Decision **PROPOSED DECISION OF ALJ LONG (Mailed 3/22/2004)**

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 certain costs incurred by PG&E pursuant to § 368(e) are just and reasonable, but we disallow certain costs shown by intervenors to be unreasonable. Costs related to catastrophic events have been removed from PG&E's § 368(e) request and PG&E is authorized to file a Catastrophic Event Memorandum Account (CEMA) application to seek recovery of such costs. Sufficient evidence was presented to assess the reasonableness of the costs booked in the System Safety and Reliability Account (SSRA); thus no further proceedings are required. 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 the electric utilities to propose cost recovery plans and, if the plans met certain criteria, the Commission was 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 restricts 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 directed the Commission on the ratemaking treatment of 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 without compromising PG&E's ability to enhance transmission and distribution system safety and reliability.

The Commission authorized PG&E's cost recovery plan 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 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.

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
	($ million)	
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

The Commission 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, the Commission took the rather unusual step of specifying the subaccounts. The Commission stated that the high degree of specificity was

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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.

required for the Commission to perform its 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, the Commission stated that D.96-12-077 properly applied § 368(e) to PG&E. Further, the Commission stated that § 368(e) may be used for on-going activities – rather than just new activities - which enhance the safety and reliability of PG&E's transmission and distribution system. The Commission stated 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.)

Opening Briefs were filed on November 19, 1999, and Reply Briefs on December 6, 1999. On March 10, 2000, PG&E, ORA, and TURN, filed a joint brief concerning issues addressed in or deferred from D.00-02-046, PG&E's 1999 GRC.

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 the Commission must 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. If not, then § 368(e)(2) directs the

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[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.)

Commission to credit those revenues against subsequent safety and reliability base revenue requirements.

There is little agreement on the standard for judging whether specific expenditures were of the kind authorized. PG&E continues to dispute whether it must demonstrate the reasonableness of its expenditures. It is undisputed, however, that the expenditures identified must be incremental to those funds authorized by the Commission in PG&E's 1996 GRC.

Also at issue is the question of how PG&E should properly credit any unspent funds to ratepayers.

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, the Commission 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. It is also clear that parties agree that in D.98-12-094, the Commission 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 PG&E to do three things to be assured recovery from ratepayers of the § 368(e) revenues it spent: (1) establish the balancing account; (2) to detail the accounting that it would use to track the incremental funds authorized in § 368(e) in a manner distinct from funds authorized in the 1996 GRC; and (3) incorporate

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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."

specific tariff language and the specific accounts and capital programs set forth in Attachment A of D.96-12-077.

PG&E does not believe that it must demonstrate that the expenditures enhance transmission and distribution system safety and reliability. In support of its position, PG&E argues that in D.96-12-077, the Commission expressly 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.

PG&E is partially correct that in D.96-12-077, the Commission directed PG&E to establish a balancing account and specified the transmission, distribution, and capital-related accounts where the incremental revenues could be recorded. But PG&E downplays the stated purpose of the Commission's direction: to track PG&E's expenditure of the incremental revenues and to assist the Commission in performing its later ratemaking duties. PG&E characterizes the decision as setting out all of the requirements for recovery of § 368(e) expenditures from ratepayers, and that the listing of the accounts established a "work-saving proxy." PG&E is wrong. Rather, D.96-12-077 establishes a balancing account that will allow the Commission to meet the requirements of the latter part of § 368(e), specific to disposition of excess revenues. The decision affirmatively states that "[p]roceeds from the base revenue increases authorized in § 368(e) are to be used only to enhance transmission and distribution system safety and reliability." (70 CPUC2d 207 at 232, Conclusion of Law 10.)

Contrary to PG&E's argument, the decision does not expressly reject ORA's and TURN's request for descriptions of the intended uses of the revenue. Instead, the decision makes no mention of the request. PG&E is correct that the

Commission did not adopt the request, but that does not preclude ORA and TURN from arguing that PG&E must demonstrate now that the expenditures were for safety and reliability enhancements.

In D.98-12-094, upon consideration of rehearing of D.96-12-077, the Commission characterized § 368(e) as allowing PG&E to devote the incremental revenues to activities with the purpose of improving the safety and reliability of PG&E's transmission and distribution system. Establishing a tracking account does not eliminate the restriction on the use of the incremental revenues to activities that "enhance" (as stated in § 368(e)) or "improve" (as stated in D.98-12-094) the safety and reliability of PG&E's transmission and distribution system. Absent a consideration of whether the incremental revenues were spent on enhancements to safety and reliability, the Commission could not fulfill the requirements of § 368(e). We read § 368(e) to provide the incremental revenues for enhanced *safety and reliability*, not enhanced *spending* authority.

Further, we agree with ORA that PG&E's interpretation would not give meaning to all of the language of the statute. It directs how the increased revenues are to be used. The statute contemplates that some revenues may not be used, or may be used improperly, and provides for an accounting of any revenues that are not expended for the stated purpose.

For these reasons, our consideration of whether the incremental revenues were spent on authorized activities will include consideration of whether:

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

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

(3) the costs were reasonably incurred.

Setting aside the disagreements among the parties on the standard that must be met pursuant to § 368(e), we note that all parties were advised that the Commission would consider the reasonableness of the expenditures. The ORA 1997 and 1998 Reports identified the reasonableness of the expenditures as an issue in this proceeding, and in its Protest, ORA again raised the issue. At the prehearing conference (PHC) held in this proceeding on May 17, 1999, when the parties and the Assigned Commissioner and Administrative Law Judge (ALJ) were discussing the proper scope of the proceeding, the reasonableness of the expenditures was highlighted. In the Scoping Memo and Ruling, the Assigned Commissioner and ALJ stated that "[n]othing in § 368(e) changes the Commission's longstanding obligation to ensure that the rates are just and reasonable (§ 451)." (*See* June 24, 1999 Ruling, p. 2.) PG&E chose to not make an affirmative reasonableness showing, but rather, to continue to argue whether such a showing is required. PG&E only provided a showing on the activities and accounts that were challenged, and then, only in rebuttal testimony.

