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Decision 91-07-006 July 2, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the matter of post-retirement benefits other than pensions.	I.90-07-037 (Filed July 18, 1990)
Application of Pacific Gas and Electric Company for authority among other things, to increase its rates and charges for electric and gas service. (Electric and Gas) (U-39-M)	Application 88-12-005 (Filed December 5, 1988)
And Related Matter.	I.89-03-033 (Filed March 20, 1989)

ORIGINAL

(See Appendix A for Appearances.)

I N D E X

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INTERIM OPINION

Background

On February 14, 1989, the Financial Accounting Standards Board (FASB)[1] issued a proposed draft on the recognition and measurement of an employer's obligation to provide post-retirement benefits other than pensions (PBOPs) and on the merits of changing the accounting for PBOPs from a cash basis to an accrual basis. That is, PBOPs cost would begin to accrue not when the liability is actually paid but while the employee is earning the benefits. PBOPs include employee benefits such as medical and dental care, life insurance, and legal services.

The FASB proposed draft was circulated for comments among the accounting and financial professions before it was finalized by the FASB[2] in December 1990. The consensus of the accounting and financial professions has been that liability for PBOPs should be recognized in the utilities' financial statements just as any other liability is recognized. This consensus was codified with the FASB's adoption of FAS No. 106, employer's accounting for PBOPs.

Since it was likely that FASB would adopt PBOPs accrual accounting, and since the liability to be recognized upon FASB's adoption of an official statement would be substantial, there was a concern that the funding of PBOPs liabilities may produce

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1 FASB is an authorative body which establishes a common set of accounting concepts, standards, procedures and conventions, commonly known as "Generally Accepted Accounting Principles" (GAAP). GAAP is recognized by the accounting profession as a whole and is used by most enterprises as a basis for their external financial statements and reports.

2 FASB issued its official statement, Statement of Financial Accounting Standards No. 106, promulgating the generally accepted accounting practice to account for PBOPs in December 1990. However, the official document was not available in print until January 1991.

significant rate shock. This investigation was opened to determine whether the shock could be reduced by authorizing affected utilities to begin collecting revenues to cover their PBOPs costs as soon as possible. Phase II of this investigation will examine the impact of FAS No. 106 for ratemaking and accounting purposes.

Both Pacific Gas & Electric (PG&E) and Southern California Gas Company (SoCal Gas) have requested rate recovery for estimated PBOPs liability in their 1990 test year general rate proceedings. PG&E has been recovering PBOP costs on a pay-as-you-go basis and has a program of providing such benefits, and pursuant to Decision (D.) 89-12-057 was denied authority to recover PBOPs contributions. However, the Commission ordered that PG&E's rate proceeding remain open to consider the recovery of pre-funded PBOPs costs after the FASB issues an official statement on PBOPs.

SoCal Gas, which began pre-funding a 401(h)[3] plan with approximately $8 million of stockholders' money in 1987, was authorized by the Commission to recover approximately $9 million in pre-funded PBOPs contributions in its 1990 test year, pursuant to D.90-01-016. An additional $8.4 million of SoCal Gas stockholders' money was contributed to the 401(h) plan in 1988 and again in 1989. SoCal Gas is the only utility currently authorized to recover pre-funded PBOPs contributions in rates. All other utilities recover PBOPs costs on a pay-as-you-go basis. However, the decision that authorized SoCal Gas to recover pre-funded PBOPs contributions placed "SoCal Gas on notice that those prior and this test year's contributions plus a reasonable rate of return will be assumed by the Commission to be available gross of tax to offset pay-as-you-go expenses in the next rate case."

3 The 401(H) plan is identified and discussed on page 28 of this order.

Phase I

In this phase of the proceeding we address several issues:

1. The benefits and detriments to ratepayers of authorizing the pre-funding of PBOPs.
2. The revenue requirements related to the pre-funding and the justifications for allowing this item to be included in rates.
3. Timing of authority to receive PBOPs funding through rates.
4. Different ratemaking treatments of PBOPs costs which may be appropriate for different industries, such as telephone and energy.
5. Available funding vehicles or alternatives for PBOPs, such as a voluntary employee beneficiary association (VEBA) or an employee benefit plan pursuant to Internal Revenue Code Section 401(h).
6. Safeguards to ensure that pre-funded amount will be used only for PBOPs in the future and that ratepayers' interests are protected.
7. Proper accounting procedures to provide adequate documentation and audit trails on fund balances and investment activities.

Pursuant to the order instituting the investigation, the respondents, identified in Appendix A to the investigation, were required to file testimony with the Docket Office. Respondents filed testimony between August 17, 1990 and August 22, 1990. Of the 28 named respondents, the following nine water utilities did not file any prepared testimony, did not explain why, and did not participate in this phase of the investigation:

1. Azusa Valley Water Company
2. California Water Service Company
3. Dominguez Water Corporation

4. East Pasadena Water Company
5. Great Oaks Water Company
6. Park Water Company
7. Santa Clarita Water Company
8. Suburban Water Systems
9. Valencia Water Company

Prehearing Conference

A prehearing conference (PHC) was held on September 27, 1990 before Administrative Law Judge (ALJ) Galvin in San Francisco. At the PHC, the ALJ ruled that any party wanting to question a witness who had offered prefiled testimony must so notify all appearances of record by October 10, 1990. The witnesses who were asked to answer questions were to appear at the first day of evidentiary hearings (October 17, 1990). Prefiled testimony of those witnesses not asked to testify could be identified and received into the record as an exhibit on the first day of evidentiary hearing if there were no changes to be made to the testimony, and if it was accompanied by an affidavit signed by the witness verifying its accuracy.

Evidentiary Hearing

Evidentiary hearings began on October 17, 1990 and continued through October 19, 1990. Prefiled testimony with signed affidavits was received from Contel of California, Inc. (Contel), AT&T Communications of California, Inc. (AT&T), Roseville Telephone Company (Roseville), Pacific Bell, SoCal Gas, and San Diego Gas and Electric Company (San Diego).

Testimony was received from San Jose Water Company's Fred R. Myer, Vice President of Regulatory Affairs; Pacific Bell's Brian E. Thorne, Director of Corporate Accounting Research and Analysis; Southwest Gas Corporation's (Southwest) Edward A. Janov, Assistant Controller; Southern California Edison Company's (Edison)

William J. Scilacci Jr., Manager of Investor Relations and Pension Investments, and Mark H. Wallenrod, Supervisor of its CPUC Case Management Group in the Revenue Requirements Department; SoCal Gas' Robert L. Ballew, Manager of Compensation and Benefits; GTE California Incorporated's (GTEC) John Blanchard, Director of Regulatory Accounting; San Diego's Charles A. McMonagle, Manager of the Financial Services Department; PG&E's Peter K. Corippo, Senior Financial Analyst, and Richard A. Weingart, Supervisor of Expense Forecasting and Analysis; and, the Division of Ratepayer Advocates (DRA) Mark Loy, Public Utility Regulatory Program Specialist I, Economics.

When concurrent briefs were filed on November 9, 1990 the first phase of this investigation was closed. However, in order to take official notice of FASB's PBOPs statement (Statement No. 106) in this order the Phase I submittal date was extended to January 14, 1991, the date that FASB No. 106 was readily available in print.

Admissibility of Prefiled Testimony

Brown Bridgman Retiree Health Care Group (Brown Bridgman) tendered comments and prepared testimony for filing with the Docket Office on October 9, 1990. These comments and testimony referred to other testimony alleged to have been filed earlier by Brown Bridgman. However, no prior documents from Brown Bridgman have been received.

Rule 44 of the Commission's Rules of Practice and Procedure requires that documents be filed with the Docket Office before they can be considered filed in a proceeding. Brown Bridgman's October 9, 1990 filing complied with Rule 44. However, no certificate of service was attached listing the names and addresses of the persons and entities served as required by Rule 4.5. Further, no copy was served on the ALJ. The ALJ first became aware of Brown Bridgman's filing when he received a copy of the

prepared comments and testimony from the Docket Office after the close of the evidentiary hearing.

Brown Bridgman may not be familiar with Commission rules. However, since it was present at the PHC where it filed an appearance to this proceeding, Brown Bridgman should have been aware of the ALJ's PHC ruling that prepared testimony to be served on all appearances of record. Brown Bridgman should also have been aware of the ALJ's PHC ruling that prepared testimony of witnesses who were needed for examination could be received into the record only if the party introduced such testimony at the hearing with an affidavit signed by its witness.

Since Brown Bridgman's October 9, 1990 comments and prepared testimony tendered for filing were improperly filed or served on the parties of record, they are rejected. Its alleged prior testimony was not received or filed in this proceeding's formal record pursuant to Rule 44. Therefore, it is moot and will not be addressed.

Motion to Strike Appendix A to DRA's Concurrent Brief

GTEC filed a motion to strike Appendix A to DRA's concurrent brief on November 19, 1990. On the same day, in a letter addressed to all parties of record, Pacific Bell requested similar treatment of DRA's Appendix.

GTEC and Pacific Bell moved to strike the Appendix because they assert that the proposal mentioned in the Appendix was not addressed in DRA's testimony or through cross-examination of DRA's witness.

DRA responded on December 10, 1990 that GTEC's motion is an attempt to deny the Commission evidence argued in the record either in DRA's own comments or during examination of DRA's witness. To clarify its Appendix, DRA resubmitted it with citations to the record.

Contrary to DRA's assertion, not all the proposals listed in the Appendix were addressed in the evidentiary phase of this

proceeding. DRA's Appendix is supplemental testimony provided after the close of evidentiary hearings without scrutiny by the appearances of record, and should not be allowed. Therefore, GTEC's and Pacific Bell's motion to strike Appendix A to DRA's brief should be granted. However, DRA's Appendix A proposals have been considered, to the extent that they are discussed in the record.

