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Decision 90-12-070 December 19, 1990

## BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority to increase rates and recover costs for re-establishment of utility service and for repair and restoration of utility facilities damaged as a result of the Northern California earthquake of October 17, 1989 and related events.

ORIGINAL

Application 90-05-003

(Filed May 1, 1990)

Kernit Kubitz, and Robert Mc Lennan, Attorneys at Law, for Pacific Gas and Electric Company, applicant;

Norman Furuta, Attorney at Law, for Department of the Navy; and Joel R. Singer, Attorney at Law, for Toward Utility Rate Normalization; interested parties.

Alberto Guerrero, Attorney at Law, and Ray Charvez, for Division of Ratepayer Advocates.

OPINIONBackground

On October 17, 1989 at 5:04 p.m., the San Francisco Bay Area was struck by an earthquake measuring 7.1 on the Richter scale. The earthquake caused deaths and widespread personal injury and property damage. Portions of the geographical area affected by the earthquake are in Pacific Gas and Electric Company's (PG&E) service territory. PG&E immediately invoked its established earthquake emergency plan to:

1. Restore utility service to its customers;
2. Repair, replace, or restore damaged utility facilities; and,
3. Comply with government agency orders resulting from the emergency.

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On October 25, 1989, PG&E filed an emergency motion requesting the establishment of a gas and electric Earthquake Recovery Account (ERA) in which to record earthquake-related gas and electric expenses and revenues for potential recovery in the future. We granted this request with specific instructions. (Decision (D.) 89-11-029, as modified by D.89-11-066.)

On May 1, 1990, PG&E filed this application seeking recovery in rates of earthquake-related expenses recorded in the gas and electric ERA.

On August 14, 1990, Prehearing Conference was held. Attorneys appeared representing PG&E, Toward Utility Rate Normalization (TURN), Division of Ratepayer Advocates (DRA), and the Department of the Navy (Navy). DRA distributed its written audit report which recommended that two disallowances in the requested recovery be made. PG&E indicated that settlement of DRA's recommendations was possible and requested time for further discussions. TURN requested time to review DRA recommendations before taking a position. Navy indicated an interest in monitoring the proceedings without participation. Parties requested that a schedule be set to accommodate both a settlement, should one be reached, and evidentiary hearings based upon PG&E's request to increase rates effective January 1, 1991. This request was granted.

On August 28, 1990, a Second Prehearing Conference was held to comply with notice requirements in the Commission's settlement rules. (Rules of Practice and Procedure, Rule 51, et seq.) No additional parties appeared. PG&E and DRA distributed a draft settlement agreement. TURN indicated that it may not sign the agreement.

On September 4, 1990, three events occurred. At 9 a.m. a duly noticed Settlement Conference was held. No additional parties appeared. TURN indicated it would not sign the proposed settlement agreement based upon its dispute over the proposed allocation of

insurance proceeds. Parties agreed to shorten to 20 days the 30-day period for comments on the settlement agreement and to waive the right to file reply comments. (Rule 51.4.) At 10 a.m., even though Public Participation Hearings were duly noticed, no members of the public appeared. Evidentiary Hearing was held on the limited issue of allocation of the insurance proceeds. Prior to 5 p.m., PG&E and DRA filed a joint motion to accept its settlement agreement.

On September 24, 1990, concurrent closing briefs and comments on the motion to accept the settlement agreement were filed by PG&E and TURN.

On October 16, 1990, TURN asked to be found eligible to receive compensation in this proceeding, citing D.90-09-024 as the decision finding financial hardship for the calendar year 1990. No opposition to this request was received. We conclude that TURN has met the requirements at Rule 76.54(a).

The Proposed Decision of Administrative Law Judge Bennett was mailed on December 19, 1990. We make revisions suggested in parties' comments that do not alter the ultimate conclusions in the decision.

