ALJ/RAB/sid * **Mailed 2/26/2002**

Decision 02-02-043 February 21, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for Authority, Among Other Things, To Increase Rates and Charges for Electric Service Effective on January 1, 2001 (U39M).	Application 00-07-043 (Filed July 27, 2000)

(See Appendix B for a list of appearances.)

OPINION AUTHORIZING AN ATTRITION RATE ADJUSTMENT INCREASE OF $150,838,000

Summary

Pacific Gas and Electric Company (PG&E) seeks an attrition increase of $184,575,000 starting January 1, 2001. The Office of Ratepayers Advocates (ORA) and others oppose. This decision grants an increase of $150,838,000, based on the effect of inflation in 2001 on 1999 forecast expenses and on rate base. Because of the uncertainty regarding PG&E's capital costs in 2001, the capital-related portion of this increase shall be subject to a true-up based on PG&E's actual 2001 capital costs. We deny an inflation increase for 2000. The $22.8 million balance in PG&E's Vegetation Management Balancing Account (VMBA) is credited to PG&E's Transition Revenue Account (TRA). ORA's proposal to refund the $22.8 million directly to ratepayers is denied. The authorized increase is effective for tariff filing purposes January 1, 2001 as required by Decision (D.) 00-12-061. However, because of the rate freeze, rates will not increase.

Introduction

In this 2001 Attrition Rate Adjustment (ARA) application, PG&E seeks an electric revenue increase of $184,575,000. PG&E's requested increase has two components: (1) an Electric Distribution and Customer Services (electric distribution) revenue requirement increase of $184.196 million and (2) a Humboldt Nuclear SAFSTOR revenue requirement increase of $379,000.[1] PG&E calculated its electric distribution ARA allowance by using: (1) 1999 recorded rate base as adjusted by the recommended adjustments included in the Energy Division's financial audit dated May 8, 2001; (2) expense levels adopted in D.00-02-046; and (3) two years of cost growth to determine the rate base and expense allowances. PG&E also requests that the balance in its VMBA be credited to PG&E's TRA.

ORA contends that attrition for PG&E for 2001 should be denied on policy grounds. ORA states that PG&E justifies its attrition request by claiming that it is needed to give it a reasonable opportunity to earn its authorized rate of return. For attrition year 2001, ORA estimates earnings of 8.22% compared to the authorized amount of 9.12%. While this earning estimate is less than authorized, ORA maintains that this calculation assumes that PG&E's bankruptcy filing will have no impact on its expenses or capital spending. ORA argues that PG&E's spending can be expected to decrease as a result of the bankruptcy. Given these circumstances, ORA recommends that attrition be denied. In the alternative, ORA recommends an attrition increase limited to $113 million. ORA says that PG&E has overstated its attrition request by escalating costs for 2000 and 2001,

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[1] PG&E's proposal for the Humboldt SAFSTOR revenue requirement was not addressed by any party other than PG&E.

rather than just 2001, and by erroneously computing its capital spending estimate. In regard to the VMBA overcollections, ORA recommends a credit directly to ratepayers rather than a credit to the TRA.

Aglet Consumer Alliance (Aglet) and The Utility Reform Network (jointly referred to as Aglet) filed a joint brief recommending a denial of relief. Aglet argues that PG&E has not met its burden to show that its proposed increase will match the anticipated cost changes that the attrition mechanism is to recover. As a result of PG&E's bankruptcy filing, Aglet expects PG&E's costs to lessen, not increase. As a secondary recommendation, Aglet would limit an attrition increase to the electric portion of $112.5 million. (See D.00-02-046, at 471.) Next best, argues Aglet, would be to authorize an increase based on a single year of expense escalation and capital additions, using PG&E's previously-authorized attrition formulas, modified for recorded 1999 capital costs. In no event should the Commission approve two years of expense escalation or capital additions. Aglet supports ORA's position regarding the VMBA adjustment.

Background

Pursuant to Ordering Paragraph 15[2] of D.00-02-046, PG&E's 1999 general rate case (GRC) decision, PG&E filed this 2001 ARA application requesting a total electric revenue requirement increase of $186.126 million. Approximately two-thirds of this proposed increase is asserted to be capital-related, caused by the continued growth in PG&E's electric distribution rate base. The remaining

[2] Ordering Paragraph 15 states: "PG&E's request for authority to implement Attrition Rate Adjustments is granted, subject to modification to take into account the results of the 1999 capital spending audit and to recognize amounts recorded in the VMBA." (D.00-02-046, mimeo., p. 545.)

one-third is asserted to reflect inflation in PG&E's electric distribution operating expenses.

On October 18, 2000, Commissioner Wood issued his Assigned Commissioner's Ruling (ACR), which, among other things, determined that (1) "[i]n no event will the Commission's final decision be issued later than January 2002"; (2) "a final order will not be issued before the end of 2000"; and (3) "[w]e will consider an interim order that would allow the final decision in this proceeding to be effective as of the date of the interim order."

On December 21, 2000, the Commission issued an interim order "that the final decision in this proceeding shall be effective as of the effective date of this Interim Order." (D.00-12-061, p. 5.) The Interim Order was effective December 21, 2000.

