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Decision 92-12-015 December 3, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

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)
And Related Matters.	Application 88-12-005 (Filed December 5, 1988) I.89-03-033 (Filed March 20, 1989)

(See Appendix A for Appearances.)

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I N D E X

OPINION

I. Summary

By this order energy, water, and telecommunications utilities under the traditional cost of service regulation and telecommunications utilities under the new incentive regulation are required to accrue their post-retirement benefits other than pensions (PBOP) for both regulatory accounting and ratemaking purposes.

The affected utilities are required to utilize the Financial Accounting Standards Board (FASB) Statement No. 106 as modified by this order to record and accrue their PBOP liability. Modifications to the Statement include the use of the utilities employees total utility service life attribution method for both the utility's transition benefit obligation (TBO) and ongoing PBOP costs unless they can demonstrate that the benefits/years of service approach will result in minimal change, and amortization of the TBO over 20 years. Recovery of PBOP costs shall be limited to tax-deductible contributions up to a maximum annual increase in PBOP recovery of 1% of the utility's prior-years' total operating revenue for traditional cost of service ratemaking utilities.

The affected utilities are also required to record a regulatory asset[1] to reflect the difference between the utility's total PBOP liability and the amount currently being paid by

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1 A regulatory asset is the recording of the utilities' costs not currently recoverable for ratemaking purpose. To qualify as a regulatory asset, it must be probable that future revenue in the amount at least equal to the asset will result from inclusion of that cost in allowable costs for ratemaking purposes, and must be based on available evidence that future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.

ratepayers. Recovery of the regulatory asset shall begin during the year when tax-deductible limits exceed PBOP costs and continue until the regulatory asset reaches zero.

Utilities under the new incentive regulation shall not be allowed recovery of their PBOP contributions made prior to adoption of the Statement as a Z factor adjustment. Funded contributions, under the same conditions applied to the traditional cost of service utilities, shall be recoverable through an annual Z factor adjustment.

Those affected utilities operating under other states' jurisdiction with their California operations being 10% or less of their total utility operations (as measured by the four-factor method)[2] may choose to be exempted from the accrued PBOP requirement for regulatory accounting purposes only. However, for ratemaking purposes, such utilities shall be required to impute the effect of accrued PBOP, as explained in this order, as part of their general rate filings. Such utilities shall also assume that their funding begins on January 1, 1993 and shall assume earnings on their imputed PBOP contributions to be at their authorized weighted cost of capital rate.

2 The four-factor method is a formula comprised of direct operating expenses, gross plant, number of employees, and number of customers. This formula is used by the utility to allocate common utility plant.

II. Background

FASB[3] issued an "exposure draft"[4] on February 14, 1989 with the intent to issue an official FASB statement that had the potential to trigger ratemaking impacts resulting from a change in the accounting for PBOP from a cash basis of accounting to an accrual basis of accounting. This meant that employers would be required to recognize the future cost of providing PBOP to their employees by accruing these costs in the employers' financial statements as they are earned during the employees' years of service. The FASB defined PBOP as those benefits other than pensions that employees receive upon their retirement from work. These benefits include medical and dental care, life insurance, and legal services.

It became apparent that the FASB would adopt a PBOP statement that would impact regulated utilities. It was also perceived that the PBOP liability for California regulated utilities would be significant. Therefore, this investigation was opened to assess the ratemaking effects of PBOP and to consider the establishment of consistent general policies and procedures for all California regulated utilities that provide PBOP.

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3 FASB is an authoritative 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 to most enterprises as a basis for their external financial statements and reports.

4 An exposure draft is a proposed FASB order issued for comments from the accounting industry. Such comments are taken in consideration with the exposure draft prior to the adoption and issuance of an official opinion by the FASB.

III. Phase I

The first phase of this investigation examined the benefits and detriments of funding PBOP prior to the FASB's issuance and prior to the effective date of its official statement. The first phase of the investigation also considered PBOP funding plans and methods to ensure that PBOP funds would be used for only PBOP benefits.

It was during that phase of the investigation that the FASB made minor changes to its exposure draft and adopted its official PBOP statement, Statement of Financial Accounting Standards No. 106 (SFAS 106 or Statement), in December 1990.