#### The Application

In its application, PG&E requests authority effective January 1, 1991 to increase electric rates by \$11.1 million and gas rates by \$3.6 million, on an annualized basis, from rates in effect on January 1, 1990. This proposed increase will recover earthquake-related expenses not presently funded in rates. The recovery of these expenses is based upon actual expenses and projected 1990 year-end balances of expenses and insurance proceeds recorded in the ERA.

PG&E also requests authority effective January 1, 1992 to reduce its then existing rates to allow approximately \$4.0 million of electric rates and \$0.9 million of gas rates from the 1991

increase to remain in effect. This adjustment will recover ongoing additional capital costs caused by the earthquake.

The requested rate increases will increase PG&E's electric and gas revenues by less than 1 percent.

PG&E indicates in the application that its total earthquake-related expenditures are \$76 million. However, from this amount PG&E excluded certain items pursuant to our orders in D.89-11-029 and D.89-11-066. PG&E excluded: \$15.7 million in costs booked prior to November 3, 1989, the effective date of the ERA; \$7 million in costs already funded in authorized rates; and \$30 million in capitalized costs. To the remaining costs, PG&E applied insurance recovery and tax credits related to the earthquake losses to arrive at its total request for recovery of \$14.7 million for 1991.

PG&E proposes to allocate the increase to both gas and electric customers based upon the rate design authorized in the most recent Annual Cost Allocation Proceeding (ACAP) decision effective at the time the requested changes in rates occur.

#### The Evidentiary Hearing

At the evidentiary hearing, PG&E introduced its "Report on Costs Resulting From the October 17, 1989 Earthquake" and a Draft Settlement Agreement. (Exhibit 1 and Exhibit 3.) DRA introduced its "Results of Examination of PG&E's Application for Earthquake Costs Recovery". (Exhibit 2.) TURN cross-examined PG&E's witnesses on the issue of allocation of insurance proceeds. (Exhibit 4.) TURN does not challenge the reasonableness of the proposed earthquake-related expenses.

PG&E's report documents the events surrounding the aftermath of the earthquake and the ensuing costs itemized by facility. The report indicates that PG&E has \$175 million in property insurance with a \$25 million deductible. The policy insures against all risks of physical loss or damage to insured property. However, certain major items, such as underground gas

and electric systems, are not insured under the policy. The basis for recovery under the policy is the cost to repair or replace the damaged property with new materials of like kind or quality, without deducting for depreciation.

Based upon normal accounting procedures, PG&E allocates insurance proceeds on a month-to-month basis first to expenses and then to capital expenditures. The insurance proceeds from the 1989 earthquake are not sufficient to recover all earthquake-related expenses, therefore, no allocation to capital expenditures is proposed. PG&E asserts that its proposed insurance allocation method has been consistently followed by the Commission, citing the allocation of MacDonald Island insurance proceeds in PG&E's 1987 General Rate Proceeding, D.86-12-095.

PG&E allocates estimated earthquake damage insurance proceeds (\$25 million) on a month-to-month basis beginning with expenses incurred on October 17, 1989, the date of the earthquake. Insurance proceeds of \$15.7 million are applied to off set the recorded expenses (\$15.7 million) prior to November 3, 1989, the effective date of the ERA. Therefore, \$9.3 million of estimated insurance proceeds (\$25 million - \$15.7 million) are allocated to ERA after November 2, 1989. PG&E believes this allocation method complies with the intent of D.89-11-066, which it asserts is the full recovery in rates of earthquake-related expenses.

In DRA's audit report, DRA concludes that PG&E's earthquake-related expenditures booked in the ERA are reasonable and in accordance with D.89-11-029 and D.89-11-066, with two exceptions, straight time labor expenses and tax deductions. DRA recommends that \$684,572 in labor expenses be disallowed because these costs represent a reallocation of company resources which are already covered in rates. DRA recommends that tax deductions in the amount of \$1,425,000 be flowed through to the ratepayer for federal income tax purposes, requiring a reduction in the proposed

revenue requirement of \$817,251. DRA does not challenge PG&E's allocation of insurance proceeds.