Because of PG&E's failure to make an affirmative reasonableness showing, TURN argues that the Commission should address the disputed amounts based on the record developed in this proceeding and direct PG&E to supplement the record. Under TURN's proposal, the decision on the record developed to date would be an interim decision. The supplement PG&E would file after the issuance of the interim decision would address all of the expenditures included in its 1996 and 1997 compliance reports that are not specifically allowed or disallowed in the interim decision. In the supplement, PG&E would have to demonstrate not only that the costs are incremental but also that they were incurred for reasonable activities that enhance transmission and distribution system safety and reliability.

TURN supports this "middle-ground" approach by bounding it with two alternatives. First, TURN argues that an appropriate, but difficult-to-justify, response to PG&E's failure to demonstrate the reasonableness of its expenditures might be to completely deny PG&E any recovery. But, as TURN acknowledges, § 368(e) intends for PG&E to be provided with some money to be used to enhance its system safety and reliability, and approving no cost recovery for that purpose would be hard to justify as consistent with the statute. Second, TURN proposes that the Commission may even wish to apply a "time-saving proxy"[7] for determining the likely reasonable level of costs that should be recovered under § 368(e). The proxy would be determined by calculating a percentage by comparing the total amount of disallowance proposed by TURN and ORA, and the total adopted disallowance for those disputed expenditures. This percentage could then be applied to the remainder of the § 368(e) expenditures PG&E seeks to recover. The Commission could then allow recovery of that reduced amount and avoid the supplement and related proceedings.

TURN argues that PG&E is asking the Commission to approve all expenditures that have either not been challenged or where the Commission agreed with PG&E's position. This approach is flawed, TURN argues, because it would relieve PG&E of the burden of demonstrating that its expenditures were consistent with the statutory directive, and it would effectively shift the burden of proof away from PG&E.

PG&E claims that TURN did not raise any issue regarding the reasonableness of PG&E's costs prior to closing argument. It argues that TURN

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[7] No doubt a humorous retort to PG&E's "work saving proxy" argument.

should have moved for the Commission to direct PG&E to include a specific showing on reasonableness shortly after the issuance of the scoping memo ruling, rather than waiting until briefs to argue for a supplemental showing. Alternatively, PG&E argues, TURN could have issued data requests questioning the reasonableness of the level of costs. It also could have raised the reasonableness of PG&E's costs in its filed testimony. PG&E states that while it bears the burden of proof, ORA and TURN bear the burden of producing evidence to support their specific recommendations. It goes on to say that TURN failed to recommend any specific adjustments to PG&E's requested recovery based on unreasonableness.

PG&E is missing the point of the TURN argument. Nowhere in its initial showing, comprised of two reports and its application, does PG&E state or demonstrate that the costs for which it seeks recovery were reasonably incurred. The activities associated with the costs are nowhere described in those documents except by the account name in which the costs were entered, notwithstanding PG&E's statements that the reports "detail" the spending of system safety and reliability funds. It is only in rebuttal testimony that PG&E describes in any detail the activities associated with the costs, and then only for those costs that ORA or TURN challenge. By this approach, PG&E has effectively tried to put the burden on ORA and TURN to prove the costs are unreasonable. PG&E all but concedes that it has shifted the burden when it argues on brief that:

> "TURN has failed to recommend any specific adjustments to [Pacific Gas and Electric Company's] Section 368(e) recovery based on <u>unreasonableness</u>, let alone provide any evidence to support specific recommendations." (PG&E Reply Brief, p. 36, emphasis added.)

PG&E goes on to argue that TURN cannot ignore the issue of reasonableness after having asked the Commission to include it in the scope of the proceeding. That is correct, but it is perhaps more important that the *Applicant* – the party that admittedly bears the burden of proof - not ignore an issue included in the scope of the proceeding.

PG&E has chosen to ignore its responsibility to demonstrate that its § 368(e) costs were reasonably incurred. It argued at the PHC, where the scope of the proceeding was discussed, that it need only demonstrate that the additional funds were used for enhancing transmission and distribution system safety and reliability, and that the funds expended were incremental to the funds authorized in the 1996 GRC decision. It argues that merely recording the expenditures in the accounts identified by the Commission constitutes demonstrating the funds were used for safety and reliability enhancement.

After hearing that argument, the assigned ALJ and Assigned Commissioner ruled "this is the appropriate proceeding to consider whether PG&E reasonably incurred the costs for which it now seeks recovery." (*Scoping Memo and Ruling*, June 24, 1999, p. 2.) In the face of that ruling, PG&E continued to present its case, with the introduction of rebuttal testimony and in evidentiary hearings. Pursuant to Rule 2.6 of the Commission's Rules of Practice and Procedure, it could have amended its initial showing to address the issue of reasonableness. It chose not to amend its showing, and so the Commission must consider the reasonableness of PG&E's § 368(e) expenditures absent a direct showing by PG&E, and with a rebuttal showing on the portion of expenditures that were challenged.

We agree with TURN that complete rejection of any recovery of expenditures made to purportedly enhance transmission and distribution system safety and reliability is not justified on this record. We also regard such an approach contrary to our understanding of § 368(e). While the code is written to account for revenues that are not used, or are recorded improperly, it contemplates that some amount of reasonably-incurred additional expenses will be recoverable. However, to the extent that PG&E deliberately and after repeated notice made no argument in support of its expenditures, we find the use of rebuttal testimony to be inadequate for making a prima facie case and as a result, we disallow recovery for all reasonable challenges raised by ORA and TURN. The disallowances and deferrals are summarized below and detailed in the next section.