The first phase concluded with the issuance of Decision (D.) 91-07-006. In that decision we found that the funding of PBOP with tax-deductible trust plans prior to January 1993, the effective date of the Statement, was in the ratepayers' best interest. We also found that adequate legal and accounting safeguards were already in existence to ensure that amounts contributed to PBOP plans would be used to provide only PBOP benefits.

Pursuant to the first decision in this investigation, the Commission gave utilities permission to fund and to recover their PBOP costs prior to the Statement's effective date, at tax-deductible contribution levels. Such recovery was subject to a reasonableness review of the utility's trust plans, actuarial assumptions, contributions, and investments in each utility's next general rate proceeding.

IV. Phase II

This decision addresses the second and final phase of the PBOP investigation. In all, there were 10 issues for this phase of the investigation, 8 of which were identified in the investigation, and the remaining 2 identified in D.91-07-006 as modified by D.91-10-024. Because several of these issues overlap each other, they have been consolidated into 5 major issues for discussion in this decision as follows:

a. Revenue requirement impacts.

b. Accounting and ratemaking treatment.

c. Legislation impacts.

d. Safeguard mechanisms.

e. "Z factor" treatment.

V. Evidentiary Hearing

A prehearing conference on Phase II issues was held before Administrative Law Judge Galvin on October 29, 1991 in San Francisco. There were 13 days of evidentiary hearings between December 2, 1991 and February 28, 1992.

Permit Group, Inc. (formerly Brown Bridgman Retiree Health Care Group), the Department of Navy, the Division of Ratepayer Advocates (DRA), GTE California Incorporated (GTEC), Pacific Bell, Pacific Gas and Electric Company (PG&E), Roseville Telephone Company (Roseville), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (Edison), Southern California Gas Company (SoCal Gas), and Southwest Gas Corporation (Southwest Gas) provided testimony on the Phase II issues.

Opening briefs were filed on March 27, 1992 and the matter was submitted upon the receipt of reply briefs on April 22, 1992.

Subsequent to the receipt of reply briefs, DRA filed a motion to strike portions of PG&E's and SoCal Gas's reply briefs which discussed and included a Duff & Phelps publication issued after the close of evidentiary hearings in this investigation. DRA asserted that the discussion and publication should not be allowed because it represented new testimony not scrutinized under examination.

Both PG&E and SoCal Gas acknowledged that the publication is not a part of the record in this proceeding and that it did not exist until after the close of evidentiary hearings. However, they contend that the publication should be considered as argument to substantiate the financial concerns expressed by their witnesses.

To the extent that the utilities' discussions and the publication summarized the financial concerns expressed by PG&E's and SoCal Gas's witnesses, they have been considered in this order. However, to the extent that the discussions and publication provided new information not already a part of the record, they were not considered in this order.

VI. Revenue Requirements

As explained in our background discussion, it was the general consensus at the time this investigation was opened that the California regulated utilities' PBOP liability would be significant. Subsequent to the institution of this investigation the FASB issued its Statement which enabled the utilities to quantify the impact of adopting the Statement for ratemaking purposes. The Statement requires all entities to discontinue the prevalent practice of recording PBOP benefits on the cash basis of accounting, or only when payment is actually made for PBOP benefits. The cash basis is being replaced with the accrual basis of accounting. Under the accrual basis entities must record PBOP benefits over the time period that their employees earn PBOP benefits, or the employees' working lives. The effective date of this Statement for California regulated utilities is January 1, 1993.

The annual PBOP costs to be accrued and recorded is called the "Net Periodic Postretirement Benefit Cost." Components of this cost include service cost,[5] interest cost,[6] actual return on plan assets,[7] and amortization of the TBO.[8]

California ratepayers will be substantially impacted if the Statement is adopted for ratemaking purposes. It was estimated that if the Statement is adopted without any modification that the ratepayers of GTEC, Pacific Bell, and SDG&E would see a $0.38, $0.75, and $0.19 monthly increase in their utility bills, respectively. Absent specific cost recovery methods and consideration of each individual utility's tax situation, net-to-gross multiplier factors may be necessary to reflect post-tax dollar payments from the ratepayers' perspective. Therefore, it is not possible to determine the resulting revenue requirement for each utility should full PBOP liability funding be adopted for ratemaking purposes at this time. However, the utilities have provided a comparison of their PBOP costs between the cash basis and accrual basis of accounting. In 1993 alone, the first year of the Statement implementation, California regulated entities that provide PBOP, except for AT&T Communications of California, Inc.,[9] would incur nearly an additional half a billion dollars in cost as summarized in the following tabulation:

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5 Actuarial present value of the expected obligation attributed to employees' service during the current period.