The Settlement Agreement

The settlement agreement indicates that PG&E agrees to the two changes recommended by DRA, certain corrections to DRA's calculations, and stipulates that total earthquake-related recovery in rates should be \$13.3 million for 1991. In addition, the settlement agreement indicates that the parties agree not to litigate in this proceeding the issue of appropriate earthquake-related depreciation adjustments.

In the joint motion to accept the settlement agreement, PG&E/DRA consider the settlement agreement reasonable for a number of reasons. In PG&E's opinion, PG&E has incurred and is incurring substantial costs to restore utility service and repair facilities damaged in the October 17, 1989 earthquake. The joint parties contend that the total expenditures of \$76 million were incurred on an emergency and extraordinary basis for the benefit of the public served by PG&E. They further believe that PG&E is obligated by Public Utilities Code § 451 to provide adequate, efficient, just, and reasonable service to its customers. Therefore, PG&E is compelled to exert all reasonable effort to restore service and repair facilities after such an event. They assert that the cost of this effort was not forecast in PG&E's base rates, nor included in existing rates.

Earthquake expenditures sought to be recovered, in PG&E's opinion, are extraordinary costs. The joint parties assert that such costs are not included in normal ratemaking estimates, and therefore, not included in existing rates. They emphasize that PG&E has excluded from its application amounts for programs already funded in existing rates.

PG&E contends that PG&E was well prepared for and responded effectively to the earthquake emergency because PG&E quickly restored service to the majority of 1.4 million electric

and 160,000 gas customers. They believe it is appropriate, as a matter of public policy, to provide for rate recovery as a sign that effective and prompt emergency action is reasonable public utility behavior under such circumstances.

PG&E urges the Commission to adopt its settlement of all issues in the proceeding and reject any changes offered by any party. PG&E believes the settlement agreement represents a reasonable balancing of the interest of ratepayer and shareholder since PG&E has substantially reduced its request for recovery. PG&E requests that the Commission consider the intention of D.89-11-066 and the entire record in the proceeding in deliberating on this matter.

#### Retroactive Ratemaking

TURN concludes that the insurance proceeds from the policies paid for by ratepayers must be applied to offset only those expenses in the ERA. In TURN's opinion, the allocation of proceeds to expenses incurred prior to the effective date of the ERA is retroactive ratemaking. The impact of TURN's position is to allocate the entire \$25 million in insurance proceeds to post-November 2 expenses, making the net recovery in this application virtually zero. Thereby, TURN urges the Commission to deny the application.

#### A. TURN's Argument

TURN contends that the Commission specifically prohibited recovery of pre-November 3 expenses because of the rule against retroactive ratemaking, citing D.89-11-066, p.3. TURN considers PG&E's method of allocation of insurance proceeds to be an unlawful diversion of ratepayer benefits to shareholders, citing case law on retroactive ratemaking. TURN contends that since PG&E does not include in the ERA all insurance proceeds, it violates our order in D.89-11-066. TURN points out that ratepayers have paid all premiums on PG&E's earthquake insurance policies and the size of the deductible is irrelevant. TURN also rejects as irrelevant

PG&E's references to the treatment of insurance proceeds for MacDonal Island damage. TURN asserts that PG&E's main motive in filing this application is to recover pre-November 3 expenses.

TURN believes PG&E's proposed method of allocation of insurance proceeds is unfair. TURN contends that the Commission's exclusion from the ERA of all pre-November 3 expenses is more than fair since ratepayers insulate PG&E against all foreseeable risks and cover extraordinary expenses on a prospective basis.

**B. PG&E's Argument**

PG&E believes its proposed allocation of insurance proceeds is reasonable for four reasons.

First, the application of some insurance proceeds to the pre-November 3d period is normal accounting practice. Insurance accrues when the damage which gives rise to the claim occurs. In this proceeding, the damage and some expenses occurred before November 3, 1989, therefore, the allocation of insurance proceeds to this period is reasonable.