We disallow:

1. $27 million for administrative and general (A&G) expense in 1997 and 1998;
2. $450,000 for advertising expenses in 1998;
3. $499,295 in automatic meter reading (AMR) costs in 1998;
4. $5.6 million in 1997 and $13.9 million in 1998 for common plant capital expenditures;
5. $7.01 million in 1997 and $ 6.3 million in 1998 for Distribution and Customer Service Support (DCSS) expenses;
6. $2.06 million in 1997 restructuring-related expenses;
7. $2 million in 1998 pole treatment expenses;
8. $929,000 in 1998 capital expenditures for meter reading vehicles;
9. $940,000 in 1998 expenses and $1.46 million in 1998 capital expenditures for Year-2000 compliance; and

We defer to a separate future application:

1. Catastrophic event-related costs, capital and expense:

a. $4.3 million in expenses and $19.6 million in capital expenditures for 1997; and

b. $12.922 million in expenses and $15.312 million in capital expenditures for 1998.

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.[8] 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 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 subaccounts

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[8] 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.

to which the § 368(e) enhancement applies. ORA recommends an $11.2 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 are "chargebacks." 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.

ORA describes chargebacks as an accounting mechanism whereby a company department charges another department for providing internal services. Chargebacks allow management to determine the full cost of providing services or products to an operating unit. ORA explains that the costs incurred to provide services to an operating unit are charged to the receiving operating unit through an appropriate O&M expense account. As such, chargebacks are internal costs for which there is management discretion and no invoice or verifiable bill exists, as would be available for external costs.

ORA states that the O&M chargeback reclassification occurred when PG&E implemented a new accounting system. ORA states, and PG&E appears to agree, that PG&E now charges to O&M expense accounts chargebacks previously charged to A&G accounts. ORA points out that PG&E's application does not request approval for only those accounts in which more was spent in 1997 or 1998 than in 1996. Instead, PG&E 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, together with PG&E's lump sum approach, it cannot verify that the funds expended are incremental to those authorized in the 1996 GRC accounts. When ORA asked PG&E if the expenditures are incremental to the 1996 GRC A&G adopted amounts, PG&E's witness stated that she did not know, and that that was not a part of her analysis. (1 R.T. 58.)

TURN also addressed the reclassification issue in briefs. It argues that PG&E knew, but chose not to inform the Commission, that it had reclassified these expenditures before the Commission adopted D.96-12-077 wherein the Commission identified the subaccounts eligible for § 368(e) treatment. TURN states that in the absence of PG&E's reclassification, none of the expenditures or activities would have been eligible for recovery. TURN also gives an example of how the reclassification and recovery, as PG&E implemented it, could provide PG&E with a total recovery that exceeds actual costs, so that PG&E profits from reclassification. (*See* TURN Opening Brief, pp. 14-15.) TURN suggests that PG&E be given an opportunity to reduce the amounts recorded in its O&M accounts by an amount equal to the reclassified A&G, and then recalculate the amount of incremental spending in those accounts. This would ensure that PG&E would not profit from its reclassification of costs.

PG&E states that the A&G chargebacks were comprised exclusively of computer and telecommunications support functions and facilities. PG&E argues that these functions and facilities are essential to its distribution and transmission personnel in performing their safety - and reliability-related work. It rebuts ORA's argument that it cannot verify that the funds expended were incremental to the 1996 GRC-authorized levels by stating that a roughly equivalent amount of O&M-type costs were reclassified and are not currently recorded in the specified subaccounts. Therefore, PG&E argues that the Commission can safely assume that the inaccuracies end up as a wash.

Ensuring that the expenditures recorded in the § 368(e) accounts were incremental to the amounts authorized in the 1996 GRC is a fundamental step toward approving PG&E's expenditures. The Commission gave PG&E account-specific instructions in D.97-12-077, stating that the high degree of specificity was required "in order for the Commission to perform its future ratemaking duties and confirm . . . that the funds expended in [the balancing] account are in fact <u>incremental</u> to the funds authorized." (70 CPUC2d 207, 230, emphasis in original.)

PG&E admits that it did not determine whether the amounts recorded in the subaccounts were incremental to the A&G amounts authorized in the 1996 GRC. TURN's cross-examination and brief revealed that, under PG&E's A&G reclassification approach, PG&E could recover more A&G costs than it actually incurred. PG&E did not convincingly rebut TURN, focusing primarily on an assertion that TURN made its argument in briefs. Thus, we find that if PG&E were to profit from the incremental funding § 368(e) provided, this would be contrary to the intent of § 368(e) and D.96-12-077 and D.98-12-094.

ORA recommends that we not allow PG&E to recover these A&G expenditures in the § 368(e) accounts. TURN suggests that we give PG&E an opportunity to recalculate the amounts recorded. Presumably, the recalculated amounts would involve another round of evidentiary hearing, briefs, and proposed decision. The record is clear in this area and we will not give PG&E another opportunity to recalculate these items. The Commission's statements and findings in D.96-12-077 and D.98-12-094 gave PG&E clear direction that its expenditures must be incremental to the 1996 GRC authorized amounts, and that the assessment of whether the expenditures were incremental would include an account-specific level of review. PG&E should remove from its 1997 recorded expenditures the $15.1 million ORA disallowed A&G expenses,[9] and PG&E should remove from its 1998 recorded expenditures the $11.9 million disallowed A&G chargebacks.

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[9] Note that the $15.1 million includes both $11.2 million in reclassified A&G costs and $3.9 million in A&G chargebacks.

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 removed. ORA acknowledges that PG&E later explained that the description assigned to the charges was in error. ORA states that PG&E claims the charges are associated with the costs of providing information to customers. ORA recommends removal because it believes that the costs should have been recorded in a different account, Account 909. On cross-examination, ORA stated that PG&E conceded that Account 909 applied to providing information to customers through public means. (Account 909 is described in Ex. 10, p. 11,855.)