6 An increase in the TBO due to the passage of time.

7 A change in the fair value of plan assets from the beginning to the end of a time period, adjusted for contributions and benefit payments.

8 The recognition of all PBOP benefit obligations at January 1, 1993 less any plan assets at that date.

9 Data for California-only operations was not available.

UTILITY	CASH BASIS	ACCRUAL BASIS	INCREASED COST
	(Millions of Dollars)		
Edison	$ 33.7	$ 86.3	$ 52.6
PG&E[10]	25.5	150.6	125.1
SDG&E	4.0	7.4	3.4
SoCal Gas	6.6	29.9	23.3
Southwest Gas[11]	.1	.3	.2
GTEC	18.3	77.1	58.8
Pacific Bell	111.3	282.7	171.4
Roseville	.1	.2	.1
	$199.6	$634.5	$434.9

VII. Transition Benefit Obligation

The substantial increase in PBOP costs under the accrual basis of accounting is primarily attributable to the TBO. This is because the Statement requires all entities to record as an operating expense the cost of all PBOP benefits earned prior to January 1, 1993. However, the entities have the option of recording the TBO as a one-time operating expense or amortizing it on a straight-line basis over either the average remaining service period of the active employees or over a 20-year time period. A majority of the California utilities that provide PBOP intend to amortize the approximately $5 billion TBO over a 20-year time period at a rate of $237 million per year as summarized below.

10 Medical only. Excluded insurance benefits because the cash basis amount was not disclosed. The insurance accrual basis amount is $10,207,000.

11 California operations only.

UTILITY	TOTAL TBO	YEARLY AMORTIZATION
	(MILLIONS OF	DOLLARS)
Edison	$ 626.0	$ 31.3
PG&E[12]	920.0	45.9
SDG&E	59.2	3.0
SoCal Gas	266.0	13.3
Southwest Gas[13]	1.9	0.1
GTEC	601.8	30.1
Pacific Bell	2,266.0	113.3
Roseville	1.6	0.1
TOTAL	$4,742.5	$ 237.0

VIII. True-up of Phase I Funding

Not all of the utilities that provide PBOP benefits to their employees implemented the permissive PBOP funding authorized by the first phase of this investigation. However, because utilities such as Pacific Bell, PG&E, and SoCal Gas began accrual funding of PBOP prior to the Statement's effective date, they were expected to true-up their interim pre-funding revenue requirements in the second phase of the investigation.

Ordering Paragraph 5 of the Phase I order gave PG&E the authority to accrue PBOP contributions in a memorandum account until its 1992 attrition rate adjustment (ARA) filing, at which time rate recovery would be authorized. Because PG&E's filing of its 1992 ARA took place after the second phase of this investigation, it was not possible for PG&E to true-up its PBOP

12 Excluded $70 million applicable to the insurance TBO.

13 California operations only.

funding in this investigation. However, PG&E did propose that the amount authorized in its 1992 ARA serve as a ceiling for revenue requirements associated with PBOP funding in excess of its pay-as-you-go costs, and that any excess revenues associated with the 1991 and 1992 contributions be returned to ratepayers through a true-up procedure in its 1996 General Rate Case (GRC).

SoCal Gas was granted authority to fund PBOP and to implement rates to recover PBOP costs in its Test Year 1990 GRC, D.90-01-016, 35 CPUC 2d 80 at 132 and 133. Although SoCal Gas was authorized to recover PBOP costs, the GRC decision placed SoCal Gas on notice that those prior and current test years' 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 SoCal Gas's next GRC. Because SoCal Gas's prior and current test years' PBOP contributions will be reviewed in its next GRC, the true-up requirement is not applicable to SoCal Gas in this investigation.

Since the FASB established January 1, 1993 as the Statement's effective date, it is not feasible for the remaining utilities funding PBOP in advance of the Statement date to true-up their PBOP costs in this investigation. Therefore, those affected utilities should true-up their PBOP costs as part of their next GRC application. The telephone utilities subject to the new regulatory framework (NRF) mechanism should true-up their PBOP costs in their annual price cap filings, consistent with the method addressed in the "Z factor" discussion in this order.

