filed) to return excess revenues that were authorized for transmission and distribution system safety and reliability activities to ratepayers as a credit to the distribution component of its TRA. The credit balance in the TRA would be transferred to the Revenue Section of the Transition Cost Balancing Account. It stated that this would result in a reduction of the Competition Transition Charge responsibility for PG&E's ratepayers.

ORA argues (as it did in 1999) that PG&E's approach skips an important step. It states that for the unspent base revenues to end up in the distribution revenue requirement, they must be credited directly to the base revenue requirement. ORA's primary recommendation is that underspending in 1997 should be credited directly against the 1998 revenue requirement, and that underspending in 1998 should be credited against the 1999 revenue requirement.

PG&E was particularly concerned about any credit against the 1999 revenue requirement being effectively an ongoing penalty. This concern appears to come from PG&E's proposed use of the 1999 revenue requirement as the starting point for future ratemaking under its performance-based ratemaking (PBR) application (A.98-11-023). PG&E was concerned that any credit against the 1999 revenue requirement of under spent funds here will be locked in place over the years its PBR mechanism is in effect. It also states that by proposing a downward adjustment to the 1999 GRC revenue requirement for unspent § 368(e) revenues, ORA is proposing that PG&E's revenue requirement should be determined to some extent in this proceeding.

ORA described how to implement its recommendation. (*See* Ex. 4, Audit Report of § 368(e) Expenditures, 1997, and Ex. 5, Audit Report of § 368(e) Expenditures, 1998, and Opening Brief, pp. 34-35.) First, the Commission should determine the reasonable level of 1997 § 368(e) spending and compare it to the $164.231 million maximum increase allowed in D.96-12-077. Second, the amount of underspending would be credited against the subsequent year's revenue requirement – the 1998 revenue requirement for system safety and reliability. The same steps would be taken for crediting unspent 1998 revenues.

ORA's recommendation directly complies with the direction in the statute to credit unspent revenues to subsequent base revenue requirements. PG&E makes no argument to explain how crediting the distribution component of its TRA, instead of the base revenue requirement, accomplishes what the statute directs. Considering that 1999 is now in the past, this adjustment will no longer provide the necessary relief.

PG&E's related concern about crediting the 1999 revenue requirement with unspent revenues has also been addressed. In D.00-02-046, the Commission determined PG&E's 1999 revenue requirement. The crediting of the 1999 revenue requirement with unspent § 368(e) revenues is in compliance with the explicit directive of § 368(e). PG&E should close its SSREFBA[50] and transfer the balance to another balancing account. In order to expeditiously process the rate

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[50] The SSREFBA was established in D.96-12-077.

recovery of the net effect of these adjustments, we direct PG&E to record the cumulative effect as a one-time adjustment to its Energy Resource Recovery Account.

IX. Comments on Proposed Decision

The alternate decision of Commissioner Brown in this matter was mailed to the parties in accordance with Rule 77.6(d) of the Rules of Practice and Procedure. Comments are filed on August 12, 2004, and reply comments were filed on August 16, 2004. The alternate decision was revised to reflect comments by TURN that the burden of proof is on PG&E, and other matters.

X. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Douglas Long is the assigned ALJ in this proceeding.

XI. Findings of Fact

1. The scope of this proceeding was described in *Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge*, issued on June 24, 1999. That ruling included within the scope of this proceeding the issue of whether the costs for which PG&E seeks recovery were reasonably incurred.

2. Section 368(e) provides PG&E incremental revenues for enhanced safety and reliability.

3. PG&E changed accounting systems and showed $27.0 million in “O&M chargebacks” and “reclassified A&G.”

4. PG&E incurred $450,000 of advertising expenses related to notifying customers of emergency situations during the time period covered by its Section 368 application.

5. PG&E incurred $499,295 in costs related to the purchase and installation of automatic metering equipment during the time period covered by its Section 368 application.

6. PG&E incurred $29.089 million in storm-and flood-related costs during the time period covered by its Section 368 application.

7. PG&E incurred $19.5 million in common plant costs during the time period covered by its Section 368 application.

8. PG&E incurred $13.31million in distribution and customer service support costs during the time period covered by its Section 368 application.

9. PG&E incurred $2.06 million in electric industry restructuring costs during the time period covered by its Section 368 application.

10. PG&E incurred $2 million in unreimbursed pole test and treat costs during the time period covered by its Section 368 application.

11. PG&E incurred $929,000 in costs related to the purchase of vehicles used for metering during the time period covered by its Section 368 application.