PG&E unreasonably withheld adequate information until it served its rebuttal testimony. Regardless of the appropriate account that should have been used, we agree with ORA that these costs are not reasonably includable for recovery as an enhancement to system safely and reliability.

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

TURN points out in its testimony that PG&E includes the costs for a new AMR program in 1998. According to TURN, AMR is designed generally to reduce meter-reading expenses, and not to provide more reliable electric service. TURN argues that the only safety arguments that could be adduced for AMR would be that fewer meter readers might be involved in traffic accidents or suffer dog bites and sprained ankles on the job. TURN therefore recommends that the Commission not allow PG&E to recover $499,295 of costs in Account 597.

PG&E attempted to rebut TURN's arguments in rebuttal testimony and on the stand. It states that it is possible to use AMR to send signals to an outage information system to let PG&E know that groups of customers are out of power; and that it would facilitate PG&E diagnosis of the distribution system relative to where an outage may have occurred. In that way, PG&E argues, AMR could enable PG&E to respond more quickly.

TURN's cross-examination of PG&E's witness made it very clear, however, that while improved outage analysis is possible with AMR, the meters that are part of the AMR program at issue here do not provide such information to PG&E. Therefore, PG&E has failed to demonstrate that the $499,295 in 1998 AMR expenditures it recorded in Account 597 enhance transmission and distribution system safety and reliability. PG&E should not be allowed to recover these costs as § 368(e) expenditures.

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

Two of the accounts the Commission identified for possible § 368(e) recovery relate to common plant: Fleet, Equipment and Tools, and Telecommunications Equipment. TURN argues that the Commission must limit the cost recovery associated with these common plant programs to those portions of the costs that may reasonably be allocated or assigned to functions that enhance system safety and reliability. Costs associated with PG&E's gas operations, and with its generation activities, TURN argues, should be excluded entirely, and those associated with transmission activities should be excluded as of April 1, 1998. TURN argues that PG&E is seeking to recover any amount of actual common plant expenditures that exceeded the total 1996 GRC-adopted level, including, for example, the costs of gas service trucks. TURN recommends reducing PG&E's unbundled common plant capital spending by $5.6 million in

1997 and by $13.9 million in 1998.[10] These amounts leave untouched the amounts unbundled to distribution for corporate services, which TURN argues, is overly generous to PG&E. TURN's recommendation applies the results of the unbundling study that PG&E filed as part of its 1999 GRC.

PG&E argues that it complied with our prior orders in accounting for common plant costs. It argues that to unbundle the common plant costs as TURN recommends would have resulted in common plant costs being allocated twice – once in the setting of the annual base revenue increases, and again in the calculation of the incremental amount. PG&E argues that such "double-counting" is unfair, unreasonable, and would understate the incremental amount recoverable.

PG&E also argues that if any unbundling of these costs is to occur now, the Commission should not apply the results of PG&E's unbundling study. PG&E argues that the Commission should apply the "four-factor method." PG&E states that it is the "unbundling method known at the time." (Ex. 3, p. 4-3.) PG&E does not describe the method or provide any citation to prior use of the "four-factor method" by the Commission.

We agree with TURN that it is appropriate to unbundle costs to the extent reasonably feasible to achieve the intent of § 368(e). As we stated above in our discussion of the standard, it is not enough to merely establish an account, record dollars in that account, and track those dollars. PG&E must demonstrate that the expenditures enhance or improve transmission and distribution system

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[10] TURN estimates the revenue requirement impact of this recommendation to be $1.0 million in 1997 and $2.5 million in 1998.

safety and reliability. The dollar values TURN recommends for removal from § 368(e) recovery are derived using PG&E's unbundling study. PG&E's argument does not explain how double-counting would occur if the Commission adopted TURN's recommendation. PG&E did not rebut the testimony TURN submitted, and it waived the opportunity to cross-examine TURN's witness, so there is no underlying record to explore to better understand PG&E's "double-counting" argument. In fact, it did not raise the issue of "double-counting" until the filing of briefs. As TURN points out, PG&E's argument relies on factual assertions that were not made on the record, and that are not subject to judicial notice or other extra-record citation. We will make the disallowance. $5.6 million and $13.9 million should be disallowed from PG&E's recovery of unbundled common plant capital spending in 1997 and 1998, respectively.

5. Distribution and Customer Service Support 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 might be necessary to maintain the same level of service, but rather points out that PG&E does not explain how such incremental DCSS spending actually increased system safety and reliability. ORA states that PG&E has never asserted that DCSS funds were spent for the purpose of improving safety and reliability. ORA argues that $7.01 million and $6.30 million in 1997 and 1998 DCSS expenses, respectively, should be disallowed.

PG&E argues that it is necessary to provide clerical support to the operations, maintenance and construction personnel that are directly providing a safe and reliable system. PG&E contends, again, that the costs of activities that are required to maintain the transmission and distribution system should be recoverable through § 368(e). Also, PG&E claims that the dollar figures ORA recommends represent removal of all the expenditures associated with DCSS, and presume that all of the costs associated with DCSS are incremental to the 1996 GRC-adopted levels. This presumption, PG&E argues, contradicts ORA's argument that PG&E has failed to demonstrate that its costs are in fact incremental, and reveals that ORA is attempting to maximize the total recommended downward adjustment in allowed § 368(e) recovery.

We share ORA's concern that PG&E did not argue how the DCSS expenditures improve safety and reliability in its direct showing. We will accord little weight to rebuttal testimony that serves only to criticize ORA or TURN when PG&E made an inadequate showing to justify the reasonableness of its actions. We will make the disallowance. We will reduce PG&E's recovery of DCSS expenditures under § 368(e) by the $13.31 million ORA recommends.