Pre-Funding Benefits and Detriments

We explained in the order instituting the investigation that the respondent utilities have the burden of demonstrating that pre-funding is in the best interest of the ratepayers. We also informed the respondent utilities that if they wished to gain approval for pre-funding, they must demonstrate that, on a present value basis, benefits can be realized by taking advantage of current tax regulations. To allow such pre-funding, the investigation requires "a finding that pre-funding is in the best interest of ratepayers."

Net Present Value

Only GTEC and Pacific Bell provided testimony on the present value impact of pre-funding to demonstrate that it is in the ratepayers' best interest. Although other utilities discussed the benefits of pre-funding on a present value basis, utilities other than GTEC and Pacific Bell did not substantiate their testimony with present value data.

GTEC's Blanchard introduced Exhibit 16 to demonstrate that pre-funding with tax-deductible contributions into a tax free plan is beneficial to the ratepayers on a present value basis. Blanchard's uncontested testimony, based on independent actuary studies, shows that GTEC's revenue requirement will increase $17.4 million in 1991, the first year that union employees' PBOPs benefits were pre-funded under a collectively bargained VEBA, and $18.6 million in the second year. However, beginning in the third year of pre-funding and continuing through the end of the 20-year

average employment cycle of GTEC's union employees, GTEC's revenue requirement would be lower than it would be if PBOPs were funded on the current pay-as-you-go basis. The cumulative ratepayer revenue requirement savings over the 20-year average employee cycle would be $254.8 million in nominal dollars, or $82.5 million on a present value basis.

Similar to GTEC's results, Thorne's present value analysis shows that if Pacific Bell contributed the maximum tax-deductible contributions allowed by the IRS into a tax free plan, ratepayers would receive a substantial benefit. By the year 1996, the cumulative additional revenue requirement needs would reach a break-even point; in all subsequent years, the ratepayers would experience revenue requirement savings. Thorne estimated that by the year 2004 the ratepayers' cumulative revenue requirement benefit would be approximately $860 million on a nominal basis and $315 million on a net present value basis.

Both GTEC's and Pacific Bell's analyses were based on the assumption that pre-funding would start prior to full accrual accounting which is expected to begin in 1993.[4] GTEC used 1991 as the starting point for pre-funding. However, Pacific Bell used 1989 as a starting point because that was the year that its shareholders paid $134 million in tax-deductible contributions to a collectively bargained VEBA.

To mitigate rate increases, Pacific Bell, requests authority to recover a $208 million revenue requirement in 1991, of which $117 million pertains to Pacific Bell's 1989 pre-funded contributions and $91 million to its 1990 pre-funded contributions. In the 1992 calendar year Pacific Bell will request authority to

4 - FASB's official PBOPs statement concluded that entities must begin to accrue their PBOPs liability in fiscal years beginning after December 15, 1992.

recover a $123 million revenue requirement resulting from 1991 contributions of $67 million and 1992 contributions of $56 million. The 1991 and 1992 revenue requirements would cause the average residential customer's bill to increase $0.85 per month, and $0.50 per month, respectively.

Other Benefits

In addition to the net present value benefit identified by GTEC and Pacific Bell, the respondent utilities identified other benefits that should be considered in deciding whether to pre-fund PBOPs cost. This is because the pre-funded contributions will be invested in plan assets and earn a return thereon. Absent pre-funding, the PBOPs liability will continue to grow without the benefit or use of funded assets accumulating tax free.

Witnesses for the energy and telephone utilities also testified that ratepayers would benefit from the accumulation of tax-deductible contributions and tax-free earnings in a trust. The utilities will be able to use the tax free accumulation of assets to lower the overall PBOPs cost to ratepayers. Ratepayer shock will be reduced when full pre-funding is adopted, an issue to be addressed in Phase II of this investigation.

Another major benefit identified by these utilities is the mitigation of inter-generation inequity which results from the current pay-as-you-go method of paying PBOPs liabilities. This inequity occurs because current ratepayers do not pay the cost of PBOPs benefits being earned by utility employees for services currently being rendered. Therefore, future ratepayers are required to pay for PBOPs benefits previously earned by the utilities' employees. The utilities concur that PBOPs benefits should be funded incrementally over the working lives of employees as these benefits are earned, similar to pension benefits.

DRA's Opposition

DRA's witness Loy examined the effects of adopting pre-funded PBOPs contributions for ratemaking purposes and concluded that adoption would not be in the ratepayers' best interest. He concluded that adoption would result in inefficiency and in the application of an unsound ratemaking principle. Loy's conclusion is based on the following:

Ability to Pay Benefit Expenses

According to DRA, the primary benefit of adopting pre-funded PBOPs is that the utilities risk of financial default will be significantly reduced. This is because pre-funding results in the accumulation of assets, or a cushion of assets, to offset potential liabilities. DRA concludes that California's regulated utilities, unlike firms in competitive markets, are already authorized a fair rate of return; therefore, their risk of default is effectively eliminated.

DRA may be correct. However, we remind DRA that the level of risk is an integral component of the rate of return consideration. The lower the utilities' risk, the lower their authorized rate of return. Concurrent with this lower risk is the ability to obtain lower interest rates for borrowed funds from the financial community. Therefore, the lower risk will benefit the ratepayers as well as the utilities.

Health Care Cost Containment

Because pre-funding will establish a pool of assets earmarked to offset future retiree medical expenses, it may provide a significant disincentive for containing benefit costs. Pre-funding may undermine the efforts by management and labor to increase the efficiency of benefit provisions and reduce health care cost inflation.

We will establish checks and balances to reduce, if not eliminate, this concern. At the same time we will expect DRA to

scrutinize pre-funded PBOPs costs and activities as a normal part of their general rate proceeding investigations.

Use of Ratepayer Funds

DRA believes that existing Internal Revenue Service (IRS) and Employee Retirement Income Security Act (ERISA) statutes do not ensure that utilities' employees will receive the PBOPs benefits that they earn and that utilities will not divert PBOPs assets to other purposes.

However, at the same time, DRA recognizes that the IRS and ERISA statutes and the National Labor Relations Act (NLRA) preclude the Commission from negotiating specific PBOPs outcomes or contractual arrangements.

We remind DRA that the IRS, ERISA and NLRA statutes do provide substantial protection to ensure that PBOPs funds are used only for PBOPs benefits, such as the establishment of trusts, and that they impose substantial penalties for diverting PBOPs funds. However, as in our Health Care Containment discussion above, we will impose additional checks and balances in this order to alleviate concerns that these funds may be used for unintended purposes.

Rate Shock

DRA believes that rate shock may be unavoidable if the utilities are allowed to pre-fund their PBOPs liabilities. DRA cites D.88-03-072, a 1988 Commission investigation into whether FASB statements should be adopted for telephone utilities, which denied a utility request to use FAS No. 87, Employer's Accounting for Pensions, because of rate shock.

DRA's citation is taken out of context. DRA is correct that D.88-03-072 addressed telephone utilities' pension costs and did not adopt the FASB draft. The issue in that order was whether we should continue to use the aggregate cost method (ACM) or adopt a "preferred pension method." The ACM method projects the employee's total benefits at his/her expected retirement date. It

discounts the total benefit on a present value basis, and levelizes, and spreads the result over future years. Rate shock was not the issue. Further, the telephone utilities were not recovering pension expense on a pay-as-you-go basis.

Similarly, rate shock is not the driving force in this investigation. The issue is whether pre-funding is in the "best interest of ratepayers." In granting rate changes we are always concerned about rate shock. However, when rate shock has occurred we have authorized procedures to mitigate the shock, such as phase-in of rates.

Risk

DRA believes that the adoption of pre-funding at this time will preclude "this Commission from choosing a superior alternative later on."

However, no evidence has been presented to show that utilities must continue funding a plan once it is established rather than changing pre-funding plans or utilizing more than one plan.

Referring to D.88-03-072, we do not find the "superior alternative" argument to be a determinative factor. There could always be a superior plan. However, so long as pre-funding is in the ratepayers' best interest, the test for determining whether PBOPs cost should be recoverable in rates is whether reasonable cost will be incurred as a result of the plan, not whether the particular PBOPs' plan is <u>the</u> superior plan.

Net Present Value Basis

DRA concluded from its analysis of the utilities' comments and testimony that they have not met their burden of proof in establishing that pre-funding is in the best interest of ratepayers. Although we have assumed, in Phase I, that tax benefits will result from pre-funding, DRA believes that the issue is really whether pre-funding will result in the "lowest cost."

DRA opposes pre-funding because it would allow utilities to raise rates so that they could receive tax benefits.

Contrary to DRA's lowest cost scenario, we are concerned with reasonable cost as discussed in D.88-03-072 and in this order. The purpose of this phase of the investigation, as stated in the order instituting the investigation, is to study the benefits and costs of pre-funding limited to tax-deductible contributions and to determine whether pre-funding is in the best interest of the ratepayers.

TURN's Opposition

Although TURN offered no witness or testimony in this investigation, it expressed its concern about pre-funding PBOPs in its PHC statement provided on the first day of the evidentiary hearing. Like DRA, TURN believes that pre-funding is premature. TURN believes that pre-funding will result in increased revenue requirements, that there is a general uncertainty about the economic and regulatory climate, that legislative changes could impact the tax deductibility of pre-funded contributions, and that it is questionable whether ratepayers would receive any benefits.

Discussion of Net Present Value and Benefits

In issuing this investigation, we stated that pre-funding makes sense only if on a present value basis, benefits can be realized by taking advantage of current tax regulations.