IX. Justification for Revenue Requirement

The utilities revenue requirement data was based on actuarial valuations of the projected cost of the respective utilities' PBOP benefits. These valuations included demographic and economic assumptions, and were performed in accordance with generally accepted actuarial principles and the Statement criteria. Demographic actuarial assumptions included historical mortality, turn-over, disability, and retirement data. Economic assumptions included long-term assumptions believed to be reasonable and consistent with one another to reflect the long-term view of future cost patterns of the individual PBOP plans in existence.

A substantial portion of the evidentiary hearing was devoted to the revenue requirement recovery issue. In essence, this issue concerned financial and regulatory considerations.

A. Financial Consideration

Financial consideration consists of the utilities' ability to maintain their financial strength and to minimize their cost of capital. In this regard, Edison and SDG&E represented that full funding of the PBOP liability would be in the ratepayers' and utilities' long-term best interest because it would help maintain the utilities' financial strength and minimize the utilities' cost of capital. Edison further represented that if we approved only partial PBOP funding, the financial risks already facing the utilities would be exacerbated and "could" result in increased cost to the ratepayer.

On the other side of this financial issue, DRA provided substantive testimony to alleviate the utilities' concern of an exacerbated financial risk. Its testimony substantiated that Standard & Poor's and Moody's Investors Service, Inc. (Moody's) already factor in the effect of PBOP liabilities. The additional PBOP reporting required by the Statement would be helpful for the rating agencies to fine-tune their assessments and could even reveal a significantly smaller burden than previously assumed by the rating agencies. It will not result in the downgrade of debt ratings in any event.

Edison countered that Standard & Poor's and Moody's ratings are irrelevant to the concerns of the equity (common stock) market because these agencies' ratings only assess fixed income securities.

There is no dispute that the bond and stock markets are significantly different. Bond holders may have a much greater level of security than shareholders because debt payments precede stockholder dividends. However, over the short term, the higher, or more favorable the rating given to the utilities' debt by rating agencies, the lower the cost, or interest rate, needed to service debt. In turn, this lower service cost directly results, absent any disallowance of PBOP costs, in the availability of additional money for shareholder dividends and/or capital improvements. Although the degree of risk assessed by rating agencies and potential stockholders is not expected to be equal, we would expect some correlation to exist between debt and common equity risk.

We recognize, as addressed by the Department of Navy, that the rating agencies have not directed their Statement comments to a specific industry, such as the utility industry. However, its testimony corroborated DRA's testimony regarding the rating agencies' current practice of projecting PBOP liabilities to arrive at rating factors.

The Department of Navy also provided testimony on the rating practices of Duff & Phelps. In addition to rating debt like the other rating agencies, Duff & Phelps ranks and rates common stock securities. As elaborated in Duff & Phelps' October 9, 1989 "Credit Decisions," there is no basis to conclude that the Statement would have any measurable impact on the companies' ability to access capital markets because the capital markets will see through to the economies which have not changed.

Although the rating agencies did not provide testimony in this investigation, DRA and the Department of Navy provided persuasive testimony to explain how the rating agencies consider PBOP liabilities in assessing risk and in establishing rating factors for debt and common stock.

There is no dispute that risk exists. What is in dispute is the degree of risk that will occur if the Statement is not adopted. However, this is not the proper proceeding to assess or to provide compensation for degrees of risk related to a single factor. Such assessment is properly addressed in rate of return proceedings where the utilities' risk is evaluated and balanced to reflect their overall risk, such as in annual cost of capital proceeding for major energy utilities and in GRC proceedings for other utilities.

The utilities have not substantiated that their financial strength and capital cost should be considered in deciding whether the Statement should be adopted for regulatory accounting and ratemaking purposes.

B. Regulatory Consideration

Regulatory considerations consist of inter-generational inequity, cost recovery procedures, Generally Accepted Accounting Principles (GAAP), time value of money, rate shock, and speculative results.

1. Inter-Generational Inequity

An inter-generational inequity presently arises with PBOP costs because, under the present cash basis of accounting, future generations of ratepayers pay for the cost of PBOP benefits earned today while current ratepayers pay for the cost of PBOP benefits earned in prior years.