On January 10, 2001, Administrative Law Judge (ALJ) Barnett established a two-phase schedule for this application and specified the following issues for Phase 1 and Phase 2:

Phase 1:

- Review of PG&E's Attrition Rate Adjustment mechanism and calculations. PG&E's request, made in Advice Letter 2040-E, for implementation of the 2001 electric attrition rate adjustment will be considered in this proceeding.

- If an attrition increase is approved, whether it should be based on two years (2000 and 2001) or one year (2001) of cost increase.

- Energy Division's financial audit.

- Review of vegetation management expenditures (for 1999 and 2000) as ordered in Ordering Paragraph 15 of Decision 00-02-046. PG&E's request made in Advice Letter 2016-E, for approval to transfer the year-end balance of the Vegetation Management Balance Account (VMBA) to the Transition Revenue Account will be considered here.

Phase 2:

- Consultant's engineering audit on 1999 capital spending.

Hearings were held in Phase 1, starting June 6, 2001. Phase 1 was submitted on August 1, 2001, upon receipt of briefs.

Attrition

Attrition is the year-to-year decline in a utility's earnings caused by increased costs which are not offset by increased rates and sales. In order to protect utility shareholders from the effect of attrition to some extent, the Commission has adopted a ratemaking mechanism called the ARA mechanism. The ARA mechanism was described in D.85-12-076 to "provide utilities with the reasonable opportunity of achieving their authorized rates of return during years in which they are not permitted under the Commission's rate case plan procedures to file for general rate relief but in which they still face volatile economic conditions." (D.85-12-076, Finding of Fact 1, 19 CPUC2d 453, 476.) (Cited in Re PG&E D.92-12-057, 47 CPUC2d 143, 273.)

D.85-12-076 presents a full discussion of the attrition mechanism to that time. The decision recognized that volatile economic conditions had lessened and that a new procedure should be considered:

> "In determining the extent of any reform, we must also weigh the fact that the four energy utilities which are parties to this proceeding have been placed on a three-year rate case cycle. (See Resolution ALJ-151, June 6, 1984.) These companies are thereby required to forego general rate relief during two years in exchange for timely rate decisions in a third year. If the rate case cycle had not been extended to three years, we would be inclined to abolish attrition as TURN proposed or to declare a moratorium on attrition allowances as Legal Division proposed.

> But such a step would subject the utilities to a lengthy period without any general rate relief. Moreover, we are concerned about eliminating attrition without first undertaking a broader review of our overall procedures governing general rate relief." (19 CPUC2d at 466.)

The mechanics of the attrition filing were set forth in Re PG&E D.93887 (7 CPUC2d 349) discussion (pp. 394-398) and Appendix E (at p. 523). The method provides for an advice letter filing, just prior to the attrition year, by the utility seeking increased rates based on the escalation of general rate case forecasted expense and rate base. The escalators are conventional indexes such as CPI and DRI. Attrition was requested and the advice letter mechanism was adopted in PG&E's recent general rate cases (D.89-12-057, 34 CPUC2d 199, 301-303; D.92-17-057, 47 CPUC2d 143, 305, Appendix C, pp. 338-354.) PG&E did not request an attrition increase in its test year 1996 GRC.

The attrition mechanism has been considered a fairly simple routine procedure. An attrition adjustment is usually requested in a general rate case; if granted it is based on forecasted numbers adjusted for inflation; and the attrition year rates are authorized by Commission resolution in response to an advice letter filing. In contrast, the Commission decision (D.00-02-046) regarding PG&E's Test Year 1997 GRC and 2001 attrition was not routine. First, it required PG&E to file an application rather than the usual advice letter; second, it limited the attrition increase to just the third year of the rate case cycle, denying attrition for year 2000; third, it instituted a number of reporting requirements that are not normally a part of an attrition proceeding. In the policy section of the decision, the Commission said:

> "According to the timing of the Rate Case Plan, PG&E should file an application for the attrition allowances authorized here <u>to provide a vehicle for enabling us to determine whether the</u>

> <u>additional costs we have authorized in this decision, in fact, reflect PG&E's normal operation</u>. The attrition allowance should be accompanied by reports documenting maintenance expenditures, including vegetation management as agreed to by PG&E in its settlement of the Rough and Ready fire investigation, I.98-07-009, pipeline safety and replacement, reliability related maintenance and capital, new business activity and related investment, as well as operation and maintenance expenditures related to distribution customer service activities. <u>These reports are intended to assure us and the public that authorized revenues are being expended for the purposes intended, and that actual earnings reflect authorized returns</u>. (D.00-02-046, p. 55 (emphasis added).)

We were concerned that "given the history of divergence between authorized revenues and actual expenditures in mission critical areas outlined elsewhere in this decision, we will require enhanced levels of monitoring and reporting between the effective date of this decision and the 2002 GRC to be filed pursuant to this decision, to <u>assure that we have 'gotten it right'</u> before authorizing the withdrawal of Commission scrutiny and reducing the monopoly cost transparency represented by PBR." (*Id.*, p. 53, (emphasis added).)