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.[11]

[11] 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).

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.[12] 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 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

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

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.[13]

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 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,

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

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.
>
> ***
>
> 13. 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, like 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 the Commission 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),[14] 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. The Commission 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.) The Commission disallowed PG&E's proposed forecast adjustment of $3,200,000 for its supplemental pole test-and-treat costs. In doing so, the Commission stated:

> PG&E's [the utility's] attempt to convert the underlying issue for this adjustment to the question of whether Pacific Bell or any other telecommunications utility will share costs of testing and treating jointly owned poles does not change the fact that the underlying cost pertains to a supplemental maintenance program. That program grew out of the Bain report and is associated with PG&E's past inadequate maintenance practices, when PG&E gave inadequate attention to pole test-and-treat activities. PG&E has not shown that it is reasonable to charge

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

> 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.

As we stated in the GRC decision, cost sharing for the costs of testing and treating jointly owned poles is appropriate. We expect that the utilities that have joint pole arrangements with PG&E and have traditionally borne a responsibility to share in the costs of maintaining joint poles will continue to do so.

We agree with TURN that PG&E should not be allowed to keep funds that are reimbursement of costs for the testing and treating of jointly owned poles and recover amounts for the program from ratepayers. The record in this proceeding indicates that PG&E, when faced with what appears to be a dispute over a delinquent payment for a service it rendered (testing and treatment of wood utility poles), is seeking compensation from ratepayers to make it whole, rather than pursuing payment from the other party. It has apparently been taking this approach with respect to the approximately $2 to $3 million annually it is owed by joint owners of poles since 1998. It is not in the public interest to allow PG&E to recover these funds from ratepayers in this proceeding, because we would then be removing any remaining incentive it may have to pursue payment from joint pole owners. Therefore, we will adopt TURN's recommendation to not allow PG&E to recover under § 368(e) the $2 million identified as costs incurred for its pole test and treat program.

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

TURN points out that PG&E included in its request $929,000 of common plant costs incurred to purchase vehicles used for metering. Because metering does not preserve the reliability of the electric distribution system, TURN argues that these costs should be deducted. PG&E argues that vehicles purchased for use in metering 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.)

TURN counters that 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. Given this information, TURN estimates that these vehicles would be needed for emergency response less than 3% of the time. TURN also states that, as illustrated by Ex. 7, the trend with PG&E's meter reading vehicle fleet numbers increasing is counter to the trend for its electric distribution vehicles that show a 20% reduction from 1997 to 1998. TURN argues that if PG&E's real concern was to provide for vehicles during emergency responses, it would have retained more of the vehicles involved in the daily operation of the distribution system, rather than reducing the numbers of those vehicles across-the-board.

In its defense, 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.)

It is appropriate for PG&E to utilize its available vehicle fleet as necessary in emergency response. PG&E is 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. The statute does require that the funds "be used by the utility for the purposes of enhancing its transmission and distribution system safety and reliability." PG&E's argument, taken to its extreme, could result in just about any expenditure being eligible for recovery through § 368(e) funds. All the services PG&E performs (like customer service), and their associated expenditures (for example, the phone system costs), "could" come in to play in response to an emergency, and be "available for emergency response duties."

It is clear from this record that the vehicle expenditures were made for the purpose of providing metering services, which are services not generally associated with transmission and distribution system safety and reliability. Secondarily, the vehicles are available for emergency response. The $929,000 of common plant costs incurred to purchase vehicles used for metering should be excluded from recovery through § 368(e).

9. Year 2000 Compliance Expenses ($940,000)

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. ORA states that, at most, the spending avoids a potential one-time problem that would not have degraded system safety, and only would degrade reliability if the system experienced an outage as the clock reached the year 2000. ORA argues that this spending is not akin to preventive-type activities such as tree-trimming in that tree-trimming is an activity that addresses an actual, rather than a potential, problem.

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

PG&E was granted a base rate increase in D.00-02-046 date February 17, 2000, in A.97-12-020. That was the appropriate proceeding, with a 1999 test year, where PG&E should reasonably have foreseen and litigate the need for Y2K-related cost recovery in retail rates. However, the benefit to system reliability is indirect at best, PG&E is obliged to have a working system to serve its customers and it fails to justify the amount recorded in the SSRA for § 368(e) costs resulted in any enhancement as envisioned in § 368(e). The end of the millennium was foreseeable by the authors of Assembly Bill (AB) 1890 and they did not include it in § 368(e). We disallow the expenses for § 368(e) purposes.

10. "Time Saving Proxy" Calculation

TURN proposed that to save time and not allow another round of testimony on the reasonableness of its filing (which PG&E clearly chose not to make in a timely fashion) that the Commission should apply the same percentage of the ORA and TURN proposals adopted to the total requested by PG&E in this application. Despite the weakness of PG&E's initial showing, and the limited weight we accord its rebuttal testimony, TURN and ORA did conduct their own analysis and make specific recommendations. PG&E responded to discovery, and the parties did not argue that PG&E obstructed them. For these reasons, we are able to consider the merits of each and every objection raised by TURN or ORA, despite the inadequacy of PG&E's initial showing. Only those disallowances that are specifically identified and justified by the parties are adopted in this decision, and no "time-saving proxy" calculation is required.

VI. Catastrophic Event Memorandum Account Costs

ORA argues that PG&E recorded as § 368(e) related expenses certain costs that are more properly recorded in the CEMA. ORA claims that PG&E recorded $23.9 million in § 368(e) accounts that should have been recorded in CEMA accounts in 1997. It claims that in 1998, PG&E recorded $28 million in § 368(e) accounts that should have been recorded in CEMA accounts. These costs were incurred to restore service after the 1997 New Year's flood and February 1998 storms. ORA is not recommending the Commission deny PG&E the opportunity to recover these costs, only that PG&E should seek recovery pursuant to § 454.9, rather than § 368(e). ORA emphasizes that CEMA costs are ineligible for recovery in a base revenue requirement, and that § 368(e) provides for enhancement to base revenues.