GTEC's and Pacific Bell's net present value analyses and testimony clearly substantiate that ratepayers will receive significant benefits from tax-deductible pre-funded contributions. A GTEC $28.8 million pre-funded contribution in 1991 will result in a $17.4 million revenue requirement for GTEC's ratepayers. Continued pre-funding will result in a revenue requirement reduction with an incremental net present value of $82.5 million over the 20-year average GTEC employee cycle.

Not only will GTEC's ratepayers face reduced costs, they also will benefit from the appreciation of pre-funded trusts assets and the accumulation of tax-free trust earnings. The utilities' PBOPs cost will thus be significantly reduced.

Pacific Bell's analyses shows that its ratepayers will receive similar benefits. Pacific Bell projects a $315 million net present value benefit by the year 2004.

DRA opposed GTEC's and Pacific Bell's present value results on three primary grounds. First, DRA did not have an opportunity to analyze the utilities' present value studies. Although most of the utilities' results were filed on August 17, 1990, DRA did not send any data requests for details of the studies until the prehearing conference on September 21, 1990.

Second, DRA does not believe that the present value studies were prepared by independent actuaries. Both GTEC and Pacific Bell used actuarial study data for their analysis. However, DRA questioned their validity, because the actuary's letterhead was not on each of the workpapers supporting the utilities' results. DRA expressed a concern that the results may be tainted even if the utilities can demonstrate that the workpapers were prepared by certified actuaries. The actuaries do not represent ratepayer interests; they represent stockholder interests, according to DRA.

Third, DRA asserts that the utilities did not show the net present value analysis as instructed by the order instituting the investigation, specifically the utilities' net present value study did not compare the pay-as-you-go costs with the pre-funded accrual basis.

DRA's opposition to GTEC's and Pacific Bell's net present value studies is superficial. DRA had adequate time to analyze GTEC's and Pacific Bell's workpapers, but unfortunately, chose to wait until the prehearing conference to begin sending data requests. Although this investigation was established on July 18,

1990, most parties, including DRA, were aware several months prior to its issuance that the Commission would order this investigation.

As to the reliability of actuarial data, GTEC used an independent actuary and Pacific Bell used that of its affiliate Pacific Telesis. Contrary to DRA's concern, certified actuaries and independent actuaries base their projections on statistical data, and not on the interests of a particular group such as stockholders.

If we shared DRA's concern, the solution would be for the Commission to retain its own actuaries. However, according to DRA's argument, the actuary would then be looking after the interest of the Commission, rather than those of the ratepayers or the stockholders. We have not retained actuaries to confirm the results of utilities' actuaries in prior pension matters and we do not intend to do so in the future for either pensions or PBOPs. The burden of proof in both pension and PBOPs proceedings rests with the utilities. Like test year estimates, actuarial assumptions use projections. To the extent that those projections are incorrect, the test year estimates will not be accurate. The testimony in this investigation has not demonstrated that the present value studies developed by actuaries are flawed.

Finally, GTEC's and Pacific Bell's analysis does comply with the present value study called for in the order instituting the investigation. The investigation states that pre-funding makes sense only if the utilities can demonstrate that, on a present value basis, certain benefits can be realized by taking advantage of current tax regulations. The "certain benefits" called for in the investigation are not defined; however, both GTEC and Pacific Bell demonstrated the existence of monetary benefits from prefunding. Whether these monetary benefits accrue to the ratepayers or ultimately result in lower rates depends on our determination as to whether or to what extent Z factor treatment is afforded. It is clear however, that ratepayers will not be harmed

by allowing Pacific Bell and GTEC to prefund. By this conclusion we do not intend to prejudge the Z factor issue, as that remains open for the next phase of this proceeding.

We have found that the utilities have substantiated that pre-funding is beneficial to the ratepayers, on a net present value basis. However, other identifiable benefits and detriments should also be considered.

An additional benefit identified by parties is the elimination or alleviation of inter-generation inequities. Such inequities occur because, unlike pensions, current ratepayers pay for PBOPs benefits only when they are actually paid to employees even though the employees are earning PBOPs benefits throughout their period of employment.

No party argues that PBOPs benefits are currently paid for in a manner similar to pension benefits. Since at least 1954 (Decision 50258 53 Cal. P.U.C. 275, 292), the Commission has recognized the social benefit of maintaining a sound pension fund and has consistently held that the funding of a pension in advance of the utility's payment of benefits is a proper current cost of service. On the other hand, with the exception of SoCal Gas, current ratepayers do not pay for PBOPs benefits being earned by the utilities' employees while serving the ratepayers. Rather, they pay only those PBOPs benefits to utilities' employees who earned their benefits in a prior time period. This results in an inter-generation inequity.

Pre-funding PBOPs to the extent that contributions are tax deductible will not eliminate the inter-generation inequities but it will result in a more equitable distribution of the PBOPs' cost burden between ratepayer generations.

Even DRA agreed that if accrual accounting, as proposed by FASB, were adopted, then pre-funding would result in a more equitable distribution of the cost burden between generations of ratepayers. The FASB did adopt accrual accounting in December

1990. Pre-funding will clearly result in a more equitable distribution of the cost burden between generations of ratepayers.

PG&E cites the pre-funding of nuclear decommissioning costs as comparable to the PBOPs pre-funding issue. In D.87-03-029 we found that it is appropriate for current ratepayers to pay their allocated, or incremental, share of the future costs of decommissioning nuclear facilities. The goal was the fair allocation of costs to the ratepayers who benefit from the power generated by the facilities. To the extent that PBOPs contributions are tax deductible, they should not be treated any differently than nuclear decommissioning costs or pension costs. Again, the reasonableness of pre-funding the entire PBOPs liability is left to Phase II of this investigation in which respondents will be required to demonstrate that funding of the total PBOP's liability is in the ratepayers' best interest. This phase of the investigation is restricted to pre-funded tax deductible contributions.

The primary detriment identified by the parties to this investigation is that pre-funding will increase current rates. However, nothing is free. Pre-funding tax-deductible PBOPs contributions are in the ratepayers' best interest as discussed above and will be adopted.

Revenue Requirements and Justification

In ordering this investigation, the Commission restricted the first phase to consideration of allowing utilities to recover pre-funded tax-deductible contributions. The order further required that in calculating their revenue requirements, the utilities consider only "the amounts that will be currently deductible as tax expense."

As discussed on page 2 of the order instituting the investigation, preliminary estimates show that the unrecorded PBOPs liability for California utilities may be in the billions of dollars. The data provided by each utility were not developed on a

uniform basis; therefore, it is difficult to determine the respondent utilities' total PBOPs liabilities. However, the following table estimates the total PBOPs liability, additional expenses and additional revenue requirement needed to pay for tax-deductible PBOPs contributions. Unless otherwise identified, the figures represent 1990 data as provided by the utilities.

	UTILITY	TOTAL LIABILITY	ADDITIONAL EXPENSE	ADDITIONAL REVENUE
		(Millions of Dollars)		
Energy				
	Edison	$ 435.0	$ 15.0	$ 11.2
	PG&E[5]	NP	66.7	46.8
	SoCal Gas	333.0	NP	8.9
	San Diego	NP	NP	2.6
	Southwest	2.7	.3	NP
Telephone				
	AT&T	NP	NP	NP
	Contel	NP	NP	NP
	GTEC[6]	NP	28.8	17.4
	Pacific Bell	2,000.0[7]	128.0	91.0
	Roseville	NP	NP	NP
Water				
	San Jose[8]	1.6	.2	NP
	TOTAL IMPACT	$ 2,772.3	$ 239.0	$ 177.9

(NP = Not Provided)

The above table suggests that California utilities have incurred a substantial PBOPs liability, in excess of $2.8 billion

5 Represents 1991 data.

6 Represents 1991 data.

7 Represents 1992 estimated liability.

8 Represents a 1989 estimate.

dollars. Although the total associated revenue requirement to ratepayers has not been quantified, utility rates will need to be increased in excess of $177.9 million if pre-funded tax deductible PBOPs contributions are authorized. To put this in perspective, Pacific Bell's average residential bill must be increased approximately $0.37 per month to pre-fund Pacific Bell's 1990 revenue requirement of $91.0 million. GTEC would need to increase its flat rate charge for residential service by $0.41 per month (from $9.75 to $10.16) if GTEC is authorized to recover 100% of its $17.4 million projected pre-funded contributions.

Retroactive Ratemaking Arguments

TURN and DRA assert that Pacific Bell's proposal to recover $117 million of 1989 pre-funded contributions and $91 million of 1990 pre-funded contributions in 1991 rates should not be authorized because such approval would constitute retroactive ratemaking. TURN explains that, with regard to Pacific Bell's 1991 recovery request, Pacific Bell stockholders began pre-funding PBOPs in 1989 without Commission authority. TURN also asserts that Edison's proposal to pay for 1990 pre-funded PBOPs with contributions that it intends to make and to recover in 1991 cannot be granted because it too would result in retroactive ratemaking.

Edison, however, has not yet begun pre-funding PBOPs. Edison did testify that it is now establishing a 401(h) plan. However, the contribution to the 401(h) plan for the 1990 calendar year need not be made in 1990 to be tax deductible. A pre-funded tax-deductible contribution for the 1990 calendar year can be made in 1991 or later. In short, only after this decision grants it authority to do so, will Edison begin to make contributions to its 401(h) plan in anticipation of expenses that will occur even further in the future. Under the circumstances present here, we do not see that the rule against retroactive ratemaking presents any obstacle to rate recovery of contributions Edison will make to its 401(h) plan after the effective date of this decision to pre-fund

expenses that otherwise would be paid by ratepayers in future years.

The retroactive ratemaking arguments raised against Pacific Bell are somewhat different than those raised against Edison. Moreover, because Pacific Bell is subject to our price cap formula, it cannot increase its rates to cover its PBOPs costs unless it can show that such an increase is allowed as a Z factor. As addressed in our ratemaking treatment discussion below, we require a better record on which to determine whether or to what extent prefunding and the change to accrual accounting for PBOPs generally may qualify for Z factor treatment. Therefore, we will resolve the retroactive ratemaking issues raised with respect to Pacific Bell at the time we address the overall Z factor issue in the next phase of this investigation.