In the attrition section of the decision, we said:

> "Giving weight to the concern that there not be a disincentive for efficient management created by an ARA and mindful that an audit of test year 1999 capital additions will give us insight into the forces growing PG&E's rate base, we will approve PG&E's proposed attrition mechanism only in part. <u>The attrition year 2000 proposal is denied.</u> The attrition year 2001 proposal is granted to the extent that PG&E may file for an attrition year adjustment as proposed, with the caveat that the rate base component may be modified to reflect the results of the audit of 1999 distribution capital spending. (*Id.*, pp. 472-473, (emphasis added).)

The Conclusions of Law contain the following language:

> 44. An Attrition Rate Adjustment (ARA) is a component of the Rate Case Plan that adjusts some elements of cost of service during the course of the rate case cycle for the purpose of sustaining utility earnings at an adequate level.
>
> 46. Allowance of an ARA adjustment for 2000 is unreasonable.
>
> 47. Allowance of an ARA adjustment for 2001 is reasonable. (*Id.*, p. 540.)

Finally, the Ordering Paragraphs provide that:

> 14. PG&E's request for authority to implement Attrition Rate Adjustments for 2000 is denied.
>
> 15. PG&E's request for authority to implement Attrition Rate Adjustments for 2001 is granted, subject to modification to take into account the results of the 1999 capital spending audit and to recognize amounts recorded in the VMBA. (*Id.*, p. 545.)

PG&E argues for a literal reading of the ordering paragraphs and conclusions of law, which would suggest that this is simply a routine attrition proceeding with an automatic increase except for minor adjustments to account for the capital spending audit and the VMBA.

ORA, on the other hand, reads the ordering paragraphs and conclusions of law in conjunction with the text of the decision which indicate that the Commission is interested in a more thorough review of the application to assure itself and the public that "we have gotten it right" in the GRC decision, (*Id.*, p. 53), that the additional expenditures authorized by the GRC decision "reflect PG&E's normal operations" (*Id.*, p. 54), and that "actual earnings reflect authorized returns." (*Id.*, p. 55.) Achieving these objectives entails a level of review atypical for an attrition proceeding.

In our opinion, ORA's analysis has "gotten it right." By requiring an application rather than an advice letter filing; by omitting a finding of the amount of the attrition year increase; and by requiring the use of selected recorded numbers rather than forecast numbers, we were seeking more detail, more accuracy, and less routine. To the extent there is ambiguity in D.00-02-046, the better course is to favor the more detailed analysis required for an application over the more routine advice letter.

At the outset, it is necessary to decide whether the 2001 ARA increase should be determined based on two years of cost growth. PG&E calculated its 2001 electric revenue requirement increase based on two years (2000 and 2001) of cost growth for expense and rate base-related items. It argues that the 2001 ARA was authorized to recover PG&E's 2001 costs, so PG&E's 2001 ARA request is based on 2001 rate base and escalated expense. There have been two years of rate base growth and expense inflation since 1999, the test year for PG&E's last GRC, and the basis of this attrition year request. Since there have been two years of cost growth, PG&E argues that it is logical to base the ARA on that growth.

ORA and Aglet contend that the implication of the Commission's denial of attrition relief in 2000 is that PG&E cannot escalate expense or rate base-related items for Year 2000 in calculating its attrition for Year 2001. ORA calculates that eliminating escalation for year 2000 reduces PG&E's request by $35 million. ORA maintains that the Commission's language on this point is clear. Giving weight to the concern that there not be a disincentive for efficient management created by an ARA ". . .we will approve PG&E's proposed attrition mechanism only in part. The attrition year 2000 proposal is denied. The attrition year 2001 proposal is granted to the extent that PG&E may file for an attrition year 2001 adjustment as proposed…" (D.00-02-046, pp. 472-473; also see Conclusion of

Law 46 and Ordering Paragraph 14.) In ORA's opinion, allowing PG&E to recoup in 2001, the attrition that was denied in 2000 contravenes the goal of giving the utility an incentive for efficient management. In denying attrition for 2000, the Commission implicitly found that 1999 authorized rates were reasonable for 2000.

In simplified form assuming 3% inflation in 2000 and 3% inflation in 2001, the respective positions look like this:

	1999 Authorized Expenses	2000 Expenses	2001 Expenses
ORA	100	100	103.00
PG&E	100	103	106.09

ORA's analysis is correct. In the GRC, we found test year 1999 forecasts to be reasonable and denied attrition for year 2000, implicitly finding the 1999 forecasts to be reasonable for year 2000. Attrition increases are based on forecast years. In this circumstance, the forecast year 2000 is the same as forecast year 1999, and the attrition year is 2001. We reach this result because in D.00-02-046, we specifically found that attrition was denied for year 2000. Consequently, PG&E's attrition increase is reduced by approximately $35 million.

Attrition Expenses

In the conventional ARA, forecast expenses are escalated to reach the attrition year revenue requirement. In this attrition proceeding, ORA notes that PG&E has spent less than authorized during 1999 and 2000 in all expense categories except Administrative and General (A&G), while showing no decline in safety and reliability. Concluding from this that PG&E does not need an increase in its expense categories, ORA recommends that attrition for 2001 be based on 1999 recorded figures (except for A&G expense). In ORA's opinion, basing attrition on recorded figures rather than authorized in areas experiencing significant underspending is consistent with the Commission's expressed desire to use this proceeding to assure itself and the public that the GRC decision "got it right."