In addition, ORA argues that the expenditures were made merely to restore service, not to enhance service. ORA argues further that PG&E has utilized insurance proceeds to offset expenditures recorded as § 368(e) expenditures, when the Commission requires that insurance offset CEMA recovery.

ORA concedes that § 368(e) mentions "emergency response" as proper spending, but draws a distinction between CEMA-recoverable costs and § 368(e) emergency response costs. For example, CEMA-recoverable costs must be costs associated with a declared disaster. ORA argues that PG&E is commingling CEMA-related costs between two differing statutory provisions, and that the Public Utilities Code is not designed to give utilities various options as to how to recover the same costs. ORA points out that the proposed settlement in PG&E's application for recovery of CEMA costs (A.99-01-011) explicitly allows PG&E to request recovery of any CEMA-related costs excluded in this proceeding in a subsequent CEMA 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. PG&E also argues that ORA ignores the statutory language that includes emergency response among the activities that may be funded with the incremental revenues § 368(e) provided. PG&E also argues that the resolution that established CEMA (Res. E-3238) states that recovery may be limited by consideration of the extent to which the level of losses are already built into existing rates, and that recovery through § 368(e) means the losses are built into rates. It also argues that the costs are incremental to the 1996 GRC because in forecasting costs for GRC purposes, PG&E does not include costs associated with events like the 1997 New Year's flood and February 1998 storms.

Finally, PG&E argues that the amounts ORA identified as storm-related are overstated. PG&E states that it identified storm-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. TURN explains that the allocation of the underlying costs among various customer classes is likely to be very different as a result of the recovery mechanism. If these costs are recovered through CEMA, TURN states that they are likely to be recovered out of "headroom,"[15] which results in a total EPMC allocation, or to be 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 vast majority of these costs being recovered from residential and small commercial customers.

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[15] 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.

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 costs of a type that is usually included in base revenues, that enhance or improve transmission and distribution system safety and reliability, and that are incremental to the revenues authorized in the 1996 GRC. PG&E acknowledges that the revenues authorized in a GRC do not include the costs and expenses associated with declared disasters. It, therefore, acknowledges that its CEMA expenditures cannot meet the § 368(e) "incremental" criteria.

Finally, TURN has made it clear that choosing the correct mechanism for recovery is not just an exercise in regulatory precision. The mechanism determines the method of calculation for sharing these costs among customer classes.

The parties also dispute the amounts that should be referred to a CEMA application. As noted above, PG&E states that the amounts that ORA identified as storm-related are overstated.

Here, in summary, are the amounts in dispute:

Storm-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

PG&E explains the $4.551 million differences between its and ORA's 1998 expense figures. PG&E's 1998 storm-related expenses do not include $3.610 million of straight-time labor or $0.940 million of benefits associated with straight-time labor. PG&E argues that it is appropriate to include straight-time labor costs because these costs were part of the 1996 GRC-adopted amounts for the accounts identified by the Commission as eligible for § 368(e) treatment. Further, PG&E argues that straight-time labor costs do enhance transmission and distribution system safety and reliability by ensuring that the necessary personnel are available to respond during storms and other emergencies. ORA contests the exclusion[16] of straight-time labor costs on four grounds:

1. that such costs are difficult to quantify;
2. that PG&E cannot determine what level of straight-time labor costs are incremental to what was in the 1996 GRC;
3. that the purported benefits associated with straight-time labor are unverifiable, soft benefits; and
4. that such costs and any benefits do not enhance system safety and reliability.

ORA explains the $4.3 million and $14.194 million differences between its and PG&E's 1997 expense and capital expenditures, respectively. It states that PG&E utilized insurance proceeds to offset these costs in this proceeding, and not just in the CEMA proceeding. PG&E conceded under cross-examination,

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[16] That is, ORA wants these labor costs included in storm-related CEMA costs and not included in § 368(e) costs.

ORA argues, that the Commission's interpretation of CEMA requires that CEMA recovery be limited by the amount net of insurance. ORA argues that to apply insurance proceeds to offset § 368(e) costs, rather than CEMA costs is, therefore, inappropriate. It also argues that PG&E should have adjusted its § 368(e) request for recovery downward by the amount it received in insurance proceeds.

PG&E claims it did record insurance proceeds against the accounts in which the costs were originally charged, but in 1998 rather than in 1997. Had it not, PG&E states that the amounts recorded in its § 368(e) balancing account for these CEMA-related costs would have been approximately $4 million higher.

We disagree with PG&E. We cannot pick and choose portions of CEMA related costs to be recoverable under § 368(e) because catastrophic events are, by definition, unforeseen. Again, it is unreasonable for PG&E to rely on rebuttal of ORA and TURN in light of the inadequate initial filing. Nor should it benefit by recovery under § 368(e) from aggregating CEMA costs with § 368(e) costs. We will exclude these costs with respect to § 368(e) recovery here and PG&E may, if it chooses, seek recovery by making an adequate showing of reasonableness in its CEMA application.

With respect to the disputed 1997 dollars, we agree with ORA that the insurance proceeds should be recorded in the appropriate CEMA accounts. This is consistent with our conclusion above that recovery of the storm-related expenditures should be brought before the Commission in a CEMA, or § 454.9 application. Therefore, we adopt ORA's figures and remove from § 368(e) recovery $4.3 million in 1997 storm-related expenses and $ 19.6 million in 1997 storm-related capital expenditures. PG&E may include, and justify in detail, those amounts in any new CEMA application it may choose to file.