Second, insurance is intended to protect both ratepayers and shareholders from extraordinary losses and division of insurance proceeds in these circumstances fairly balances the interests of both. Ratepayers benefited from PG&E's expenditures both before and after November 3, 1989 and in recovering such expenditures through insurance prior to November 3, 1989, PG&E is not unjustly enriched, but merely compensated for some of the costs of providing service to the public.

Third, ratepayers have received the benefit of lower rates associated with the level of insurance coverage and premiums authorized in D.86-12-095, PG&E's 1987 General Rate Case order. In the 1987 proceeding, the Commission adopted insurance recommendations with lower premiums and a higher deductible than those proposed by PG&E. Also in the 1987 proceeding, base rates were set for the period in which the earthquake occurred. Ratepayers, having benefited by lower rates must now share the



extraordinary expenses not included in rates and not fully covered by insurance.

And lastly, in the 1987 General Rate Case, the Commission found that shareholders should not be "thrust...into the insurance business" by being required to absorb the deductible in the event of an uninsured loss (D.86-12-095, pp. 216-218). Should TURN's position be adopted, shareholders would absorb a significant portion of the deductible in this proceeding, contrary to the Commission's finding in 1987.

PG&E considers it sound public policy to create an incentive for prompt utility action to repair facilities and to restore service after an extraordinary event until a mechanism for rate recovery is in place. PG&E argues that November 3 is an arbitrary date, the first day a Commission Conference was held after the earthquake, and has no relevance to the prudence of the costs incurred.

PG&E interprets case law on retroactive ratemaking as allowing recovery in rates of extraordinary expenses not set by or in a general rate proceeding. PG&E argues that there is no retrospective promulgation of general rates to recover costs incurred before the ERA was effective.

#### Discussion

PG&E asserts that the earthquake of October 17, 1989 was an extraordinary event warranting recovery in future rates for related expenses. Prior to the settlement agreement, DRA found all ERA recorded expenses reasonable and in compliance with D.89-11-066 except straight-time labor and tax deductions. PG&E adopted DRA's recommendations in the settlement agreement. TURN did not sign the settlement agreement because it challenges the allocation of insurance proceeds to earthquake-related expenses. However, no party disputes the fact that the earthquake of October 17, 1989 was an extraordinary event or that it is reasonable for PG&E to recover

in future rates earthquake-related expenses, if any, which are not funded in rates and not offset by insurance proceeds. PG&E's month-to-month allocation of insurance proceeds to all earthquake-related expenses not in rates results in allocating \$15.7 million to expenses prior to the effectiveness of the ERA and \$9.3 million to expenses after the effectiveness of the ERA. We cannot agree that this method results in retroactive ratemaking.

We required PG&E to record in the ERA any earthquake-related expenses and costs recovered as a result of the earthquake, including insurance proceeds. (D.89-11-066, Ordering Paragraph 1 and 2.) PG&E has complied with this request by excluding expenses already funded in rates and recording its estimate of earthquake-related cost recovery.

We prohibited PG&E from recording in the ERA costs incurred prior to November 3, 1989. (D.89-11-066, Ordering Paragraph 3.) PG&E has complied with this order.

We stated that the costs recorded in this account may be subject to future recovery in rates following review by the Commission of the reasonableness of incurred costs, verification and approval of recording methodology, identification of revenue which offsets recorded costs and review of current funding for the purpose of system repair and maintenance. (D.89-11-066, Ordering Paragraph 4.) Thus, we explicitly left for future resolution the amount of costs and methodology by which costs would be allocated for recovery in future rates. Under our order in D.89-11-066, PG&E will recover no more in future rates than authorized in the ERA. There is no issue of retroactive ratemaking under these circumstances.