ORA states that there are serious problems with PG&E's recorded amounts for both A&G Account 920 and the Account 923. The former includes Performance Incentive Plan (PIP) costs that were expressly disallowed by the GRC decision and assigned to shareholders. The latter includes allocations from the holding company to the utility that are over three times the amount found reasonable by the Commission. The difference exceeds $60 million. ORA asserts that PG&E should not be rewarded with an attrition increase to the extent it is based on costs that were either disallowed on policy grounds or are unreasonable on their face. In short, PG&E should not be rewarded for this type of overspending. Adoption of ORA's proposal for calculating expense attrition results in a $12 million decrease in expenses.

PG&E argues that ORA's position is directly contrary to the standard ARA mechanism – forecasted expenses escalated by formula – and is contrary to D.00-02-046. PG&E contends that Ordering Paragraph 15 is quite clear about the only two modifications to the adopted ARA mechanism the Commission will consider: i.e., "the results of the 1999 capital spending audit and to recognize amounts recorded in the VMBA." (*Id.,* at 545.) ORA's efforts to circumvent the implementation of the adopted ARA mechanism by proposing a new ARA mechanism where the various expense components would be based on the lower of authorized or recorded expenses should be rejected as being both unfair and inconsistent with D.00-02-046. As PG&E points out, had ORA recommended that recorded numbers be used for all of the expense components, PG&E's ARA request would have increased.

D.00-02-046 tells us to take a closer look at PG&E's attrition filing than we would normally do had the filing been by way of an advice letter. That we have done. There have been four days of public hearing, 30 exhibits, and briefs by the active parties. But taking a closer look does not necessarily mean changing past practices. ORA would have us change from forecast expenses to recorded expenses when determining attrition relief, with an exception for higher recorded expenses with which ORA disagrees. For those expenses, we are asked to use lower forecast numbers. This approach is contrary to past ARA practice, takes on the appearance of a general rate case, and leads to inconsistent results as each party picks and chooses the numbers it is most comfortable with. Adopting ORA's expense calculations would still leave PG&E with a revenue shortfall to achieve its 9.12% authorized rate of return. ORA's primary recommendation would result in PG&E earning a rate of return of 8.22% in 2001. (Appendix A, Column H.)[3]

We conclude that in an ARA application filed in response to authority granted in a GRC, the better course is to use forecast expense and rate base unless the GRC decision specifies a different method. We do not disapprove of the use of recorded numbers or adjusted numbers to determine the need for

[3] Regardless of how we decide the expense dispute ORA would still recommend no increase because of the perceived effect PG&E's bankruptcy filing has on PG&E's operations.

attrition; but the history of this application and the order in D.00-02-046 do not support the proposal of ORA.

Bankruptcy

PG&E filed for bankruptcy protection in April 2001. The bankruptcy resulted not from the company's distribution operations, but from the fact that frozen retail electric rates were insufficient to recover the cost of electric commodity purchases in the unregulated power markets. The California Department of Water Resources has now largely taken over the electric commodity purchasing function. ORA says there is very little evidence in this record regarding the impact that the bankruptcy is likely to have on PG&E's spending in 2001 on either the expense side or the capital side. However, the Commission itself has noted that cost cutting efforts are a potential solution to the company's cash flow problems. (D.01-01-018, p. 18.) Furthermore, upon the filing of the bankruptcy PG&E was relieved from immediate payment of all capital cost and expense obligations that were incurred in 2001 and unpaid as of the date of the bankruptcy. To the extent these bills go unpaid, it will reduce costs in 2001.

Aglet argues that in times of utility liquidity problems and financial distress, it is reasonable to anticipate that PG&E will not expand its electric distribution costs but will seek opportunities to reduce its capital-related and operations and maintenance expenditures. As the Commission has stated, the current situation "is decidedly not business as usual and the utilities need to realize that ratepayers are not the only answer to their dilemma." (D.01-01-018, at 160.) Aglet maintains that PG&E will likely reduce distribution expenditures in the near term, and therefore recommends that the attrition increases authorized in D.00-02-046 should be rescinded or, suspended. Aglet's primary recommendation is for the Commission to deny any attrition relief for 2001, because approval of an electric attrition adjustment in 2001 would not improve service quality but would be a subsidy to shareholders. ORA agrees with this analysis and supports denial of attrition for the reasons stated.

PG&E argues that its bankruptcy filing has had no effect on its need for attrition relief. It says that the positions of ORA and Aglet are based on supposition, not facts. PG&E contends that there is no record evidence that

PG&E's expenses in 2001 will decrease, let alone decrease enough to make this ARA application unnecessary. PG&E says that its revenue requirements are determined by operating expense and capital-related items including taxes, depreciation, and return on weighted average rate base. Two-thirds of PG&E's ARA request is due to capital-related items. Its weighted average rate base is growing. The year 2000 end-of-year rate base is larger than 2000 weighted average rate base, and 2001 weighted average rate base will be larger still. PG&E's 2001 capital additions would have to be cut by 94% in order to produce a weighted average rate base equal to its 2000 weighted average rate base.