12. PG&E incurred $2.086 million in costs related to Year 2000 compliance during the time period covered by its Section 368 application.

XII. Conclusions of Law

1. Section 368 (e) costs must be incremental to the costs authorized in PG&E's 1996 GRC in order to be recoverable.

2. The Commission, in determining whether the incremental revenues were spent on authorized activities, should consider; (1) whether the activities *enhanced or improved* transmission and distribution system safety and reliability; and (2) whether the costs were reasonably incurred.

3. In D.96-12-077, the Commission established a balancing account to allow the Commission to meet the requirements of § 368(e)(2), specific to disposition of excess revenues.

4. The establishment of a tracking account does not eliminate the restriction on the use of the incremental revenues to activities that enhance or improve the safety and reliability of PG&E's transmission and distribution system.

5. PG&E had the burden of proof on the issue of its compliance with Section 368, D.96-12-077 and D.98-12-094.

6. PG&E had the burden of proof with respect to the allowability of specific expenditures.

7. Section 368(e) contemplates that revenues may not be used, or may be used improperly, and provides for an accounting of revenues that are not expended for the stated purpose.

8. The Commission should not adopt TURN's "time saving proxy" approach to allow recovery of revenues, as contemplated in § 368(e).

9. PG&E should be allowed to recover $27.0 million in "A&G chargeback" expenses and "reclassified O&M" expenses.

10. PG&E should be allowed to recover $450,000 in costs related to notifying customers of emergency situations.

11. PG&E should not be allowed to recover $499,295 in AMR costs.

12. PG&E should seek recovery of $28.089 million in storm- and flood-related costs in an application filed pursuant to § 454.9.

13. PG&E should not be allowed to recover $2.06 million in contested electric industry restructuring costs.

14. PG&E should not be allowed to recover $2 million unreimbursed pole test and treat program costs at this time.

15. PG&E should not be allowed to recover $929,000 of costs incurred to purchase vehicles used for metering during the time period covered by its Section 368 application.

16. PG&E should be allowed to recover $2.086 million in Y2K compliance.

17. PG&E should close its SSERFBA except as discussed in Conclusion of Law 14 and transfer the balance to its TRA.

18. PG&E should create a memorandum account to track reimbursement of 1998 costs for the testing and treating of jointly owned poles and credit any amounts received from joint pole owners to ratepayers.

19. The 1996 GRC adopted revenues for tree-trimming were based on cash accounting, and it is appropriate to calculate the § 368(e) revenue requirement "increment" using spending figures that are accounted for using that same accounting method.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) shall remove from Pub. Util. Code § 368(e) recovery storm-related capital and expenses of $29.089 million recorded in 1997 and 1998. PG&E may include this amount in a new Catastrophic Event Memorandum Account application.

2. PG&E shall file an Advice Letter detailing the current status of payments from joint pole owners for work performed in 1997 and 1998, and should actively seek reimbursement of costs from such joint pole owners. To the extent that PG&E receives reimbursement from joint pole owners, such funds shall be tracked in a memorandum account and credited to ratepayers.

3. PG&E shall credit the System Safety and Reliability Enhancement Fund Balancing Account (SSREFBA), before interest, for the following amounts and shall not recover from ratepayers the following contested amounts through increases in base revenues authorized pursuant to Pub. Util. Code § 368 (e):

	Dollars in Millions				
	1997		**1998**		`
	Expenses	**Capital**	**Expenses**	**Capital**	**Total**

1. Automatic Meter Reading		0.499	0.499
2. Vehicles Used for Metering	0.930		0.930
3. Electric Industry Restructuring Cost	2.06		2.06
Expenditure Totals	$2.99	$0.499	$3.489

4. PG&E shall file an advice letter within 45 days of mailing in compliance with this decision work papers sufficient for Energy Division to determine that the SSREFBA disallowances and interest are correctly calculated.

5. PG&E shall transfer the adjusted balance of the SSREFBA except for pole test and treat costs to its Energy Resource Recovery Account.

6. 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 attached Proposed Alternate Decision of Commissioner Brown on A.99-03-039 In the Matter of the Application of Pacific Gas and Electric Company to Consolidate the Review of Pacific Gas and Electric Company's Expenditures in 1997 and 1998 to Enhance Transmission and Distribution System Safety and Reliability Pursuant to Section 368(e) of the California Public Utilities Code.(U39E), on all parties of record in this proceeding or their attorneys of record.

Dated August 5, 2004, at San Francisco, California.

Carmen Viernes

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.

* *

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