Timing Authority to Fund Through Rates

Respondents were asked to provide testimony on how PBOPs revenue requirements should be recovered and on how such funding should be treated for ratemaking purposes if there is a lag between PBOPs funding and the recovery of PBOPs contributions.

Revenue Requirement Recovery

DRA believes that the general rate case is the most appropriate proceeding for utilities seeking recovery for pre-funded PBOPs contributions. This proceeding enables parties to investigate the reasonableness of the calculations and assumptions underlying the utility's pre-funded contributions.

Of the 28 named respondents to this investigation, two (SoCal Gas and Pacific Bell) have already established pre-funded PBOPs plans and AT&T has already adopted PBOPs accrual accounting. SoCal Gas began pre-funding PBOPs in 1987 with stockholder funds through a Voluntary Employee Benefit Association (VEBA) trust vehicle and began recovering its pre-funded PBOPs contributions in rates effective January 1990, pursuant to its 1990 general rate case D.90-01-016. Pacific Bell, which also uses a VEBA plan, began

its pre-funding of PBOPs in 1989 with stockholders' money, and has not yet received authority to recover its pre-funding contributions in rates. AT&T began pre-funding its PBOPs liability in May 1990, retroactive to January 1, 1990. AT&T's change was implemented without a request to increase rates because unlike those of other respondents, AT&T's rates are based on what the market will bear, not on a rate of return or revenue requirement. AT&T did not identify the type of PBOPs plan it utilizes.

Pacific Bell's and GTEC's proposed recovery mechanism is unique. It is addressed in the following section entitled "Ratemaking Treatment by Industry."

Except for Pacific Bell and GTEC, the respondent utilities concur with DRA that the general rate case is the proper procedure to recover pre-funded PBOPs contributions. Therefore, all respondent utilities, except for Pacific Bell and GTEC, should be authorized to recover in their next general rate proceeding those pre-funded PBOPs contributions that are tax deductible.

Since the investigation recognizes that a lag may exist between pre-funding contributions and their recovery in rates, respondents were asked to provide testimony on how the utilities should be compensated for this lag.

Lag in Recovery of Pre-Funded Contributions

DRA recommends that the utilities be authorized to use attrition filings and expedited applications in those instances where the utility's requested PBOPs revenue requirement and pre-funded vehicle are identical to those which the utility has identified in this investigation, or has been authorized in a general rate proceeding.

Respondents recommended that they be authorized to recover their pre-funded PBOPs that are tax deductible immediately, rather than waiting for their next general rate case.

Edison seeks authority to increase its "Authorized Level of Base Rate Revenue (ALBRR) under its ERAM proceeding to recover

the revenue requirement associated with Edison's 1990 and 1991 pre-funded contributions. It seeks authority to recover its 1992 and subsequent pre-funding contributions through its general rate case proceedings.

Although PG&E has not yet established a pre-funded plan, it seeks to recover its 1991 pre-funded contributions as an adjustment to rates authorized in D.89-12-057. This decision kept open PG&E's general rate proceeding to address, among other matters, the funding of pre-funded PBOPs upon the conclusion of this investigation. Pursuant to an October 10, 1990 ALJ ruling, PG&E's Application (A.) 88-12-005 was consolidated with this investigation for the limited purpose of addressing pre-funded PBOPs contributions.

San Diego recommends that an interest-bearing balancing account[9] be authorized to account for any time lag between the receipt of funds collected in rates and the amounts necessary for pre-funding PBOPs. Without such a procedure, San Diego asserts that the stockholders will be adversely impacted because they would be required to advance the necessary funds without receiving any compensation for their use.

ConTel's recommendation is similar to San Diego's, except that Contel recommends that a memorandum account[10] be established to track pre-funded contributions. The memorandum account would then be incorporated into the utilities' next ratemaking proceeding.

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9 A balancing account requires utilities to record and track specific activities in their accounting records and to reflect these activities in their financial statements.

10 The traditional definition of a memorandum account, as explained in D.90-05-034, is a side record which is not shown on the utilities' financial statements.

Since our regulatory framework requires the major utilities[11] to file general rate proceedings every three years, it is reasonable to provide a recovery mechanism for those utilities that establish and utilize a tax deductible pre-funded PBOPs plan prior to their filing a general rate proceeding. Failure to do so will deny the utilities an opportunity to recover their costs and may cause them to re-allocate to PBOPs contributions cash flow earmarked for capital improvements and operating expenses.

We will adopt Contel's proposal. Those utilities that utilize a tax deductible PBOPs plan should track their PBOPs cost, net of tax, in an interest bearing memorandum account and seek an opportunity to recover their PBOPs cost in their next rate recovery proceeding such as a general rate filing, an attrition filing, or an ERAM filing as proposed by Edison. The interest rate should be consistent with the current Federal Reserve 90-day commercial paper rate as reported in the Federal Reserve Bulletin.

Edison should be allowed the opportunity to recover the revenue requirement associated with 1990 and 1991 PBOPs contributions, consistent with any other base rate related item, through an adjustment to the Authorized Level of Base Rate Revenue under the ERAM. This request should be filed by an advice letter filing in accordance with General Order 96-A and the rate increase criteria previously set forth in this decision.

Ratemaking Treatment By Industry

Respondents were asked to identify unique circumstances in their respective industries that could require a rate recovery method different from that of other utility industries.

11 Except for Pacific Bell and GTEC who were placed on a price-cap formula regulatory incentive program pursuant to D.89-10-031.

Pacific Bell and GTEC, the major intraLATA telecommunications carriers, assert that the traditional general rate case proceedings, attrition filings, and advice letter filings do not apply to them since the Commission established its new incentive rate regulation, pursuant to D.89-10-031.

D.89-10-031 replaced Pacific Bell's and GTEC's traditional cost-of-service regulation with a price cap index formula used to adjust Pacific Bell's and GTEC's rates on a yearly basis. Incorporated as part of the formula was a "z" factor to reflect exogenous conditions.

Pacific Bell believes that its pre-funded PBOPs contributions should be recovered through the "z" factor in its annual price cap filing because it is an exogenous condition. GTEC concurs that the "z" factor may be applicable to reflect pre-funded PBOPs contributions because such contributions are exogenous changes beyond management's control.

On the other side, DRA states that the appropriate mechanism for the major intraLATA telecommunications carriers to recover pre-funded PBOPs contributions is not the "z" factor but the use of "expedited applications".

As to subsequent recovery proceedings for the major intraLATA telecommunications carriers, DRA asserts that there is no need for a rate recovery procedure outside of the price cap formula because the inflation and system growth components of the formula provide for recovery of such costs. DRA explains that the formula's inflation component addresses increased medical costs and that its growth component addresses investments and medical costs.

Other utilities such as San Jose Water and SoCal Gas acknowledge that a unique rate recovery mechanism is not necessary for the water or energy utilities. However, if the water and energy utilities' traditional cost-of-service rates are replaced with incentive rates also a unique mechanism must be established

for these utilities to recover their pre-funded PBOPs contributions.

There is no dispute that the new regulatory framework for major intraLATA telecommunications carriers replaced the standard rate recovery procedure with the price cap formula. However, it was not our intent to re-utilize standard rate recovery mechanisms. To do so would eliminate the usefulness of the incentive regulatory environment, as discussed and adopted in D.89-10-031. Therefore, Pacific Bell and GTEC should use their incentive price cap formula to recover pre-funded PBOPs contributions via their annual price cap filings.

Still in dispute is how pre-funded PBOPs contributions should be reflected in the price cap formula. On the one side, Pacific Bell and GTEC represent that contributions should be reflected in the z factor. On the other side, DRA recommends that Pacific Bell's and GTEC's initial contributions be recovered through an expedited proceeding, and believes that there is no need for further proceedings because the price cap formula automatically considers subsequent contributions.

Each party offers plausible reasons for their recommended treatment of PBOPs contributions within the formula. However, neither Pacific Bell nor GTEC has shown that its method accurately meets the formula criteria. The OII in this proceeding required all parties to provide testimony and comments on both of the following issues:

1. The revenue requirements resulting from the pre-funding and the justifications for such requests.

2. Differential ratemaking treatment for PBOPs costs for different industries, such as telephone vs. energy.

These instructions required Pacific Bell and GTEC to demonstrate why and how pre-funding should be treated for ratemaking purposes. The OII specifically mentioned the new and unique circumstances of

these two telephone utilities. "The new regulatory framework for Pacific Bell and GTE California may require that we treat these companies differently than other companies. (OII, p. 5.) To the extent that Pacific Bell and GTEC believe pre-funding and PBOPs costs to constitute a Z factor, these instructions also required the utilities to show if and how pre-funding and PBOPs costs would not be captured in the GNPPI through the annual price cap filing.

The Commission has had but a few opportunities to review an applicant's request for a Z factor adjustment. Therefore, we are providing further guidance on the requirements for a complete Z factor showing in a proceeding in which an OII specifically instructs parties to submit evidence pertaining to "differential ratemaking treatment of PBOPs costs for different industries, such as telephone vs. energy." (OII, p. 4.)

In D.89-10-031 we made it clear that to be considered for Z factor treatment, costs must meet the following standards:

1. Costs must be "clearly beyond a utility's control" (p. 180).

2. Costs must not be "reflected in the economywide inflation factor" (Conclusion of Law 26).

This decision (D.89-10-031) also states on page 181 that the utilities "bear a strong burden to show that any requested Z factor adjustment reflects only cost increases beyond those which will be picked up in the economywide inflation factor."