In regard to reduced expenses in 2001, PG&E points out that D.01-03-029 ordered PG&E to reinstate certain programs and rescind layoffs that might have resulted from those programs. Since that decision was issued, PG&E has filed compliance reports with the Commission, which document how PG&E has complied with D.01-03-029 by restoring staffing levels in meter reading, call centers, and other operations areas.

PG&E testified it has the ability to: (1) fully staff its customer call centers; (2) read meters on a monthly basis for all customers; (3) timely respond to service calls and outages; and (4) connect new customers. PG&E has started to restore various cash conservation measures, including: work required by others (WRO); Electric Rule 20A projects; gas pipeline replacement projects coincident with electric Rule 20A; pole replacement program; and records and literature fulfillment. PG&E has restored deferred merit increases for PG&E's approximately 6,000 non-union employees (in January, union employees received pay increases for 2001 in accordance with PG&E's union agreements), and the payment of the component of the management performance incentive associated with year 2000 operating objectives.

The evidence shows that PG&E has not reduced electric distribution operating expenses because of its bankruptcy filing. In response to D.01-03-029, PG&E has reinstated programs to assure adequate service. There is no evidence that the bankruptcy filing has had any appreciable affect on PG&E's distribution expenses. The record is less clear regarding the impact of PG&E's financial condition on its capital-related costs.

Rate Base

In Ordering Paragraph 15 of D.00-02-046, PG&E's request for authority to implement its 2001 ARA is granted, "subject to modification to take into account the results of the 1999 capital audit…."

Ordering Paragraph 12 states the scope of the financial audit:

> "The Energy Division shall conduct an audit of calendar year 1999 distribution capital spending by PG&E and report to the Commission on or before November 15, 2000. The scope of the audit will include capital projects closed to Plant in Service during calendar year 1999 and verification of amounts spent." (D.00-02-046, at p. 545.)

The Commission, in the text of D.00-02-046, describes how the results of the audit will be used:

> "The audit will establish an accurate year end 1999 electric distribution rate base. It should commence with a year end 1998 rate base, and examine actual capital spending in 1999. If there has been a variance between 1998 forecast and actual spending for 1998, it will not persist beyond the conclusion of the audit."

Based on Ordering Paragraphs 12 and 15 and the Commission discussion of the use of this audit, PG&E used recorded 1999 capital-related data as modified by the results of the Energy Division financial audit as the base for calculating the capital-related portion of the ARA. Since no party disputed the results of the audit, and PG&E has fully implemented the results of the audit in its 2001 revenue requirement, PG&E says we should adopt PG&E's recorded 1999 rate base as a starting point for the attrition calculation.

ORA and PG&E both use a rate base calculation methodology consistent with the methodology used in the last two PG&E GRC proceedings in which attrition was approved. This methodology limits capital-related increases in an attrition year to increases in plant, depreciation reserve, and deferred tax items that are caused by rate base growth. The plant growth projection is based upon a seven-year average. As a starting point, ORA used the same recorded adjusted rate base figure utilized by PG&E in its October 27 update filing. ORA's rate base estimate of $7,292,186,000 is approximately $14 million less than the estimate in PG&E's original showing and $16.8 million less than PG&E's revised showing. ORA's estimate also includes the adjustments recommended by the Energy Division audit. The only difference between PG&E's rate base and ORA's is ORA's exclusion of escalation for 2000. As we have found it proper to exclude escalation for 2000 in regard to expenses, we find it proper to exclude escalation for 2000 in regard to rate base. We adopt an attrition rate base of $7,292,186,000.

However, as discussed above, 2001 was an extraordinary year, and PG&E faced unprecedented financial problems. It is reasonable to conclude that PG&E's financial woes would impact PG&E's capital spending. PG&E has informed the Commission of efforts to reduce costs such as scaling back of distribution undergrounding work.

The record before us is insufficient to determine if PG&E's financial problems resulted in extraordinary reductions in PG&E's capital spending in 2001, but PG&E should recover its reasonably incurred costs. Therefore, while we approve the increase in capital-related costs stated above, we will make this increase subject to revision downward should PG&E's actual 2001 capital costs be less than the assumed amount underlying our increase. This will enable PG&E to recover its costs, but protect ratepayers should we determine PG&E's capital spending was reduced in 2001.

