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Decision 92-02-037 February 5, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

ORIGINAL

Application 90-05-003
(Filed May 1, 1990)

Roger J. Peters, Harry W. Long, Jr., and Kermit R. Kubitz, Attorneys at Law, for Pacific Gas and Electric Company, applicant.
Joel Singer, Attorney at Law, for Toward Utility Rate Normalization; Norman J. Furuta, for Federal Executive Agencies; and Robert T. Feraru, for Public Advisor's Office.
Albert C. Guerrero, Attorney at Law, and Raymond A. Charvez, for Division of Ratepayer Advocates.

OPINION ON REHEARING

In this proceeding, Toward Utility Rate Normalization (TURN) seeks a modification of Decision (D.) 90-12-070 issued on December 20, 1990.

I. Background

On October 17, 1989, a severe earthquake occurred causing loss of life and extensive property damage over a large area of northern California. As a result of the earthquake, service over a large portion of Pacific Gas and Electric Company's

(PG&E) service area was disrupted and facilities of PG&E were extensively damaged, necessitating costly repair or replacement. A portion of PG&E's loss was covered by casualty insurance.

On October 25, 1989, PG&E filed an emergency motion to establish a balancing account, known as the Earthquake Recovery Account (ERA), to record, for later recovery, PG&E's expenditures related to the October 17 earthquake. In D.89-11-029, dated and effective November 3, 1989, as revised by D.89-11-066, dated November 22, 1989, the Commission authorized PG&E to set up the ERA and allowed it to begin recording costs/expenses into this account prospectively. In the words of the Commission:

> "In past proceedings where we have authorized an account for the purpose of recording changes in expenses and revenues resulting from extraordinary and unanticipated events, we have authorized the utility to book into the account only those expenditures which are incurred on or after the date the account is authorized. To do otherwise would constitute retroactive ratemaking. (D.89-04-075, D.89-04-041, D.88-03-017, and D.84-12-060.) Therefore, we will authorize PG&E to book into the account only those costs which are incurred on or after the date of this order [November 3, 1989]." (page 2.)

On May 1, 1990, PG&E filed Application 90-05-003 seeking recovery in rates of the earthquake-related costs/expenses recorded in the ERA. During the course of the proceedings, a settlement was ultimately reached between PG&E and the Commission's Division of Ratepayers Advocates (DRA). The settlement, inter alia, adopted PG&E's methodology for allocating $25 million in earthquake-related insurance proceeds which PG&E had received or expected to receive for its covered loss. This methodology allocated on a month-to-month basis $15.7 million of those proceeds to costs/expenses incurred from October 17 to November 2, 1989 and $9.3 million, the remainder of the $25 million insurance recovery, to costs/expenses incurred on and after November 3, 1989. Though aware of the

settlement, TURN was not a signatory to it and in the proceedings challenged the insurance allocation method proposed by PG&E and DRA.

In D.90-12-070, issued December 19, 1990, the Commission approved and adopted PG&E's method of allocating the insurance proceeds, and concluded that the prohibition against retroactive ratemaking does not apply to the allocation of insurance proceeds recovered from earthquake insurance based on the damage and destruction of utility property. We then granted PG&E a $13.65 million rate increase to recover the remainder of the post-November 3 costs/expenses in the ERA.

II. Rehearing

On January 22, 1991, TURN filed an application for rehearing of D.90-12-070, arguing that by allowing PG&E to "divert" the $15.7 million of the anticipated $25 million insurance proceeds to cover pre-November 3 costs/expenses, this Commission was engaging in retroactive ratemaking. In support of its position, TURN argued that absent the application of the $15.7 million to cover the pre-November 3 costs/expenses, the entire $25 million insurance recovery would have been applied to reduce the costs/expenses accrued in the ERA. It continued that since the "diverted" $15.7 million in insurance proceeds exceeded the $13.65 million rate increase later granted PG&E, the entire earthquake-related rate increase would have been eliminated if the ERA had been legally applied. TURN further argued that D.90-12-070 is unlawful because it modifies D.89-11-066, the revised interim opinion, without notice to TURN and an opportunity for TURN to be heard.