Given that the record on the issue in Phase One is incomplete, we will direct Pacific Bell, GTEC, DRA, and other interested parties to present testimony and evidence in Phase II of this proceeding which may be used to determine if the Z factor standards have been met. Compliance with those standards will be essential to a finding that Z factor treatment is appropriate. We anticipate that the testimony will include a discussion of the transition obligation, projected pay-as-you-go costs, projected

accrual costs, and how each obligation, cost, or other testimony relevant to the discussion of a Z factor is both beyond utility control and not otherwise captured in the GNPPI. If Pacific Bell and GTEC hope to recover revenues associated with PBOPs costs through a Z factor adjustment, we expect that Pacific Bell and GTEC will make the required showing in its entirety in Phase II.

Alternative Funding Vehicles For PBOPs

Respondents to this investigation identified five methods to fund PBOPs. They are pay-as-you-go, Internal Revenue Code (IRC) Section 401(h), Voluntary Employees' Beneficiary Association (VEBA), pension benefit enhancement, and corporate-owned life insurance.

Pay-As-You-Go

Pay-as-you-go is the method most utilities use to fund PBOPs. Under this method, the benefits paid by the utility are tax deductible when actually paid and are not taxable to the retirees when benefits are received.

The pay-as-you-go method is the least cost method in the short term. However, Edison asserts that in the long term it is the most expensive funding method because there is no asset buildup to offset escalation in benefit costs.

Internal Revenue Code Section 401(h)

IRC Section 401(h) allows a utility to establish separate accounts under its established pension plan to which the utility may make tax-deductible contributions for retirees and their dependents. The 401(h) plan is subject to Employee Retirement Income Security Act (ERISA) reporting, disclosure, and fiduciary requirements. The income earned in the 401(h) plan accumulates tax-free, and the benefits paid by the plan to the retired employees and dependents are not considered taxable income to the retiree.

However, the 401(h) funding plan has its limitations. First, the PBOP benefits provided under this plan must be

incidental to the utility's overall retirement benefits provided under its qualified retirement plan. The IRC defines such contributions as incidental if the utility's 401(h) contributions do not exceed twenty-five percent (25%) of the utility's yearly aggregate contributions to its qualified pension plan.

Second, the plan must account for 401(h) contributions, distributions, and earnings separately. No part of the trust fund or earnings is subject to reversion until all of the PBOP liabilities under the plan are satisfied. If reversion takes place such amounts are subject to excise and income tax.

Finally, the 401(h) plan is funded solely with reference amounts needed to fund pension benefits and does not reflect the actual liability associated with PBOPs. It does not take into account PBOP benefit levels, medical inflation, or increased use of medical services. Therefore, the amount set aside under this plan may be insufficient to meet future PBOP commitments.

Voluntary Employee Benefit Association

IRC Section 501(c)(9) allows a utility to set up a VEBA to provide PBOPs for employees and retirees. This plan cannot be restricted to retirees, but must also include active employees. The VEBA must be an entity separate from the utility and must obtain tax-exempt status from the IRS. Its funds must be used exclusively for its beneficiaries, that is employees and retirees. VEBA plans are subject to ERISA reporting, disclosure, and fiduciary requirements.

Utility contributions to the VEBA are tax deductible within limits; the benefits paid by the plan to employees and retirees are not taxable income to the employees or retirees.

The disadvantages to this plan are: (1) that the maximum tax-deductible contribution is based solely on the utility's current costs without consideration of inflation; (2) income earned on the plan's investment is taxed at trust rates unless invested in tax-free instruments; and (3) the transfer of any excess pension

assets to a VEBA triggers a 100% excise tax. Most of these disadvantages can be avoided with the establishment of a collectively bargained VEBA.

However, a collectively bargained VEBA can be established for the utility's union employees only pursuant to arm's length negotiation over benefits between employee representatives and the utility, and only if at least 90% of the employees covered by the VEBA are represented employees. The utility's contributions are tax deductible and the benefits are not taxable income to the employees or retirees. In addition, under the collectively bargained VEBA, tax-deductible contributions can include an element for inflation and income earned on the plan's investments is not taxed.

Pension Benefit Enhancement

A defined benefit pension plan can be modified to include PBOPs benefits. This plan enables a utility's contributions to be tax deductible and plan income to be tax-free, and allows for unlimited contributions as long as they are reasonable, necessary, and do not exceed the maximum benefit limits.

The disadvantage to this plan is that it taxes the retiree on the value of PBOP benefits received. No other plan does so.

Utility-Owned Life Insurance

A utility-owned life insurance plan enables a utility to buy life insurance on its employees or retirees and to name the utility as the beneficiary. The policies are owned by the utility. The premium payments are not tax deductible. However, the utility may borrow from the cash value to pay its post-retirement benefit costs. Interest on the policy loans is considered deductible to the utility. If the utility holds these policies until the employee or retiree dies, the proceeds received by the utility are tax-free.

Southwest Gas and Pacific Bell explain that this plan provides limited cash for PBOPs payments because the cash is generated solely from the cash value of the policies and proceeds upon death. Such cash may be substantially below the amount needed to fund a utility's PBOP. Since California law is not clear on whether the Utility has an insurable interest in its employees and retirees, borrowing against the policies to pay PBOPs may be considered taxable income by the IRS.

Discussion of Alternative Funding Vehicles

Although DRA opposes any pre-funding of PBOPs, it recommends that if a pre-funding method is adopted the bulk of the pre-funding liability be shifted from employer contributions to retiree contributions through an enhanced pension plan. DRA asserts that this will allow the entire health care revenue requirement to be deducted from the utility's taxable income and to be protected under the IRS and ERISA rules. It will also permit retirees to use health care expenses as a tax deduction. Currently, the IRS allows individuals such as retirees to report as an itemized deduction all health care expenses in excess of 7.5% of the retirees adjusted gross income. However, if the retiree does not itemize, no such deduction is allowed.

DRA rejects the 401(h) plan because utility contributions are limited to 25% of the utility's pension contribution and are not related to PBOP liability. Inadequate PBOP funding results because the PBOP liability, which is not funded, is larger than the pension liability. If a pension plan is fully funded, then no 401(h) contribution is allowed. Further, contributions to a 401(h) plan are not vested so any excess or refunds go to the employer.

DRA also rejects the VEBA method because, since all dividends received are taxable, capacity of the fund to grow is limited. Also, VEBA requires the PBOPs accumulated reserve to be reduced each tax year by all PBOPs payments thereby limiting the growth of the assets. The amount of the reserve is based on

current PBOPs costs ignoring PBOPs inflation and unfunded liability. Further, DRA believes that it is not clear whether VEBA PBOPs funds can be used for unrelated purposes.

To date, most California utilities use the pay-as-you-go method. However, three utilities currently pre-fund at least a portion of their PBOPs costs with an alternative method. AT&T changed its accounting procedures to accrue expenses and amortize previously unfunded PBOPs liabilities, effective on its regulated books of account in May 1990, retroactive to January 1, 1990. Pacific Bell established a collectively bargained VEBA effective December 29, 1989, and SoCal Gas established a 401(h) plan in 1987. Of these three utilities, only SoCal Gas, pursuant to D.90-01-016, recovers pre-funded PBOP costs through rates.

Edison and Roseville intend to implement a 401(h) plan if authority is granted to recover pre-funded PBOP costs through rates. On the other side, GTE, San Diego, and PG&E intend to implement one or both forms of the VEBA. Contel, Southwest Gas, and San Jose Water have not yet decided which plan they intend to use if approved.

The positive and negative aspects of the alternative funding plans discussed in this order show that it is difficult, if not impossible, to select one preferred method for all utilities. This is because of the diversity of each utility's level of pension plan funding, collective bargain agreements, PBOPs benefit packages, and deductibility of PBOPs contributions.

The selection of a pre-funding method is a management decision which should be made by the individual utility. However, because the first phase of this investigation considers only pre-funded contributions that are tax deductible, and because it is not known whether utilities can have an insurable interest in their employees and retirees, the utility-owned life insurance plan should not be utilized at this time. Further, if utilities want to obtain rate recovery for pre-funded PBOPs contributions, they

should be required to substantiate in rate recovery proceedings that their selected pre-funding plan is reasonable and that it mitigates the impact on the ratepayer rates caused by the utility's pre-funding contribution.

PBOPs Funding Safeguards

Parties to this investigation were asked to identify safeguards necessary to ensure that pre-funded contributions will be used only for PBOPs in the future and to ensure that ratepayer interests are protected.

DRA is concerned that the Commission's ability to ensure that PBOPs funds are used only for PBOPs benefits is limited because IRS regulations and NLRA preclude the Commission from requiring the utilities to negotiate specific PBOPs outcomes or contractual arrangements.

DRA asserts that uniform disclosure requirements, actuarial assumptions and actuarial methods need to be adopted by the Commission before it can conclude that these pre-funded contributions are accurate and are a fair representation of the utilities' liability. Because DRA finds a lack of specificity and documentation in the utilities' testimony, DRA asserts that there is insufficient information available to establish safeguards to protect ratepayers. Without these safeguards, DRA is concerned that utilities may use rate recovery methods based on excessive requests for the following purposes:

a. To enhance active employee and retiree benefits by reducing the utilities' pension contribution and extending active employees pension coverage.

b. To fund unauthorized projects.

c. To subsidize non-regulated or parent company operations.

d. To fund investments that are not tax deductible.

To alleviate these concerns, DRA recommends that only those contractual arrangements that do not allow employers to unilaterally reduce employee benefit coverage, or to receive refunds should be approved.