Adopted Results of Operations

The comparison of PG&E, ORA, and adopted results of operations is:

		PG&E Requested 2001	ORA's Primary Recommendation for 2001	ORA's Secondary Recommendation for 2001	Adopted
	A	B	C	D	E
1	REVENUES				
2	General Rate Case Revenue	2,088,338	2,088,838	2,088,838	2,088,838
3	Increase	184,196	0	112,940	150,838
4	General Rate Case Revenue	2,272,533	2,088,838	2,201,778	2,239,676
5					
6	OPERATING EXPENSES				
7	Transmission	723	552	552	690[1]
8	Distribution	414,862	373,460	373,460	397,629[2]
9	Customer Accounts	193,468	173,169	173,169	186,525[3]
10	Uncollectibles	7,643	7,024	7,405	7,532
11	Administration & General	191,158	187,177	187,177	186,726[4]
12	Franchise Requirements	14,335	11,629	13,293	13,851
13	Subtotal Expenses	822,189	753,011	755,055	792,953
14					
15	Depreciation	417,617	416,891	416,891	416,891
16					
17	TAXES				
18	Property	83,417	83,417	83,417	83,417
19	Payroll	32,194	32,194	32,194	32,194
20	Business	335	335	335	335
21	Subtotal other taxes	115,946	115,946	115,946	115,946
22					
23	Subtotal expenses	1,355,752	1,285,848	1,287,892	1,325,790
24					
25	Income basis for State Taxes	916,781	802,990	913,886	913,886
26	State Corporation Franchise Tax	37,156	27,097	36,900	36,900
27	Income basis for Federal Taxes	879,625	775,894	876,986	876,986
28	Federal Income Tax	212,862	176,556	211,938	211,938
29	Net for Return	666,763	599,338	665,048	665,047

(continued on next page)

1 Escalation, year 2001 – 2.95% (Ex. 11, p. 1-15, L. 15-17.)

2 Escalation, year 2001 – 3.29% (Ex. 11, p. 1-15, L. 15-17.)

3 Escalation, year 2001 – 3.62% (Escalation for customer accounts is the same as for A&G, Ex. 5, p. 1-18, L. 17-18, L. 25-26).

4 Escalation, year 2001 – 3.62% (Ex. 11, p. 1-11, L. 15-17).

30					
		PG&E Requested 2001	ORA's Primary Recommendation for 2001	ORA's Secondary Recommendation for 2001	Adopted
	A	B	C	D	E
31					
32	Total Revenues	2,272,533	2,088,838	2,201,778	2,239,676
33	Total Operating Expenses	1,605,770	1,489,500	1,536,730	1,574,629
34	Net for Return	666,763	599,338	665,048	665,047
35					
36	Rate Base	7,309,012	7,292,186	7,292,186	7,292,186
37					
38	Rate of Return on Rate Base	9.122%	8.219%	9.120%	9.120%[5]

In reaching our adopted results of operation electric revenue requirement increase, we started with authorized expenses of 1999 (see Appendix A, Col. A), omitted inflation for 2000, used the 2001 escalation factors shown on the results of operations table (above), and used the current rate of return of 9.12%. This results in an electric revenue requirement increase of $150,838,000. This is a reasonable increase based on the rate base, escalators and the rate of return adopted in this decision, as discussed above.

The Vegetation Management Balancing Account

PG&E, ORA, and Aglet agree that for the two-year period 1999-2000, PG&E spent approximately $22.8 million less on vegetation management expenses than the Commission included in PG&E's distribution revenue requirement in the 1999 GRC decision. They dispute how best to handle the

[5] A 9.12% rate of return was authorized in PG&E's recent cost of capital decision (D.00-06-040 in A.99-11-003). Ordering Paragraph 2 of D.00-06-040 states that "PG&E's adopted cost of capital is effective February 17, 2000 as authorized by D.00-02-049." (At p. 23.)

VMBA overcollection. PG&E recommends that we credit the VMBA overcollection to the TRA. ORA and Aglet recommend that the VMBA overcollection be refunded directly to ratepayers.

In D.00-02-046, we described our regulatory objective for creating the VMBA:

> "Beginning with 1999, the VMBA will collect authorized revenues and actual vegetation management expense, and <u>will true-up these amounts annually to the extent the authorized revenues exceed expense.</u> In this way, ratepayers will not be harmed if the estimates we adopt as reasonable for 1999 prove to be imprecise. (Emphasis added.) (D.00-02-046 at p. 148.)

The distribution revenue requirement adopted in the 1999 GRC includes the approved vegetation management expenses. In both 1999 and 2000, PG&E recorded that revenue requirement in the TRA. In 1999 and 2000, PG&E also recorded the authorized revenue requirement and the actual expenditures for vegetation management in the VMBA.

PG&E proposes to true-up both the VMBA and the TRA by crediting the underexpenditures from the VMBA to the TRA. PG&E argues that the effect of its proposal to reduce the TRA is to true-up the GRC revenue requirement, so the distribution revenue requirement recovers only actual vegetation management expenditures. The revenue requirement component of the distribution rate ends up being exactly the same as recorded expenditures. Thus, ratepayers are not harmed by the estimates adopted in the GRC. PG&E says this approach is fair to both ratepayers and shareholders. Under the rate freeze, which was in effect in both 1999 and 2000, ratepayers did not see an overall increase to their rates and bills when the Commission adopted the 1999 GRC revenue requirement, which included the vegetation management expenses. Therefore, they should not receive a one-time refund or credit on their bills due to a reduction to the GRC increase.