Except for TURN's argument in its brief and reply brief, the parties to the proceeding concur that inter-generational inequity currently exists for PBOP expenses. SoCal Gas explained that funding will ensure that the appropriate group of ratepayers funds the benefit as it is accruing, and that a pool of funds will be available to guarantee that the earned benefits will be given. The remaining utilities also believe that now is the time to correct this inequity and to properly reflect the cost of providing service. According to the utilities, failure to adopt the

Statement will result in the PBOP liability's growth to a level that will result in major rate shock to future generations of ratepayers.

Even DRA, opposed to adoption of the Statement, concurred that "If accrual accounting, as proposed by FASB, is adopted, then pre-funding will result in a more equitable distribution of the cost burden between generations. Accrual accounting results in the same generation of ratepayers paying for the benefit as was served by the employee who earned that benefit."[14]

However, adoption of the Statement without modification will not result in inter-generational equity. This is because, as testified by the Department of Navy, the Statement requires that the TBO related entirely to prior periods be amortized and included as a component of the PBOP accrual amount. The amortization of this TBO would result in a continuation of this inequity over the duration of the TBO amortization period, not to exceed 20 years. Therefore, inter-generational inequity needs to be considered in

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14 DRA represented in its comments to the ALJ's proposed decision that it never concurred with this position. However, DRA represented that if it did agree to this reasoning, it wants to rectify its mistake via its comments to the ALJ's proposed decision.

We need only to look at DRA's prepared testimony (Exhibit 23) which fostered its initial position and to DRA's response to cross-examination questions (RT 220) which memoralized its position, both of which were given under oath. We also find additional discussions of DRA's initial position in Exhibit 63 and in GTE's Phase II brief.

DRA's recanting of testimony provided under oath, which questions the credibility of its testimony as a whole, is accorded no weight and should not have been filed as part of DRA's comments to the ALJ's proposed decision, pursuant to Rule 77.3. Only factual, legal, or technical errors may be addressed in comments to the ALJ's proposed decision.

deciding whether the Statement should be adopted for regulatory accounting and ratemaking purposes.

2. Consistent Cost Recovery Mechanisms

Several of the utilities contended that rate recovery of the PBOP liability is necessary to be consistent with their current recovery of pension and nuclear decommissioning costs.

Edison, for one, asserted that adoption of the Statement would place PBOP funding on a cost basis consistent with the "cost of service" principle applied to the funding of both pension and nuclear decommissioning costs. Not only would it make available funds to pay PBOP, it would require current ratepayers to pay their full cost of service and lessen the burden on future ratepayers with a growing liability not applicable to service that the future ratepayers would receive. In addition, current ratepayers' costs would be minimized through the maximization of earnings on the PBOP funding.

The Department of Navy concurred with the utilities' assessment that the recovery of PBOP accrued funding would be on a more consistent basis with the recovery of pension and nuclear decommissioning cost. However, it asserted that consistency should not be the driving force because the objective of each recovery program is different. For example, the objective of setting aside funds for future decommissioning of a nuclear plant is in the public interest to alleviate a potentially dangerous activity which, if done improperly, could jeopardize public safety. The Department of Navy did not believe that this same public policy objective existed with respect to the funding of PBOP benefits.

DRA acknowledged that PBOP, pensions, and nuclear decommissioning funding must currently recognize the expense of liabilities that will not come due for a considerable period of time and that a long lag time creates uncertainty about the expected cost. However, DRA does not believe that the decommissioning cost recovery procedure is relevant to this investigation because, unlike nuclear decommissioning, there is no Public Utilities (PU) Code requirement to fund PBOP, and because the California Nuclear Facility Decommissioning Act required affected utilities to set up an externally managed, segregated sinking fund. DRA cited PU Code §§ 8321-8330 which provide specific funding requirements for the decommissioning of nuclear facilities.

DRA summarized that, unlike nuclear facilities, PBOP has no public health and safety impact, environmental impact, or national security interest that justifies PBOP accrual recovery similar to nuclear decommissioning costs.

DRA's and the Department of Navy's public health and safety concerns were not disputed. Such criteria may be important but do not necessarily comport with the reasonable cost of service criteria that utilities must meet to obtain an opportunity to recover costs through rates. Further, neither party substantiated the relevancy of their public health and safety concerns to the recovery of PBOP costs.