In its response to TURN's application for rehearing, PG&E denied that the rule against retroactive ratemaking is violated by D.90-12-070 and argued that, as the Commission found in Finding 15 and Conclusion 2 in D.90-12-070, insurance recovery does not require Commission action and is, therefore, not retroactive ratemaking.

By D.91-04-031, filed April 10, 1991, the Commission granted a "limited rehearing [of D.90-12-070] ...for the purpose of reconsidering the appropriate allocation of insurance proceeds to be adopted in determining PG&E's cost recovery for costs associated with the earthquake of October 17, 1989."

Pursuant to notice, a prehearing conference was held before Administrative Law Judge (ALJ) Robert L. Ramsey on June 26, 1991. At that conference, two matters were considered: first, the question of whether a further evidentiary hearing would be required, and second, a question involving information produced by PG&E in response to a second data request made by TURN. At the conclusion of the conference, it was generally thought that a further evidentiary hearing would not be necessary, and PG&E was directed to furnish additional information to fully comply with TURN's second request for data.

Pursuant to notice, a second prehearing conference was held before ALJ Ramsey on July 30, 1991. At that conference, PG&E offered into evidence PG&E's response to TURN's second data request. TURN's representative acknowledged that the offered documentation was what it was represented to be and interposed no objection to its being received in evidence. PG&E's response was then marked and received without objection as Exhibit 5. Further, PG&E indicated that for the purpose of this proceeding, the total amount of insurance recovery that PG&E could expect was $25 million, and that it was prepared to call a witness to so testify. TURN's representative stipulated to that amount. Also at the conference, a discussion was held concerning the necessity of a

further evidentiary hearing. The parties agreed that no further evidentiary hearing was necessary and that following the submission of briefs, the dispute could be determined as a matter of law. Both parties then, on the record, waived a hearing. The parties were then directed to file simultaneous briefs not later than September 13, 1991, at which time the case would stand submitted.

The parties timely filed the directed briefs and the case was submitted on September 13, 1991.

III. Issue

The primary question to be determined is whether the application of $15.7 million of the $25 million insurance recovery to recoup pre-November 3, 1989 losses constitutes retroactive ratemaking. We also address TURN's allegation that D.89-11-066 was unlawfully modified by D.90-12-070 because of lack of notice to TURN prior to its adoption.

A. TURN's Position

Most simply stated, TURN presents a single thesis: PG&E's allocation of $15.7 million of the $25 million insurance recovery to pre-November 3 earthquake-related costs/expenses constitutes prohibited retroactive ratemaking. This argument is, in turn, comprised of four main points: (1) the application of any portion of the $25 million insurance recovery to offset any earthquake-related cost/expense incurred by PG&E prior to November 3, the date the ERA was authorized, constitutes retroactive ratemaking; (2) retroactive ratemaking is prohibited in this State; (3) the entire $25 million insurance recovery should have been applied to offset only post-November 3 costs/expenses in the ERA; and (4) if the entire $25 million insurance recovery had been offset against only post-November 3 costs/expenses in the ERA, it would have exceeded the post-November 3 costs/expenses and no rate increase would have been necessary.

Based on the above argument, TURN requests the Commission to "conclude that PG&E has proposed an allocation of insurance proceeds which directly violates the prohibition against retroactive ratemaking and D.89-11-066" and as a result, "the Commission should issue a new decision rejecting the settlement and rescinding the rate increase previously granted under this application."

B. PG&E's Position

In essence, PG&E argues that D.90-12-070 does not constitute retroactive ratemaking because insurance recovery does not flow from ratemaking, and secondly, that the allocation of insurance proceeds adopted by D.90-12-070 is not inconsistent with either D.89-11-029 or D.89-11-066, but merely interprets those decisions to require that insurance fairly allocable to post-November 3, 1989 be used to offset post-November 3 expenses.

We conclude that PG&E could lawfully apply $15.7 million of the $25 million insurance proceeds to recoup earthquake-related costs/expenses incurred between October 17 and November 2, 1989 and the remaining $9.3 million to post-November 3 costs, and thereafter obtain a rate increase to recover the balance of costs/expenses which were booked into the ERA on and after November 3, 1989.