The earthquake-related insurance proceeds in this proceeding are not rates or revenue automatically generated by the ratemaking process. The earthquake insurance proceeds in this proceeding are generated by the damage and destruction to PG&E property. In PG&E's 1987 rate proceeding we faced a similar

situation of allocating insurance proceeds. The dispute was whether the insurance proceeds should first be applied to expenses and or to capital accounts based on the economic impact of each method on the ratepayer and shareholder. The insurance proceeds were insufficient to recoup both expenses and capital expenditures. We concluded that the former method was preferred, applying proceeds first to expense accounts, because it prevented the shareholder from being placed in the position of absorbing the amount of an insurance deductible which may vary. We rejected staff's argument that insurance proceeds belong to the ratepayer who pays the insurance premiums. (PG&E Rate Proceeding (1987) 23 CPUC 2d 149, 266-267.)

PG&E applies to this proceeding the methodology for allocating insurance proceeds that we adopted in 1987. PG&E does not violate our ERA order by using a methodology authorized in 1987 to record insurance proceeds in the ERA. We indicated in D.89-11-066 that such methodology would be verified and approved in the future. We recognize that there is no request for treatment of capital expenditures in this proceeding. However, TURN requests that PG&E's shareholders be required to absorb a large portion of the deductible. In 1987 we rejected this ratemaking treatment and the same arguments for this treatment that are asserted in this proceeding.

We cannot even agree that PG&E's proposed method of allocating proceeds results in a sharing of proceeds with the shareholder. The proceeds are applied to the accounts in which the expenses are incurred. This is straightforward reimbursement.

Based upon DRA's investigation and verification of expenses and insurance proceeds in the ERA, PG&E's agreement to adopt DRA's two adjustments to these expenses and TURN's lack of challenge to the reasonableness of ERA recorded expenses and insurance proceeds, we find the amounts recorded in the ERA reasonable.

Based on our discussion above, we find no violation of the prohibition of retroactive ratemaking in the PG&E allocation of insurance proceeds to the total earthquake-related expenses. We find this allocation consistent with our 1987 decision regarding MacDonald Island insurance proceeds and reasonable to adopt in this proceeding.

**Findings of Fact**

1. PG&E initially requested recovery in rates of \$14.7 million in revenue requirements related to the Bay Area earthquake of October 17, 1989.

2. The earthquake at October 17, 1989 was an extraordinary event.

3. PG&E indicates in the application that its total earthquake-related expenditures are \$76 million. However, from this amount PG&E excluded certain items pursuant to our order in D.89-11-029 and D.89-11-066. PG&E excluded: \$15.7 million in costs booked prior to November 3, 1989, the effective date of the ERA; \$7 million in costs already funded in authorized rates; and \$30 million in capitalized costs. To the remaining costs, PG&E applied insurance recovery and tax credits related to the earthquake losses to arrive at its total request for recovery of \$14.7 million.

4. DRA has audited the expenses and cost recovery recorded in the ERA. DRA indicates that PG&E has complied with our orders regarding the ERA and that its recovery expenses are reasonable with two exceptions. DRA recommends two adjustments to the ERA: reduce labor expense by \$684,572 due to double recovery and flow through tax benefits to the ratepayer, resulting in a reduction of the revenue requirement of \$817,251.

5. PG&E and DRA subsequently entered into a settlement agreement whereby PG&E adopts DRA's recommended reductions and reduces its requested recovery to \$13.3 million for 1991.

6. The settlement agreement also indicates an agreement not to litigate the issue of capital depreciation adjustments caused by the earthquake.

7. The settlement agreement adopts PG&E's methodology for allocating \$25 million in estimated earthquake-related insurance proceeds. This method is to allocate on a month-to-month basis \$15.7 million of these proceeds to expenses incurred from October 17, 1989 to November 2, 1989 and \$9.3 million, the remainder of insurance proceeds, to expenses incurred on and after November 3, 1989.

8. TURN is not a party to the settlement agreement and challenges the insurance allocation method proposed by PG&E and DRA.

9. TURN alleges that the PG&E insurance allocation method constitutes retroactive ratemaking. TURN proposes to allocate all insurance proceeds to expenses incurred on November 3, 1989 and thereafter. TURN bases its position on the fact that the effective date of the Earthquake Recovery Account authorized by the Commission is November 3, 1989.