Further, DRA recommends that, until accounting, auditing, and disclosure regulations can be established, SoCal Gas' rate recovery of pre-funded PBOPs authorized by D.90-01-016 should be either refunded to SoCal Gas ratepayers or suspended. Since D.90-01-016 did not provide for SoCal Gas' rates applicable to its PBOPs contributions to be subject to refund, any serious consideration of DRA's request to require SoCal Gas to refund pre-funded PBOPs costs currently recovered in rates would raise very serious retroactive ratemaking concerns and should not be considered.

On the other side, the utilities assert that IRS and ERISA safeguards ensure that pre-funded contributions will be used only for PBOPs benefits. For example, VEBAs and 401(h)'s, by their terms and associated tax and pension regulations, safeguard the use of such funded amounts for future PBOP liability. Similar controls exist for the other funding vehicles discussed in this phase of the investigation.

VEBA funds are held in a "trust" for the exclusive purpose of providing PBOPs to the utilities' employees. Pacific Bell explains that even if a VEBA Trust were terminated at some future date, the current tax rules require any funds remaining after liabilities to the beneficiaries are satisfied not to revert back to the employer. Rather, they must be used to provide similar PBOPs benefits permissible under the VEBA to the beneficiaries of the trust.

Southwest Gas explains that the 401(h) plans are a sub-part of the pension plans authorized by Congress and, as a condition of qualification and tax deductibility, the committed funds and associated interest must be used only to provide PBOPs.

San Diego Gas & Electric adds that trustees with specific fiduciary responsibilities further safeguard the proper management and disbursement of pre-fund contributions and assets.

Pursuant to the official FASB statement, PBOPs plan assets must be segregated and restricted, usually in a trust, to be used only for post-retirement benefits. Similarly, as discussed by Southwest Gas and San Diego Gas & Electric the utilities are bound by IRS, ERISA, and NLRA requirements to ensure that PBOPs assets are used for only PBOPs benefits. Substantial penalties exist for non-conformance.

The IRS and ERISA requirements, like FASB requirements, generally require plan assets to be placed in a trust. The trustee has a fiduciary responsibility to ensure that plan assets are used only for the intended purpose. Those assets not segregated in a trust must be restricted so that the PBOPs funds cannot be used for non-PBOPs benefits. Whether the PBOPs contributions are placed in a trust or not, yearly audits of the funds' activities will be conducted by a firm of independent accountants.

Sufficient IRS, ERISA, and NLRA requirements are in place to ensure that funds placed in a PBOPs plan will be used only for PBOPs benefits. These requirements make DRA's concerns about unauthorized use of PBOPs funds moot and alleviate the need to impose extra safeguards. Since this phase of the investigation is limited to tax deductible PBOPs contributions, DRA's concern regarding nondeductible investments need not be addressed.

However, we will take the most conservative approach as it relates to PBOPs funding and require that the utilities establish trusts for the receipt, investment, administration, and disposition of PBOPs benefits. As a condition of recovering pre-funded PBOPs contributions in rates, the utilities should make their trust agreements readily available to the Commission's Advisory and Compliance Division (CACD) and DRA upon request. Further, utilities should substantiate in each rate recovery

proceeding that their pre-funded PBOPs contributions are not used to enhance active employees' and retired employees' benefits while reducing the utilities' pension contributions.

Proper Accounting Procedures

The final issue to address in this phase of the investigation is the proper accounting procedure to provide documentation and an audit trail on fund balances and investment activities.

DRA recommends that pre-funded contributions be tracked in a "memorandum account" until accrual accounting is required by FASB. DRA asserts that this accounting arrangement is analogous to the treatment of construction work in progress in that the accrued balances would receive a rate of return based on the 60-day commercial paper interest rate in lieu of being included in rates. Subsequently, when the majority of utilities begin pre-funding, then the Commission should revisit this issue.

The utilities assert that current accounting procedures provide adequate documentation and audit trails on fund balances and investment activities. Utilities are required to maintain their accounting records in conformance with a Uniform System of Accounts (USOA) as adopted by this Commission. Separate USOA's have been adopted for Gas, Electric, Telephone, and Water utilities.

PG&E and other utilities intend to establish separate sub-accounts for their PBOPs costs and accrued liability. These activities are audited yearly by an independent certified public accounting firm (CPA) and are subject to Commission scrutiny in rate proceedings. The utilities' independent CPAs would also conduct a detailed analysis of the utilities' contributions to the trust, trust investments, and accounting records detailing transactions between the utilities and trustees. In addition, VEBA and 401(h) pre-funding vehicles are subject to ERISA reporting, disclosure, and fiduciary requirements.

San Jose Water asserts that no further accounting procedures are necessary. It asserts that the current procedures are already numerous and onerous. Further, we already accept such accounting relative to pension plans which have a significantly higher balance of risk. However, if the Commission wants further comfort, it could require utilities to establish separate impound accounts and annual reports on the account activity similar to the annual balancing account reports.

DRA's proposal does not address the issue of proper accounting procedures to provide adequate documentation and an audit trail. The establishment of a memorandum account would be an added record burden on the utilities because they would need to maintain a new set of records applicable only to PBOPs. Another vehicle would be the balancing account method which requires the utilities to record and track specific activities in their existing accounting records and to show the PBOPs activity in their financial statements.

The USOAs adopted by this Commission provide sufficient account detail so that an audit trail exists. As elaborated by San Jose Water, substantial controls already exist. The establishment of a balancing account would only add to the substantial documentation. However, to easily identify and track PBOP activity within the utilities' accounting records, the utilities should be required to use sub-accounts for all PBOP activities.

We also note that FAS No. 106 uses the projected unit credit method to calculate PBOPs accruals. In D.88-03-072 we rejected this method for calculating pension accruals in declining to adopt FAS No. 87 for ratemaking purposes. Nonetheless, there may be some value in reconsidering FAS No. 87 if we adopt the projected unit credit method according to FAS No. 106.

We put Parties on notice that we will reopen I.87-02-023 to examine the consistency of accounting for pension and PBOPs

costs if we adopt the projected unit credit method in Phase II of this proceeding.

Petitions and Motion to be Removed from the List of Respondents

AT&T Communications of California, Inc. (AT&T) and Citizens Utilities Company of California (Citizens) filed petitions to be removed from this investigation's respondent list on August 6, 1990 and August 17, 1990, respectively. Subsequently, on August 30, 1990 Del Este Water Company (Del Este) filed a motion to be removed from this investigation's respondent list.

AT&T seeks to be removed from the respondents list because unlike the energy, water, and local exchange telecommunication utilities, AT&T does not offer monopoly services, nor is it regulated by the Commission under a traditional rate base, rate-of-return framework. AT&T adopted the FASB accounting change in May 1990, retroactive to January 1, 1990. However, because of the competitive market in which AT&T operates, it has not sought an increase in prices.

Citizens provides its retired employees telephone service concessions that may be classified as PBOPs. However, their impact is minimal. Citizens has no plans to implement any other PBOPs at this time. Similarly, Del Este, with no present PBOP benefits, has no plans to implement PBOPs in the future.

AT&T, Citizens, and Del Este each have legitimate reasons to be removed from the respondent service list. However, this investigation was opened to gather information and to analyze the potential ratemaking impacts of implementing FASB's accounting for PBOPs. AT&T, Citizens, and Del Estes may not be directly impacted by this investigation, but, each can give added insight from the perceptive of an interexchange carrier, and from the perceptive of utilities that do not offer PBOPs. Therefore, AT&T, Citizens, and Del Este should not be removed from this investigation's respondent service list.

Request for Finding of Eligibility

On December 3, 1990, TURN filed a request for finding of eligibility for compensation, pursuant to Article 18.7, Rule 76.54 of the Commission's Rules of Practice and Procedure. No party has filed a response to TURN's request.

Article 18.7 contains the requirements to be met by intervenors seeking compensation "for reasonable advocate's fees, reasonable expert witness fees, and other reasonable costs to public utility customers of participation or intervention in any hearing or proceeding of the Commission initiated on or after January 1, 1985, to modify a rate or establish a fact or rule that may influence a rate." This proceeding was opened to examine the potential ratemaking impacts of the FASB's accounting treatment for employee PBOPs. Therefore, this proceeding clearly falls within the definition of applicable proceedings.

Rule 76.54 requires that a request for eligibility be filed within 30 days of the first prehearing conference or within 45 days of the close of the evidentiary record. TURN's request was filed within 45 days of the last day of evidentiary hearings on October 18, 1990 and complies with the second option of Rule 76.54.

Rule 76.54(a) requires that a request for eligibility include four items:

1. A showing that participation would pose a significant financial hardship. Also a summary of the party's finances. If the party has already made a showing of financial hardship in the same calendar year the party needs only to make reference to that decision by number to satisfy this requirement.

2. A statement of issues that the party intends to raise.

3. An estimate of the compensation that will be sought.

4. A budget for the party's presentation.

Significant Financial Hardship

TURN has previously been found to have met its burden of showing financial hardship for the 1990 calendar year in Decision (D.) 90-09-024, dated September 12, 1990. Therefore, the Rule 76.54(a)(1) requirement has been satisfied.

Statement of Issues

In its request, TURN states that the issues it intends to raise are a matter of record as set forth in its examination of witnesses and in its brief. In the first phase of this investigation TURN addressed retroactive ratemaking issues raised by certain respondents' pre-funding proposals and the alleged failure of Pacific Bell and GTEC to show that their pre-funding proposals will benefit ratepayers. Because testimony for the second phase of this proceeding has not yet been filed, TURN can not predict the issues that it will raise in that phase. TURN has identified the issues it intends to raise to the extent possible and therefore meets this requirement.

Compensation Estimate

TURN budgeted $12,000 for the first phase of this proceeding. However, because it is too early to know the nature of TURN's participation in the second phase, TURN cannot estimate the compensation that it will request for that phase of the proceeding. The precise amount of compensation and its reasonableness will be addressed in its compensation filing. TURN has provided a budget for its participation in the first phase of this proceeding.