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.

ORA states that throughout the audit report preparation and distribution, and the discovery process, PG&E maintained that it used the accrual method of accounting for recording expenses like tree-trimming expenses. It was not until PG&E served its rebuttal testimony, about seven months into the proceeding, that ORA was informed that cash-basis accounting was used for tree-trimming and other miscellaneous distribution expenses. ORA argues that $21.6 million in "1997 expenses" actually pertain to expenses incurred in 1996 for consulting or contract services like tree trimming. It further argues that $5.4 million in "1998 expenses" were for tree trimming work completed prior to 1998. ORA recommends that these prior period transactions be excluded from § 368(e) recovery. It states that § 368(e) provides for annual base revenue increases for 1997 and 1998, and expenditures should be recorded for the appropriate accounting period. It argues that the Federal Energy Regulatory Commission (FERC) and generally accepted accounting principles require accrual-based accounting, and not cash-based accounting.

ORA also argues that PG&E's tree-trimming expenditures do not have the characteristics that PG&E describes as the types of expenditures that lend themselves to cash-basis accounting. Specifically, ORA argues that the level of tree-trimming expenditures is not consistent between years. Rather, ORA argues, the level of tree trimming expenditures almost tripled over the five-year period, 1994-1998.

PG&E counters this argument by stating that the relevant years for this proceeding are 1996 through 1998. In those years, PG&E contends that tree trimming expenditures were steadily increasing.

PG&E also argues that ORA's recommendation is inflated and unreasonable because it is based on a flawed approach. Most important among the flaws from PG&E's perspective is that ORA ignores transactions that would have been recorded in 1997 and 1998 under the accrual method but were not since the transaction was recorded on a cash basis after the relevant accounting period. From its historic experience, PG&E asserts to include these transactions, and thereby make adjustments in both directions, would likely result in the adjustments that cancel each other out.

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.)

Generally, we believe that ORA has demonstrated that accrual accounting is the generally accepted accounting method for large companies to record expenses, and that it is the method required by FERC. PG&E has failed to demonstrate that applying the cash method of accounting to tree-trimming expenses is appropriate. It has failed to demonstrate that the Commission has explicitly endorsed such an exception to generally accepted accounting principles. We are concerned that allowing recovery of these prior period transactions would reward PG&E for accounting practices that deviate, without our consent, from our accounting policy. However, PG&E testified that it has used cash accounting throughout the 1990's, and it is apparent the 1996 GRC-adopted revenues for tree-trimming used PG&E's estimate. It appears, therefore, that 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. In this limited situation, it is appropriate to calculate the increment using spending figures that are accounted for using the same accounting method. As so limited, 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. That position, PG&E argues, should be rejected.

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.

During the pendency of this proceeding, PG&E filed a petition to withdraw A.98-11-023 that was granted. (*See* D.00-06-058.) As directed in that decision, PG&E filed an application for a much more circumscribed PBR on September 1, 2000. PG&E filed a new application for a PBR, A.00-09-002, but it has since been closed by D.03-09-029. Therefore, there is no conflict with any potential PBR mechanism.

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[17] and transfer the balance to another balancing account. In order to expeditiously process the rate recovery of the net effect of these adjustments, we direct PG&E to record the cumulative effect as a one-time adjustment to its Distribution Revenue Adjustment Mechanism (DRAM) account adopted on April 1, 2004 in Resolution E-3862.[18]

IX. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on April 12, 2004 by TURN and PG&E, and reply comments were filed on April 19, 2004 by TURN and PG&E. We have considered these comments and to the extent necessary this decision reflects any changes we determined to be appropriate.

X. Assignment of Proceeding

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

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

[18] In its April 12, 2004 Comments, PG&E proposed the use of this account instead of the Energy Resource Recovery Account. At the time the proposed decision was circulated for comment, the DRAM did not exist.

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 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, not enhanced spending authority.

3. PG&E, although it had ample opportunity to comply with the *Scoping Memo and Ruling*, chose to not make an affirmative reasonableness showing, but rather, to continue to argue whether such a showing is required.

4. Expenditures that were adequately challenged by other parties are unreasonable in the face of no adequate demonstration by PG&E that the challenged expenditures enhance or improve transmission and distribution system safety and reliability.

5. PG&E admits that it did not determine whether the reclassified A&G amounts recorded in the sub accounts were incremental to the A&G amounts authorized in the 1996 GRC. Under PG&E's A&G reclassification approach, it could recover more A&G costs than actually incurred.

6. PG&E described the challenged advertising expenditures, distinguishing them from Account 909 expenditures, but did not demonstrate that the expenditures enhanced transmission and distribution system safety.

7. While improved outage analysis is possible with AMR, the meters that are part of the AMR program at issue here do not provide such information to PG&E. PG&E has failed to demonstrate that the $499,295 in AMR expenditures it recorded in Account 597 enhanced transmission and distribution system safety and reliability.

8. PG&E acknowledges that the revenues authorized in a GRC do not include the costs and expenses associated with declared disasters. It therefore acknowledges that its CEMA expenditures cannot meet the § 368(e) "incremental" criteria.

9. Straight-time labor costs are included in the 1996 GRC adopted amounts for the subject accounts. PG&E has not demonstrated that these costs enhance system safety and reliability by improving the availability of personnel necessary to respond during storms and other emergencies.

10. It is appropriate to unbundle common plant costs to the extent reasonably feasible to ensure cost recovery of those portions of the common plant costs allocated or assigned to functions that enhance system safety and reliability, consistent with the intent of § 368(e).

11. PG&E's argument that double-counting would occur were the Commission to adopt TURN's common plant unbundling recommendation is not explained and relies on factual assertions that were not made on the record and are not subject to judicial notice or extra-record citation. PG&E did not rebut the testimony TURN submitted, and it waived the opportunity to cross-examine TURN's witness, so there is no underlying record to justify PG&E's "double-counting" argument.