Although PU Code §§ 8321-8330 mandate a funded accrual basis of cost recovery for the decommissioning of nuclear facilities, the absence of a code section for PBOP costs, in itself, is not a basis to treat PBOP costs differently from the recovery of decommissioning costs.

DRA's arguments are irrelevant to the investigation. This is because the code sections relied on by DRA were not added to the PU Code until 1988,[15] approximately 5 years after energy utilities were authorized to implement an accrual basis of accounting for decommissioning costs pursuant to D.83-04-013, 11 CPUC 2d at 115. Similarly, the Nuclear Facility Decommissioning Act cited by DRA did not come into existence until 1985,

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15 Stats 1980, Ch 1560, Sec 5.

approximately 3 years after utilities were authorized to fund their decommissioning costs on an accrual basis of accounting. Clearly, DRA's statutory basis for treating the recovery of PBOP costs differently from the recovery of decommissioning cost is without merit.

Since developing a consistent cost recovery mechanism is an issue in this investigation, it should be beneficial to review the criteria considered in the establishment of a cost recovery mechanism for nuclear decommissioning costs. D.83-04-013 of Order Instituting Investigation (OII) 86, issued January 21, 1981, resulted from our concern that adequate funds be available for the decommissioning of nuclear facilities, and that such cost be distributed equitably over time among the customers who benefit from the nuclear plant operation. In that decision we rejected the direct operating expense method because it was found that ratepayers at the time of decommissioning would unfairly bear the total costs, and those ratepayers who benefited from the power plant operating would not bear any cost.

We used four specific criteria to assess and evaluate various cost recovery mechanisms; assurance, cost, flexibility, and equity. Although the criteria were established in 1983, nothing convinces us that the criteria are outdated. Rather than re-inventing the wheel, we will use the same criteria in this investigation. Such criteria will be applicable in this investigation to assess the various cost recovery mechanisms and to determine whether such mechanisms should be applied consistently.

DRA further believed that the pension funding method is not relevant because unlike PBOP, which have no minimum funding requirement, all entities that provide pensions are required under Internal Revenue Service (IRS)/Employee Retirement Income Security Act (ERISA) requirements to fund employee pensions on an accrual basis.

However, no party argued that PBOP are currently being paid to retirees in a manner similar to pension benefits. Since at least 1955 (D.50258, 53 CPUC 275 at 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.

Consistent cost of service policy and cost recovery mechanisms are valid concerns that need to be considered in determining whether the Statement should be adopted for accounting and ratemaking purposes.

3. <u>GAAP Consistency</u>

Pacific Bell believes that our recent trend to conform regulatory accounting with GAAP, such as in the Uniform Systems of Accounts (USOA) Rewrite including the implementation of accrual accounting for incentive awards and workers' compensation, makes it desirable to adopt the Statement for ratemaking purposes.

We concur that the accrual accounting for incentive awards and workers' compensation was previously adopted. As to the adoption of GAAP for workers' compensation, Pacific Bell was the only telephone utility impacted because it was the only telephone company which opted to self-insure its workers' compensation liability.

More significantly, Pacific Bell failed to note that the USOA Rewrite decision, 26 CPUC 2d at 349, was applicable to only regulated telephone utilities and did not automatically adopt future GAAP changes. We took great pains in that decision to make it known that we were not entrusting our regulatory accounting and ratemaking policy to GAAP. To ensure that this point was understood we ordered the major telephone utilities[16] to provide revenue impact studies to the Commission Advisory and Compliance Division (CACD) and DRA within 90 days after the FASB released new GAAP pronouncements. At the same time we told the major telephone utilities that future controversial GAAP pronouncements would result in the institution of an investigation so that the GAAP pronouncement could be considered on an evidentiary record. Regulatory consistency with GAAP is not a valid reason to adopt the Statement.

4. Time Value of Money

Southwest Gas asserted that the funding of PBOP liability would enable the utilities to take advantage of the time value of money by investing funds and earning a return thereon. This return on investment would be available to pay PBOP costs and directly result in a lower overall cost to the ratepayer.

No party disputed that returns of invested funds would result in lower overall cost to the ratepayer. However, interested parties such as DRA and the Department of Navy questioned whether ratepayers would benefit on a net present value basis if the ratepayers funded PBOP in advance of actual payment.