Budget

TURN provides the following budget for its participation in the first phase of of this proceeding:

Attorney Fees @ $150 per hour	$11,250
Other Reasonable Fees	750
TOTAL BUDGET	$12,000

For the reasons discussed under the statement of issues, TURN is unable to provide a budget for the second phase of this proceeding.

Common Legal Representation

Rule 76.54(b) allows other parties to comment on the request, including a discussion of whether a common legal representative is appropriate. Pursuant to Rule 76.55, our decision on TURN's request may designate a common legal representative. However, no party has filed any comments on this issue. Therefore, we find no current need to designate a common legal representative in this proceeding.

TURN has satisfied all the requirements for a finding of eligibility for compensation in this proceeding. TURN is placed on notice that it may be subject to audit or review by CACD and, therefore, should keep adequate accounting records and other documentation in support of all claims for intervenor compensation. Such records should identify specific issues for which compensation is being requested, the actual time spent by each employee, the hourly rate paid, fees paid to consultants, and any other costs incurred for which compensation may be claimed.

Section 311 Comments

The ALJ's proposed decision on this matter was filed with the Docket Office and mailed to all parties of record on May 17, 1991, pursuant to Rule 77 of the Commission's Rules of Practice and Procedure.

Comments were timely filed by DRA, Edison, GTEC, Pacific Bell, PG&E, SDG&E, SoCal Gas, and TURN, and timely provided by Brown Bridgman. Reply comments were timely filed by DRA, Edison, GTEC, Pacific Bell, and TURN.

We have carefully reviewed the comments and reply comments filed by the parties to this proceeding that focus on factual, legal or technical errors in the proposed decision and in citing such errors make specific references to the record, pursuant

to Rule 77.3. To the extent that these comments and reply comments required discussion, or changes to the proposed decision, the discussion or changes have been incorporated into the body of this order. Comments and reply comments which merely reargue positions taken in briefs, and which provide new factual information, untested by cross-examination, were not considered.

Findings of Fact

1. PBOPs include employee benefits such as medical and dental care, life insurance, and legal services.

2. Although D.89-12-057 denied PG&E authority to recover PBOPs contributions, it kept PG&E's rate proceeding open to consider the recovery of PBOPs costs upon the FASB's issuance of an official PBOPs' statement.

3. SoCal Gas, which began pre-funding PBOPs with a 401(h) plan in 1987 with stockholder money, is currently the only utility authorized to recover pre-funded PBOPs contribution in rates.

4. Official notice is taken of FASB's Statement No. 106, employers' accounting for PBOPs, approved by FASB in December 1990 and readily available in print in January 1991.

5. Brown Bridgman's prepared testimony tendered with the Docket Office on October 9, 1990 was not served on the appearances of record or the ALJ, and did not comply with Rule 4.5.

6. Prepared testimony from witnesses not needed for examination was received into the record only if the party introduced such testimony at the evidentiary hearing with an affidavit signed by their witnesses.

7. Brown Bridgman did not introduce its testimony at the evidentiary hearing.

8. Brown Bridgman's testimony purported to have been filed prior to its October 9, 1990 comments and testimony was not filed with the docket office.

9. Not all of the proposals identified in DRA's Appendix A to its brief were addressed in the evidentiary phase of this investigation.

10. DRA's Appendix A to its brief is supplemental testimony provided after the close of the evidentiary hearing without scrutiny by the appearances of record.

11. Respondent utilities have the burden to demonstrate that pre-funding is in the best interest of the ratepayers.

12. Only GTEC and Pacific Bell provided testimony on the present value impact of pre-funding PBOPs.

13. Ratepayers will receive benefits for the time value of money contributed to a PBOPs plan via lower overall costs to ratepayers.

14. Without pre-funding, the PBOPs liability will continue to grow without the benefit or use of funded assets accumulating tax free earnings.

15. Pre-funding will mitigate the inter-generation inequity which results from the current pay-as-you-go method.

16. The utilities concur that PBOPs benefits should be funded incrementally over the working lives of employees as these benefits are earned, similar to pension benefits.

17. Pre-funding PBOPs will reduce the utilities' risk and enable them to obtain lower interest rates for borrowed funds.

18. IRS and ERISA statutes preclude the Commission from negotiating specific PBOPs outcomes or contractual arrangements.

19. IRS, ERISA, and NLRA statutes provide substantial protection to ensure that PBOPs funds are used only for PBOPs benefits.

20. Rate shock was not an issue in D.88-03-072.

21. The driving force in this investigation is whether pre-funding is in the best interest of the ratepayers.

22. The adoption of a pre-funded plan will not commit ratepayers to a particular funding plan or preclude the Commission from considering a superior plan later on.

23. Continued pre-funding will result in a revenue requirement reduction on an incremental net present value basis.

24. Ratepayers will benefit from the appreciation of pre-funded trust assets and from the accumulation of tax-free trust earnings.

25. Respondent utilities were required to demonstrate that on a present value basis certain benefits can be realized by taking advantage of current tax regulation.

26. The utilities used data obtained from their independent actuaries and affiliated actuaries to substantiate that pre-funding is in the ratepayers' best interest.

27. Certified and independent actuaries base their projections on statistical data, not on the interest of a particular entity.

28. Actuarial assumptions use projections, similar to test year estimates, and to the extent that the projections prove incorrect, the test year estimates and actuarial assumptions will not be accurate.

29. GTEC's and Pacific Bell's net present value studies comply with the present value studies called for in this investigation.

30. PBOPs benefits accrue similarly to pension benefits.

31. Unlike pension costs which are recovered on a pre-funded basis, except for SoCal Gas, ratepayers do not pre-fund PBOPs benefits being earned by the current utility employees.

32. Current ratepayers pay only for those PBOPs benefits that are currently being received by utility employees even though the benefits were earned in a prior time period.

33. Tax deductible pre-funded contributions will alleviate the inter-generation inequity and provide a fairer distribution of the PBOPs cost burden among ratepayer generations.

34. D.87-03-027 found that it is appropriate for current ratepayers to recognize and to begin pre-funding their incremental share of future costs for decommissioning nuclear facilities.

35. Pre-funding PBOPs with tax-deductible contributions is in the ratepayers' best interest.

36. Respondent utilities total unfunded PBOPs liability exceeds $2.8 billion.

37. Edison is in the process of establishing a 401(h) plan and intends to pre-fund a 1990 and 1991 contribution in 1991, but has not yet begun pre-funding PBOPs.

38. The general rate case proceeding, except for Pacific Bell and GTE, is the proper procedure to recover future pre-funded PBOPs contributions.

39. The current regulatory framework requires the major utilities to file general rate proceedings on a three-year cycle.

40. D.89-10-031 replaced Pacific Bell's and GTEC's traditional cost-of-service regulation with a price cap index formula.

41. Pacific Bell, GTEC, and DRA did not substantiate that their method of reflecting pre-funded contributions in the price cap formula meets the price cap formula criteria established in D.89-10-031.

42. IRC § 401(h) allows a utility to establish separate accounts under its established pension plan to make tax deductible PBOPs contributions for retirees and their dependents.

43. The 401(h) plan subject to ERISA reporting, disclosure, and fiduciary requirements is funded solely with reference to amounts needed to fund pension benefits and does not reflect the actual liability associated with PBOPs.

44. A VEBA plan must be used exclusively for the benefit of the beneficiaries of the plan.

45. A utility's contributions to a VEBA plan is tax deductible within limits and the benefits paid by the plan to employees and retirees are not considered taxable income to the employees or retirees. Earned income is taxed at trust rates unless it is derived from tax-free investments.

46. A collectively bargained VEBA can be established for the utility's union employees pursuant to an arm's length negotiation over benefits between employee representatives and the utility, if at least 90% of the employees covered by the VEBA are represented employees.

47. A collectively bargained VEBA allows for tax-deductible contributions to include an element for inflation and earned income on the plan's investments is not taxed.

48. A defined benefit pension plan can be modified to include PBOPs benefits and enable the utility's contributions to be tax deductible and plan income to be tax free, and to allow for unlimited contributions as long as they are reasonable, necessary, and do not exceed the maximum benefit limits.

49. Retirees are taxed on the amount of PBOPs benefits received from a pension benefit enhancement plan.

50. The utility's premium payments to a utility-owned life insurance plan are not tax deductible.

51. The utility-owned life insurance plan provides limited cash for PBOPs payments.

52. The IRS may consider the amounts borrowed against utility-owned life insurance plans to be taxable income.

53. Contributions to a 401(h) plan are not allowed if the utility's pension plan is fully funded.

54. It is difficult, if not impossible, to select one preferred pre-funding plan for all utilities.

55. D.90-01-016 did not make SoCal Gas rates applicable to pre-funded PBOPs subject to refund.

56. The current tax rules require that any remaining funds from a terminated VEBA plan be used to provide similar PBOPs benefits to the beneficiaries of the trust.

57. FASB 106 requires PBOPs plan assets to be segregated and restricted, usually in a trust, to be used for only post-retirement benefits.

58. A trustee has a fiduciary responsibility to ensure that plan assets are used only for the intended purpose.

59. IRS, ERISA, and NLRA requirements are in place to ensure that funds placed in a PBOPs plan will be used only for PBOPs benefits.

60. Utilities are required to maintain their accounting records in conformance with a USOA as adopted by this Commission.

61. The utilities' accounting records are audited yearly by an independent CPA and are subject to Commission scrutiny in rate proceedings.

62. The USOAs adopted by this Commission provide sufficient account detail so that an audit trail exists for PBOPs contributions, investments, and benefits.

63. Although not directly impacted by PBOPs, AT&T, Citizens, and Del Este can provide us with PBOPs impacts from the perspective of an interexchange carrier and from the perspective of utilities that do not provide PBOPs benefits.