12. It was not demonstrated that the expenses in question, to provide clerical support to the operations, maintenance and construction personnel, are directly providing enhancing safe and reliable system over existing authorized funding.

13. All of the challenged electric industry restructuring activities and the associated costs are implementation costs specific to development and implementation of the ISO.

14. Other parties believed PG&E had identified <u>all</u> restructuring implementation costs in its § 376 application, and the settlement struck in that proceeding among those parties was, at least in part, predicated on that assumption.

15. In D.00-02-046, the Commission stated that cost sharing for the costs of testing and treating jointly owned poles is appropriate.

16. Vehicle expenditures, recorded as common plant costs, were made for the purpose of providing metering services, which are services not generally associated with transmission and distribution system safety and reliability.

17. Y2K activities, are not like tree-trimming, and do not address a potential problem or enhance transmission and distribution system safety and reliability by preventing problems from occurring.

18. ORA's recommendation for crediting unspent revenues directly complies with the statute to credit unspent revenues to subsequent base revenue requirements.

19. PG&E makes no argument in its showing to explain how crediting the distribution component of its TRA, instead of the base revenue requirement, complies with the statute.

Conclusions of Law

1. The Commission, in determining whether the incremental revenues were spent on authorized activities, should consider; (1) whether the costs recorded were *incremental* to the costs authorized in the 1996 GRC; (2) whether the activities *enhanced or improved* transmission and distribution system safety and reliability; and (3) whether the costs were reasonably incurred.

2. 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.

3. The establishment of a tracking account does not eliminate the restriction on the use of the incremental revenues to activities that "enhance" (as stated in § 368(e)) or "improve" (as stated in D.98-12-094) the safety and reliability of PG&E's transmission and distribution system.

4. The Commission should accord little weight to PG&E's rebuttal testimony used in lieu of an initial filing of adequate detail.

5. PG&E had the burden of proof in its initial filing.

6. 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.

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

8. PG&E should remove from its 1997 recorded expenditures the $15.1 million ORA recommends for removal relating to A&G reclassification and chargebacks. PG&E should remove from its 1998 recorded expenditures the $11.9 million ORA recommends for removal relating to A&G chargebacks.

9. PG&E should not be allowed to recover advertising expenses under § 368(e).

10. PG&E should not be allowed to recover $499,295 in 1998 AMR costs as § 368(e) expenditures.

11. It is appropriate for PG&E to seek recovery of the storm-related costs at issue here in an application filed pursuant to § 454.9.

12. The Commission should remove from § 368(e) recovery $8.371 million in 1998 storm-related expenses without prejudice to PG&E including that amount in any new CEMA application it may choose to file.

13. PG&E should remove from § 368(e) recovery $4.3 million in 1997 storm-related expenses and $19.6 million in 1997 storm-related capital expenditures without prejudice to PG&E including those amounts in any new CEMA application it may choose to file.

14. PG&E's recovery of unbundled common plant capital spending should be reduced by $5.6 million in 1997 and by $13.9 million in 1998.

15. For the Commission to allow recovery of electric restructuring implementation costs unmentioned in PG&E's § 376 application now would reward PG&E for its obfuscation (whether intentional or accidental), undermine the basis for D.99-05-031, and undermine the Commission's settlement process generally. PG&E should not be allowed to recover the remaining $2.06 million from 1997 funds in contested electric industry restructuring costs under § 368(e).

16. PG&E should remove from 1998 § 368(e) recovery the $2 million identified as costs incurred for its pole test and treat program.

17. The $929,000 of common plant capital costs incurred to purchase vehicles used for metering should be excluded from recovery through 1997 § 368(e) funds.

18. The Commission cannot, on the basis of this record, find that any Y2K expenditures in this application were intended to enhance system reliability.

19. Crediting the 1999 revenue requirement with unspent § 368(e) revenues would have been in compliance with the explicit directive of § 368(e) in 1999.

20. Closing the SSREFBA is reasonable in light of the impossibility of transferring the unspent revenues to be spent on 1999 activities.

21. PG&E should close its SSERFBA and transfer the balance to its DRAM.

22. This order should be effective immediately to allow recovery without further delay.

23. Consistent with the conclusion that recovery of the storm-related expenditures should be brought before the Commission in a CEMA, or § 454.9 application, storm-related insurance proceeds should be recorded in the appropriate CEMA accounts.

24. PG&E should not be allowed to keep funds that are reimbursement of costs for the testing and treating of jointly owned poles and recover amounts for the program from ratepayers.

25. 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 expenses of $4.3 million and $12.92 million recorded in 1997 and 1998, respectively, and storm-related capital expenditures of $19.6 million and $15.31 million recorded in 1997 and 1998, respectively. PG&E may include these amounts in a new Catastrophic Event Memorandum Account application.

2. 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. Administrative and General	15.100		$11.900		$27.000
2. Advertising			0.450		0.450
3. Automatic Meter Reading			0.499		0.499
4. Common Plant "Unbundling"		5.600		13.900	19.500
5. Distribution & Customer Service Support	7.010		6.300		13.310
6. Electric Industry Restructuring Costs		2.060			2.060
7. Pole Test and Treat Costs			2.000		2.000
8. Vehicles Used for Metering		0.930			0.930

9. Year 2000 Compliance			0.940	1.460	2.400
Expenditure Totals	$22.110	$8.590	$22.089	$15.360	$ 68.149

3. 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.

4. PG&E shall transfer the adjusted balance of the System Safety and Reliability Account to its Distribution Revenue Adjustment Mechanism balancing account.

5. This proceeding is closed.

This order is effective today.

Dated ____________________________, at San Francisco, California.

APPENDIX A

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(END OF APPENDIX A)