ORA takes no exception to the costs recorded in the account. However, ORA takes issue with PG&E's recommendation to transfer the balance into the TRA, which currently has an undercollection associated with energy purchases of $6.5 billion. ORA notes that there are several proceedings before this Commission that are litigating energy cost issues. Those proceedings will decide whether or not the utilities' ratepayers will have to absorb any or all of those energy costs. PG&E's proposed method of disposition of the underspent vegetation management expenditure dollars therefore amounts to PG&E's requesting recovery of $22.8 million of its approximately $6.5 billion in energy costs.

Rather than using underspent tree-trimming dollars to offset energy costs, ORA recommends that these savings be refunded to customers thereby holding them harmless in the manner intended by the Commission. ORA argues that this unusual one-way balancing account was adopted only after a pattern of years of underspending the authorized amounts for electric distribution maintenance, of which tree trimming is a major component, and a finding by the Commission that PG&E's maintenance practices during this period were deficient. (D.00-02-047, pp. 132, 133.) In ORA's view, this balancing account was adopted, at least in part, to avoid a recurrence of the practice whereby funds earmarked for one purpose, are used for some other purpose. A refund protects ratepayers from having monies earmarked for the purpose of tree-trimming being funneled off to reduce energy costs.

Aglet also supports refunding the balance to ratepayers. Aglet recommends accomplishing this by adding a provision to the Electric Deferred

Refund Account, or through one-time bill credits. ORA supports this recommendation.

ORA and Aglet argue that because PG&E spent $22.8 million less than authorized ratepayers are harmed if that $22.8 million is not refunded to them. This is not persuasive. Throughout the period when the vegetation management account was in issue, rates have been frozen. While emphasizing vegetation management in the GRC, the Commission neither increased rates nor changed rates. Even if the Commission had done nothing in the GRC regarding vegetation management, rates would have been exactly the same. PG&E also spent less than authorized in other accounts, but no party suggests a refund in those accounts. Merely because we put special emphasis on vegetation management does not make the account subject to refund. Ratepayers did not pay one dollar more when vegetation management costs were forecast in rates; there is nothing to be refunded. PG&E's accounting method is correct. We clarify that the balance in the vegetation management account should apply to the TRA on a prospective basis and should not apply to past TRA undercollections.

The Capital Spending Consultant's Report

Ordering Paragraph 12 of D.00-02-046, in relevant part, states:

> "In addition, the Energy Division shall contract with a consultant who will assess the contribution of capital spending to system reliability, capacity and adequacy of service. PG&E shall reimburse the Commission for the cost of this contract. PG&E is authorized to record these costs in a memorandum account. PG&E shall file an advice letter implementing this memorandum account. The advice letter shall be effective on completion of review by the Energy Division for compliance with this order."

This decision is scheduled to issue in January 2002. The consultant's report was expected in August 2001, but was delayed to October 1, 2001. It has not yet been received. When received, a prehearing conference is expected to be set to review the report's findings.

ORA comments that although the consultant's report is currently due on October 1, 2001, there is no assurance it will be completed by that date and even if it is, it is unlikely that its recommendations could be incorporated into a decision by the end of the year. PG&E recommends that the consultant's report be addressed in the context of its 2002 GRC proceeding. ORA has no objection to addressing the report in that forum. However, to the extent the consultant finds that PG&E's capital spending in 1999 was unreasonable, ORA recommends that this proceeding be left open to incorporate the ratemaking effects of a lower rate base.

We do not believe this proceeding should be kept open to receive the consultant's report. Should the report, in ORA's opinion, have a more than minor impact on attrition results of operation we will look favorably on a petition for modification pursuant to Rule 47.

Comments

Comments on the proposed decision of ALJ Barnett were received from ORA, TURN, Aglet, and PG&E. PG&E recommends that the proposed decision be adopted without change. The gist of ORA, TURN, and Aglet comments is that the proposed decision is erroneous in not adopting their version of the evidence. This was the position taken in their briefs. Rule 77.3 states that "Comments which merely reargue positions taken in briefs will be accorded no weight and are not to be filed." Further, no proposed findings of fact and conclusions of law were included as an appendix to their briefs (Rule 77.3).

Nevertheless, we have reviewed their comments on the proposed decision's treatment of capital costs, income taxes, and VMBA, and, with one exception, find they are no more than a repetition of their briefs. ORA, TURN, and Aglet note our reduction of capital costs as a result of our rehearing order in PG&E's general rate case (D.01-10-031), and request its inclusion herein.

In D.01-10-031, we granted partial rehearing of D.00-02-046, the PG&E general rate case upon which this attrition proceeding is based. We reduced the capital increase we approved in D.00-02-046 by $24.8 million and we granted rehearing regarding a portion of PG&E's estimated $171 million in capital spending for 1998. We "ordered that any rates that are raised based on the electric distribution capital forecast adopted in D.00-02-046 be made subject to refund." To the extent that the $24.8 million modification impacts the revenue requirement authorized in this decision, rather than reopen this proceeding to make a routine downward adjustment, we request the Energy Division to review PG&E's Advice Letter filing implementing this decision to assure compliance. Any further modification of this decision as a result of the rehearing ordered in D.01-10-031, should be made by petition to modify pursuant to Rule 47, or a compliance filing.