10. The PG&E insurance allocation method reimburses expense accounts to which earthquake expenses are charged. This method is reasonable and consistent with past allocation of insurance proceeds.

11. TURN does not dispute the reasonableness of total earthquake-related expenses PG&E records in the ERA.

12. TURN's proposed method of allocation does not spread the insurance proceeds to all earthquake-related expenses. This method allocates no proceeds to expenses prior to November 3, 1989. For this reason, this method is unreasonable.

13. PG&E's earthquake related expenses, as adjusted by DRA in the settlement agreement, are reasonable. The settlement agreement should be adopted.

14. There is no dispute between the parties that the earthquake of October 17, 1989 was extraordinary, that the ensuing expenses are not funded in rates and that it is reasonable to allow recovery in rates of unfunded and uninsured expenses reasonably incurred to restore service.

15. Insurance proceeds recovered as a result of earthquake insurance are not rates or revenues automatically generated in the ratemaking process.

16. PG&E requests that its rate increase be effective January 1, 1991, in order to combine rate adjustment with those of other pending proceedings.

17. The increases in rates and charges authorized by this decision are justified, and are just and reasonable.

#### Conclusions of Law

1. The application should be granted to the extent set forth in the Findings of Fact.

2. The prohibition against retroactive ratemaking does not apply to the allocation of insurance proceeds recovered from earthquake insurance based on the damage and destruction of utility property.

3. PG&E's method of allocating insurance proceeds should be adopted.

4. This decision should be effective immediately.

#### O R D E R

#### IT IS ORDERED that:

1. PG&E is authorized an increase in electric base rates effective January 1, 1991, of \$9,865,000, representing: (a) the 1990 year-end balance in the Earthquake Recovery Account for the Electric Department (\$5,643,000); and (b) the 1991 revenue requirement (\$4,222,000) associated with earthquake-related expenses and capital additions of the Electric Department. The

increase will be allocated to electric customer classes on the same basis as the attrition-related changes effective on that date. The 1990 year-end balance in the Earthquake Recovery Account shall be transferred to the Electric Revenue Adjustment Account on January 1, 1991, and the 1991 revenue requirement shall be reflected in the base revenue amount.

2. PG&E is authorized an increase in gas base rates, representing the 1991 revenue requirement (\$928,000) associated with earthquake-related expenses and capital additions of the Gas Department. This increase will be allocated to gas customer classes in proportion to the amount of Gas Department base revenue requirements allocated to each gas customer class in Decision 90-04-021. The allocation will be adjusted when the Annual Cost Allocation Proceeding (ACAP) decision resulting from PG&E's Application (A.) 90-08-029 becomes effective.

3. PG&E is authorized to transfer \$2,533,000, representing the 1990 year-end balance in the Earthquake Recovery Account for the Gas Department, to the core and noncore Gas Fixed Cost Accounts on January 1, 1991, for amortization in rates when the rates are adjusted pursuant to the ACAP decision resulting from Pacific Gas and Electric Company's A.90-08-029.

4. PG&E is authorized to adjust its base revenue amounts and base rates on January 1, 1992 to reflect 1992 revenue requirements

associated with the 1989 earthquake of \$4,128,000 (electric) and about \$876,000 (gas). These figures are subject to change to reflect the Commission's adopted cost of capital for 1992. It should be noted that the Commission's adopted cost of capital for 1992 is 10.00%.

This order is effective today.  
Dated December 19, 1990, at San Francisco, California.

G. MITCHELL WILK, President  
FREDERICK R. DUDA, Commissioner  
STANLEY W. HULETT, Commissioner  
JOHN B. OHANIAN, Commissioner  
PATRICIA M. ECKERT, Commissioner

I CERTIFY THAT THIS DECISION  
WAS APPROVED BY THE ABOVE  
COMMISSIONERS.