64. This proceeding falls within the Article 18.7 requirements to be met by intervenors seeking compensation.

65. TURN's request for a finding of eligibility complies with the second option or Rule 76.54.

66. D.90-09-024 found that TURN had a significant financial hardship for purposes of any proceedings in which TURN participates during 1990.

67. There is no need to designate a common legal representative at this time.

68. Whether prefunding benefits GTEC's and Pacific Bell's ratepayers may depend in part on the determination of whether or to what extent Z factor treatment is afforded.

Conclusions of Law

1. Brown Bridgman's October 9, 1990 tendered comments and prepared testimony should be rejected.

2. GTEC's and Pacific Bell's motion to strike Appendix A to DRA's brief should be granted.

3. Respondent utilities should be authorized to recover pre-funded tax-deductible contributions placed in a PBOPs plan as long as the utilities implement safeguards to ensure that contributions are used for only reasonable PBOPs benefits.

4. The utilities should track their tax deductible pre-funded PBOP's cost in an interest bearing memorandum account.

5. Edison's proposal to recover in 1991 rates pre-funded PBOPs contributions that it will make after the effective date of this decision is not barred by the rule against retroactive ratemaking.

6. TURN should be found eligible to claim compensation in this proceeding under Article 18.7 of our Rules.

INTERIM ORDER

IT IS ORDERED that:

1. Brown Bridgman Retiree Health Care Group's October 9, 1990 comments and prepared testimony shall be struck from the record.

2. DRA's Appendix A to its brief shall be struck from the record.

3. AT&T Communications of California, Inc.'s, Citizen Utilities Company of California's, and Del Este Water Company's

motion to be removed from this investigation's respondent list shall be denied.

4. Respondent utilities shall be authorized to recover in rates tax-deductible contributions paid to a pre-funded Post Retirement Benefits Other than Pensions (PBOP) plan after the effective date of this decision if they:

a. Establish and use an Internal Revenue Code (IRC) § 401(h) plan, a Voluntary Employee Benefit Association (VEBA) plan, a collectively bargained VEBA plan, or a pension benefit enhancement plan for their pre-funded tax-deductible contributions. A utility-owned life insurance plan shall not be used.

b. Establish and use an independent trust for the receipt, investment, administration, and disposition of PBOPs benefits.

c. Use distinct sub-accounts within their respective Uniform System of Accounts adopted by this Commission to account and track all PBOPs activities.

d. Meet the requirements of Ordering Paragraph 7.

5. Respondent utilities, other than Southern California Gas Company, that implement and use a tax deductible PBOPs plan should track their PBOPs costs, net of tax, in an interest bearing memorandum account and seek an opportunity to recover their PBOPs costs in their next rate recovery proceeding, such as in a general rate filing, an attrition filing, or as an increase to the Authorized Level of Base Rate Revenue under the ERAM as requested by Southern California Edison Company. Interest on these memorandum accounts shall be calculated at the current Federal Reserve 90-day commercial paper rate as reported in the Federal Reserve Bulletin. PG&E shall accrue its PBOP costs through such a memorandum account until its next attrition adjustment filing in connection with its general rate case. The utilities shall

terminate the PBOPs memorandum account treatment in their next general rate case proceeding and should reflect tax deductible PBOPs costs as part of their test year expenses.

6. In addition, Pacific Bell, GTEC, and DRA shall present testimony and evidence in Phase II which may be used to determine if Z factor treatment is proper for recovery of a portion of PBOPs costs, and if so, to what extent.

7. Respondent utilities that seek recovery of their pre-funded PBOPs contributions shall substantiate in their next general rate case for which hearings are held that their:

a. Selected pre-funded plan is a reasonable plan that mitigates the impact on ratepayers' rates by demonstration that their plan's actuarial assumptions, contributions, and investments are reasonable.

b. Pre-funded PBOPs contributions are not used to enhance active employees and retired employees benefits by reducing the utilities pension contributions and extending active employees pension coverage.

c. Compliance with Ordering Paragraph 4.

8. The Division of Ratepayers Advocate motion to require Southern California Gas Company to refund pre-funded PBOPs contributions being recovered through its 1990 rates shall be denied.

9. Respondent utilities shall provide in Phase II, in addition to testimony and comments on Ordering Paragraphs 5 and 6 of the investigation, testimony and comments on the benefits and detriments to the ratepayers of pre-funding respondent's entire PBOPs liability.

10. Toward Utility Rate Normalization (TURN) is eligible to claim compensation for its participation in this proceeding. TURN shall maintain adequate accounting records and other necessary documentation in support of any claims that it may have for intervenor compensation and make such documentation available to the Commission's Advisory and Compliance Division upon their request.

This order becomes effective 30 days from today.

Dated July 2, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
G. MITCHELL WILK
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

I will file a written concurring opinion.

JOHN B. OHANIAN
Comissioner

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

NEAL J. SHULMAN, Executive Director

APPENDIX A

List of Appearances

Respondents: John Barker, for California American Water Company; Beck, Young, French, & Ackerman, by Jeffrey F. Beck and Sheila B. Brutoco, Attorneys at Law, for Citizens Utilities Company of California; Kenneth K. Okel and Kathleen S. Blunt, Attorneys at Law, for GTE California Incorporated; Nancy W. Doyne and David R. Clark, Attorneys at Law, for San Diego Gas & Electric Company; William A. Ettinger, Attorney at Law, for AT&T Communications, Inc.; Cooper, White & Cooper, by Gretchen Franz, Attorney at Law, for Roseville Telephone Company; Orrick, Herrington & Sutcliffe, by Robert Gloistein, Attorney at Law, for Contel of California, Inc.; E. R. Island and J. E. Jackson, Attorneys at Law, for Southern California Gas Company; Richard S. Jarrett, for CP National; Robert M. Johnson, Attorney at Law, for Southwest Gas Corporation; Daniel J. McCarthy, Attorney at Law, for Pacific Bell; Roger J. Peters, Kermit R. Kubitz, and Gary P. Encinas, Attorneys at Law, for Pacific Gas and Electric Company; Richard K. Durant, Carol B. Henningson, M. D. McDonald, and Frank A. McNulty, Attorneys at Law, for Southern California Edison Company; Robert A. Loehr, Attorney at Law, and Fred R. Meyer, for San Jose Water Company; and James D. Salo, Attorney at Law, for Sierra Pacific Power Company; Stoel, Rives, Boley, Jones & Grey, by Robert V. Sirvaitis and James C. Paine, Attorneys at Law, for Pacific Power & Light Company.

Interested Parties: Brown, Bridgman Retiree Health Care Group, by Stanley H. Clow and Fred D. Van Remortel; Nossaman, Guthner, Knox & Elliott, by Jose E. Guzman, Jr., Attorney at Law, for Westport Management Services, Inc.; and Thomas Long and Michel Florio, Attorneys at Law, for Toward Utility Rate Normalization.

Division of Ratepayer Advocates: James S. Rood and Rufus G. Thayer, Attorneys at Law, and Mark Loy.

(END OF APPENDIX A)

I.90-07-037
D.91-07-006

Concurring Opinion of Commissioner John B. Ohanian

I applaud Commissioner Wilk's handling of this case. Commissioner Wilk has crafted a decision that is fair to the utilities, their employees, and the ratepayers -- not a small achievement considering the arcane and intricate nature of the issues involved.

There are, however, two aspects of my vote today which I feel need some elaboration. Today's decision observes that in D.88-03-072 we rejected for ratemaking purposes the use of FAS No. 87, Employers' Accounting For Pensions. The decision further notes one substantial similarity between FAS No. 106 and the rejected FAS No. 87, namely, the use of the projected unit credit method[1] in calculating service costs for both pensions and PBOPs. Given this similarity between FAS No. 87 and 106, the decision goes on to announce our intent to reconsider the use of FAS No. 87 for ratemaking "if we adopt the projected unit credit method according to FAS No. 106" in Phase II of this proceeding.

I wholeheartedly agree with this conclusion. However, my reading of FAS No. 106 reveals that the similarities between FAS No. 87 and FAS No. 106 are much broader and more substantial than indicated in today's decision. Indeed, the authors of FAS No. 106 (and the Exposure Draft which preceded it) go to great lengths to make it clear that FAS No. 87 and 106 are siblings, if not twins. Therefore, in deciding whether or not to reopen I.87-02-023, I will be comparing FAS No. 87 against the entire package

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1. FAS No. 106 refers to the "benefits/years of service approach" instead of the "projected unit credit method." But as pointed out in Footnote 18 of the Exposure Draft, the benefits/years of service approach is virtually synonymous with the projected unit credit method.

of what we adopt in the next phase of this proceeding, not just one component of that package (i.e., use of the projected unit credit method).

The second point of elaboration concerns the five alternative vehicles that utilities may choose among to fund PBOPs. As the decision notes, one of these vehicles consists of modifying existing pension plans to include PBOPs benefits. The advantages of choosing this funding vehicle are that it enables a utility's PBOPs contributions to be tax deductible and plan income to be tax free; and allows for unlimited contributions so long as they are reasonable, necessary, and do not exceed the maximum benefit limits.

To me, this vehicle has an additional appeal. Several of our utilities are fortunate enough to possess pension funds with surpluses of assets. Perhaps these surplus assets can be used to mitigate the expected rate shock from funding PBOPs. Therefore, before I will vote for increasing rates to fund PBOPs, I expect those utilities with overfunded pension plans to either use their excess assets to fund their PBOPs obligations; or to make a convincing showing as to why their pension plans cannot or should not be modified so as to use the surplus assets to fund their PBOPs obligations.

/s/ John B. Ohanian
John B. Ohanian, Commissioner

July 2, 1991
San Francisco, California