IV. Discussion

The concept of retroactive ratemaking, though widely recognized and condemned, is generally not well understood. Not all present rate adjustments based on prior events constitute retroactive ratemaking as some, including TURN, seem to think. Retroactive ratemaking basically consists of an adjustment of future rates upward or downward to recover shortfalls or refund windfalls occasioned by prior rates which were incorrect. To use a legal analogy, it is an attempt at rate setting nunc pro tunc.

The general concept of retroactive ratemaking is spelled out in the case law of numerous other states. Retroactive ratemaking occurs when a rate is set so as to permit collection in the future for expenses attributable to past services. (State ex rel. Utilities Commission v. Nantahala Power and Light Co., 309 S.E. 2d 473, 485, 65 N.C. App. 198.) It is the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate of return with the rate actually established. (State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W. 2d 4159 (Mo.).) Adjustments to future rates to rectify undue past profits are retroactive ratemaking. (Madison Gas and Electric Co. v. Public Service Commission of Wisconsin, App., 441 N.W. 2d 311, 321, 150 Wis. 2d 186.) Retroactive ratemaking occurs when additional charge is made for past use of utility service, or the utility is required to refund revenues collected, pursuant to then lawfully established rates, for such past use. (State ex rel. Utilities Commission v. Edmisten, 232 S.E. 2d 184,194, 291 N.C. 451.) Retroactive ratemaking only occurs when new rates are applied to prior consumption. (Citizens of State v. Public Service Commission of Florida, 448 So. 2d 1024, 1027.) In short, under these cases retroactive ratemaking seeks to adjust for past rate errors. It is a future rate set artificially high or low to compensate for a prior rate error.

The rule against retroactive ratemaking must be interpreted in light of the California Supreme Court's discussion of what constitutes ratemaking subject to the rule. At a minimum, there must be ratemaking to trigger the prohibition. As the Court stated in Southern California Edison v. Public Utilities Commission (1978), 20 Cal. 3d 813:

> "At the risk of belaboring the obvious, we observe that before there can be retroactive ratemaking, there must at least be

RATEMAKING."[1] (Emphasis in original, 20 Cal. 3d at 817.)

Here, the allocation of casualty insurance proceeds to offset losses traceable not to past incorrect rates, but to destruction of physical plant facilities resulting from a natural disaster totally unrelated to past rates, cannot, by definition, be considered retroactive ratemaking. It is not ratemaking, it is an allocation of insurance proceeds. It is nothing more than simple, straightforward reimbursement for a casualty loss. Casualty insurance has nothing to do with ratemaking beyond the extent to which the premiums paid for the insurance policy would be classified as an item of expense which, like any other legitimate cost of doing business, is factored into and recoverable in rates.

Monies paid PG&E by its casualty insurance carrier for a loss covered by an insurance policy is not compensation for, nor traceable to, a loss occasioned by a past incorrect rate, but is reimbursement for the loss of specific tangible property described or listed in the policy declarations or in the policy itself.

If the dollar losses suffered by PG&E were the result of a past rate that was incorrect, any attempt by PG&E to recoup those losses through an increase in future rates would raise serious questions about retroactive ratemaking, but that is not the situation here. Moreover, the parties agreed that past rates did not include such ratemaking allowances for earthquakes. Also, the parties agreed that the appropriate adjustments have been made to offset currently funded system repair and maintenance.

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1 Indeed, Southern California Edison said that the restrictions of the rule against retroactive ratemaking were "limited to the act of promulgating 'general rates.'" (20 Cal. 3d at 816, emphasis added.) See also California Manufacturers Association v. Public Utilities Commission, 24 Cal. 3d 251, 261 (1979); Toward Utility Rate Normalization v. Public Utilities Commission 44 Cal. 3d 870, 874, n.1 (1988) (both limiting rule against retroactive ratemaking under California law).