Findings of Fact

1. In D.00-02-046, the Commission left open the policy decision of whether any ARA increase should be granted.

2. In D.00-02-046, the Commission adopted a mechanism for determining the appropriate ARA allowance.

3. D.00-02-046 adopted an attrition increase method for 2001 based on one year of cost growth from 2000 to 2001.

4. D.00-02-046 approved an ARA mechanism to calculate the capital-related portion of the allowance for 2001 based on recorded 1999 capital additions as modified by the Energy Division's financial audit with one year of escalation.

5. The expense portion of the ARA is calculated by applying escalation to expense levels adopted in the GRC decision.

6. We should not wait until the Energy Division consultant's report on 1999 distribution capital expenditures is completed and reviewed before issuing a decision in this proceeding.

7. Attrition increases are based on forecast years. In D.00-02-046, we specifically found that attrition was denied for year 2000. Therefore, the forecast year 2000 is deemed the same as forecast year 1999, and the attrition year is 2001.

8. PG&E has not reduced electric distribution operating expenses because of its bankruptcy filing. In response to D.01-03-029, PG&E has reinstated programs to assure adequate service. The bankruptcy filing has had no appreciable affect on PG&E's distribution expenses. Its effect on PG&E's capital costs is less clear.

9. PG&E used recorded 1999 capital-related data as modified by the results of the Energy Division financial audit as the basis for calculating the capital-related portion of the ARA. This approach does not consider the potential for reductions in capital spending that may have resulted from PG&E's financial problems in 2001.

10. ORA's estimate of rate base included the adjustments recommended by the Energy Division audit. The only difference between PG&E's rate base and ORA's is ORA's exclusion of escalation for 2000. It is proper to exclude escalation for 2000 in regard to rate base. We adopt an attrition rate base of $7,292,186,000.

11. Making the capital-related portion of PG&E's attrition increase subject to true-up should actual 2001 capital-related costs be lower than assumed herein will protect ratepayers in the event that PG&E's unusual financial troubles led to a reduction in capital spending in 2001.

12. It is reasonable to base PG&E's attrition increase on the 9.12% rate of return authorized in D.00-06-040.

Conclusions of Law

1. In an ARA application filed in response to authority granted in a GRC, the reasonable policy course is to use forecast expense and rate base unless the GRC decision specifies a different method. We do not disapprove of the use of recorded numbers or adjusted numbers to determine the need for attrition; but the history of this application and the order in D.00-02-046, do not support such use.

2. The entire rate increase authorized by this decision solely applies to PG&E's electric department. The rate increase will not be reflected in rate changes at this time due to the electric rate freeze.

3. Column E of the results of operation table set forth above is reasonable and is adopted.

4. Based on the escalators, rate of return, and rate base adopted in this decision, PG&E is entitled to an attrition rate adjustment rate increase of $150,838,000, which we find to be reasonable, subject to downward revision to reflect the $24.8 million ratebase reduction of D.01-10-031.

5. The capital-related portion of this increase should be adjusted downwards if PG&E's actual capital costs in 2001 are less than the costs underlying this increase.

6. PG&E's proposal to true-up both the VMBA and the TRA by crediting the $22.8 million underexpenditures from the VMBA to the TRA is reasonable.

7. A Humboldt Nuclear SAFSTOR revenue requirement increase of $379,000 is reasonable.

O R D E R

IT IS ORDERED that:

1. Within 10 days of the effective date of this order, Pacific Gas and Electric Company (PG&E) shall file revised tariff sheets to implement the electric revenue requirements set forth in the relevant findings and conclusions of this decision, including a reduction in the capital-related portion of the adopted attrition increase should PG&E's actual 2001 capital costs be less than those assumed herein. In conformity with Decision 00-12-061, PG&E shall make one-time adjustments, with interest, to its electric Transition Revenue Account, other electric accounts, and all electric balancing accounts, to reflect the difference, including interest, between the electric revenue requirement amounts that have been recorded between January 1, 2001, and the effective date of the revised tariff sheets, and the amounts that would have been recorded had a final decision in this proceeding been issued by December 31, 2000. The revised tariff sheets shall become effective on filing, subject to a finding of compliance by the Energy Division with this decision and with the $24.8 million capital reduction ordered by D.01-10-031, and shall comply with General Order 96-A. The revised tariff sheets shall apply to service rendered on or after their effective date.

2. The Humboldt Nuclear SAFSTOR revenue requirement is increased by $379,000.

3. PG&E shall true-up both its Vegetation Management Balancing Account (VMBA) and its Transition Revenue Account (TRA) by crediting the underexpenditures from the VMBA to the TRA.

4. To the extent that the rehearing ordered in D.01-10-031 modifies the electric distribution capital forecast adopted in D.00-02-046, which in turn modifies the electric distribution capital forecast of this decision, the rates authorized in this decision are subject to refund.

5. The revised tariff sheets to be filed pursuant to this order will not be reflected in a rate increase at this time due to the electric rate freeze. Any rate change based on these revised tariff sheets shall go into effect only on further order of the Commission.

6. This proceeding is closed.

This order is effective today.

Dated February 21, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
RICHARD A. BILAS
CARL W. WOOD
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