The Department of Navy acknowledged that an independent analysis of the long-term impact of funding on the accrual basis done by Coopers & Lybrand in a joint study with the National Association of Accountants demonstrated that an accrual funded plan would be less expensive than on a pay-as-you-go basis. However, the analysis showed that it would take approximately 23 years for the accrual funding method to achieve this advantage.

16 Pacific Bell, GTEC, AT&T Communications of California, Inc., Continental Telephone Company of California, and Citizens Utilities Company of California.

From its Exhibit 75 net present value analysis of the various utilities' PBOP costs, DRA concluded that any net benefit attributable to switching from the cash basis to accrual basis of accounting for ratemaking purposes would not occur until decades into the future. However, DRA concurred with the results of a Salomon Brothers' economic analysis incorporated into DRA's exhibit which concluded that funding under a 401(h) account or under a collectively-bargained voluntary employee benefit association (VEBA) would provide an economic advantage over the cash basis method. Unfortunately, DRA's present value analyses do not give any weight to the present value of earnings that would accumulate from the investment of accrued payments into trusts or any effect to the TBO liability. DRA's Exhibit 75 and Exhibit 93 give opposing present value results. Although the time value of money should be considered in determining whether the Statement should be adopted for regulatory accounting and ratemaking purposes, it should not be a major consideration.

5. Rate Shock

SoCal Gas believes that rate shock is best avoided by authorizing the funding of PBOP and funding the TBO amortization over a 20-year period. Failure to do so, according to SoCal Gas, would cause rate shock to some future generation of ratepayers who would finally get the bill to pay the PBOP costs.

DRA, consistent with its Phase I position, was equally concerned about ratepayer shock. However, DRA defined rate shock as a 1% or more increase in total operating revenue requirement borne by current ratepayers. By this standard even accrual funding and amortization of the TBO could constitute rate stock.

As explained in the Phase I order, rate shock should not be the driving force in this investigation. We are always concerned about rate shock. However, when the risk of rate shock is present, we have authorized procedures to mitigate the shock, such as phased-in rates.

6. <u>Speculative Results</u>

DRA believes that PBOP are too speculative to warrant rate recovery at this time. DRA questioned the availability and reliability of data necessary to measure the employers' PBOP obligations and costs. This concern was also identified in the Statement. DRA also contended that the decision on how and when to fund the obligation should not be related to when the obligation is incurred. One other major contention was that the growth components and inflation factors for labor and non-labor costs do not adequately capture medical cost increases.

Similar concerns were addressed in OII 86, and in response to our flexibility criteria to implement a decommissioning funding method. Flexibility was a primary criterion in that investigation because the mechanism being adopted had to be responsive to technical, economic, legal, and political conditions over at least the next 30 years. The same needs hold true in this proceeding.

In view of the many uncertainties, we deem it very important that the financing mechanism adopted in this order be adaptable. Consistent with this position, the funding mechanism and payments should be evaluated in each operating utility's GRC or other rate proceeding. At that time, operating experience and any changes in cost-related factors would be reviewed and adjustments made similar to the review controls implemented by Ordering Paragraph 7 of our Phase I decision.

X. Alternative PBOP Funding Sources

Traditionally, operating costs are paid for by the utilities' ratepayers. However, because of the magnitude of PBOP liability and future costs, we were interested in considering alternative funding mechanisms. Alternative sources included shareholder contributions, employee contributions, and the transfer of funds from other funds such as pension funds. Parties were requested to address such alternative sources.

A. Shareholder Contributions

Shareholder contributions can be a potential source for funding PBOP benefits. However, Edison and other utilities pointed out that the basic cost of service ratemaking procedure dictates that the utilities should have the opportunity to receive sufficient revenue in rates to recover their reasonable operating expenses, including PBOP costs, taxes, and a fair return on invested capital.

As early as 1914, the Commission held that the real controlling element in fixing rates is what it costs the utility to perform the service, Fesler v Pacific Tel. & Tel Co., 4 Cal R.R.C. 711 (1914). Subsequently, the U.S. Supreme Court clearly established in F.P.C. v Hope Natural Gas Co., 320 U.S. 591 (1944), that shareholders in regulated firms must be allowed the opportunity to earn returns that are sufficient to attract capital and are comparable to those they would expect in the unregulated sector for bearing the same degree of risk.