Had D.89-11-029 and D.89-11-066 ordered PG&E to deduct all insurance proceeds recorded in the ERA from all earthquake-related costs incurred after November 3, 1989, as TURN seems to suggest, then TURN's thesis might be better chosen. However, we did not order allocation of the insurance proceeds in that way. As review of the pertinent language reveals, we required PG&E to record in the ERA "for possible future recovery, all costs" (D.89-11-066, p. 3) reasonably incurred in response to the restoration of service as well as "any earthquake-related costs recovered, such as insurance proceeds" (Id. at p.3 and Ordering Paragraph 2). We stated "we may limit the recovery of recorded expenditures to the extent such expenditures are offset by other factors" (Id. at 4). We then stated, "For example, before authorizing recovery of any expenditures recorded in this account, we intend to determine if there are any offsetting insurance proceeds" (Id.).

The costs booked into the ERA were subject to later reasonableness review (as is routine prior to balancing account recovery). So, too, the insurance proceeds booked into the ERA were subject to later review to determine the extent to which they were offsetting of costs incurred on and after November 3, 1989 and therefore deductible from the balance in the ERA.

Nothing that TURN has argued demonstrates any error in our original determination that the proposal advanced by PG&E and DRA for allocating the insurance proceeds between the two timeframes is reasonable and should be adopted. Contrary to TURN's assertion, there has been no "diversion" of insurance proceeds.

Based upon our further consideration and the above analysis, we finally conclude that D.90-12-070 did not modify D.89-11-020 or D.89-11-066. Rather, D.90-12-070 adopted an allocation method recommended by two parties, PG&E and DRA, following evidentiary hearing on that issue. TURN disagreed with the allocation method and has now had two opportunities to make its

case for an alternative allocation. Thus, TURN has had its "day in court" on all issues in this proceeding. Accordingly, we reject TURN's allegation that prior decisions were unlawfully modified by D.90-12-070 because of lack of notice to TURN prior to its adoption.

The Commission has recognized the problems inherent in recovery from extraordinary and unanticipated events such as the earthquake and the more recent catastrophic fire in Oakland, California and fully appreciates the difficulty of providing in ratemaking for such events. In response to the general problem and to avoid a future repeat of the type of conflicts illustrated by this case, in Resolution No. E-3238, issued on July 24, 1991, the Commission authorized utilities, even before the smoke of a disaster has cleared, to set up an account into which disaster-related costs/expenses will be booked for later recovery. Had PG&E in this case been able to set up the ERA immediately after the earthquake, rather than having to file an emergency motion and wait for Commission approval, virtually all of the prudently incurred expenses/costs accrued to that account would be recoverable in rates, and the rate increase approved might well have exceeded that which was granted. As it was, under the settlement the ratepayer was treated fairly in that the ratepayer got the benefit of $9.3 million in insurance recovery, and was not burdened with the entire amount accrued in the ERA subsequent to November 3, 1989. Rather than PG&E "diverting" $15.7 million to pre-November 3 earthquake-related expenses, it did what it had every right to do, and TURN has no basis for complaint.

After rehearing, we find no reason to modify D.90-12-070, and hereby reaffirm the allocation of $15.7 million of the $25 million insurance recovery to pre-November 3 earthquake-related costs/expenses and the remaining $9.3 million to post-November 3 earthquake-related costs/expenses booked into the ERA as set forth in that decision.

Findings of Fact

1. The primary issue in this case is not ratemaking, but involves nothing more than the allocation of a $25 million insurance recovery.

2. TURN's allegations that prior decisions in this case were modified without providing it notice or the opportunity to be heard are without merit.

3. No reason has been demonstrated that would cause the Commission to modify D.90-12-070.

Conclusions of Law

1. The allocation of PG&E's $25 million insurance recovery in accordance with the settlement agreement between it and DRA does not constitute retroactive ratemaking.

2. D.90-12-070 did not modify D.89-11-029 or D.89-11-066.

3. D.90-12-070 should not be modified.

4. TURN's request for modification of D.90-12-070 is without merit and should be dismissed.

O R D E R

IT IS ORDERED that:

1. Toward Utility Rate Normalization's request for modification of Decision (D.) 90-12-070 is hereby dismissed.

2. D.90-12-070 remains the decision of this Commission in this case.

This order is effective today.

Dated February 5, 1992, at San Francisco, California.

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

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

NEAL J. SHULMAN, Executive Director