As delineated in the aforementioned Fesler and Hope Natural Gas Co. decisions, the utilities' cost of doing business, including PBOP costs, is properly recoverable from ratepayers through the cost of service. Unless the regulatory policy of allowing utilities to recover reasonable costs incurred in the performance of utility service is changed, which we do not intend to do at this time, the use of shareholders' funds to pay for PBOP benefits is not a viable alternative to ratepayer funding.

B. Employee Contributions

Another alternative to ratepayers funding PBOP could be employee contributions. In this regard, DRA does not believe that the utilities have seriously considered the cost shifting of health care costs. Therefore, DRA recommended that the utilities become more pro-active in labor negotiations to minimize ratepayer burden in funding PBOP and that the utilities work toward the establishment of health cost containment programs and a shift of employers' PBOP costs to their employees.

DRA specifically recommended that the cost containment program be restructured in a way that benefits would be provided by giving the employers more control over what prices are charged. This could include the establishment of health maintenance organizations and preferred provider organizations and giving the employee a direct role in the drafting of insurance contracts and the price schedules for medical procedures and services.

Alternatively, DRA recommended that defined contribution PBOP plans, similar to defined contributions pension plans, could be established whereby the employer allocates a specified amount to each employee's account and relinquishes the investment decisions to the employee through investment options available in the market.

Under DRA's alternative scenario, the employee would be responsible for using the money to purchase health insurance after retirement. Pursuant to such an arrangement, the contributions would be tax deductible for the employer and by definition, the employer will have no PBOP liability beyond its annual contribution, even though contributions may not cover the entire amount of health insurance costs incurred during retirement. However, any PBOP received by an employee may be taxable to the employee.

DRA's proposal to shift PBOP costs from employers to employees is not a new idea and has already been aggressively implemented by many of the utilities. For example, Pacific Bell has taken steps to involve retirees in the payment of health care cost. Effective January 1, 1993, Pacific Bell limited its contribution towards the cost of retiree medical benefits for all employees who retire on or after January 1, 1991 and restricted Medicare Part B premiums.

Similarly, SDG&E has implemented PBOP cost containment and employee sharing programs. In SDG&E's case, those employees who retired prior to January 1, 1987 pay a portion of the medical insurance premium for their dependents age 65 and over, and those who retire after December 31, 1986 pay the difference between a fixed monthly contribution by SDG&E and the full cost of medical coverage.

As acknowledged by DRA, any change to PBOP applicable to represented employees would require the utilities to negotiate with their employee unions. Under the National Labor Relations Act (NLRA) regulators and others are precluded from prescribing outcomes for collectively bargained agreements. This means that management and labor negotiate or otherwise agree to any compensation levels or arrangements free from outside interference, regulatory or otherwise. However, there is no regulatory assurance that unfair or unreasonable arrangements will receive rate recovery. Such assurance has generally been reserved for GRC type proceedings where employee benefits and costs are closely scrutinized in unison with the results of the total negotiated package.

PBOP cost containment and shifting of PBOP costs from the utilities to the employees are viable supplements to the PBOP revenue recovery issue. However, such activities will not replace the need for ratepayer funding. Therefore, employee funding is not viable as a complete alternative funding source for PBOP costs.

The utilities are encouraged to continue with their PBOP cost containment programs and employee sharing efforts to the extent that such activities result in fair and reasonable costs for the services being provided. At the same time, DRA is encouraged to continue monitoring and reviewing the reasonableness of the utilities' PBOP cost activities.

C. Pension Funds

Excess pension assets are another potential source for funding PBOP. Pension plans could be used two ways to fund PBOP.

First, existing pension plans could be modified to include PBOP. The advantage of this method is that a utility's PBOP contribution would be tax deductible and the plan income would be tax free with the provision for unlimited contributions so long as they are reasonable, necessary, and do not exceed the maximum benefit limits. There are two major disadvantages. First, the utilities would need union approval. Second, it would transform PBOP, which are tax free to retirees, into a taxable benefit in the form of pension payments. The taxability to retirees may result in higher cost to the ratepayer unless the utilities can negotiate a non-monetary benefit with the unions for giving up a tax-free benefit.

The second method of utilizing the pension fund as a source of PBOP funding was created by the passage of the Omnibus Budget Reconciliation Act of 1990. This allows employers to transfer annually a certain portion of excess pension assets to an Internal Revenue Code (IRC) § 401(h) retiree medical account. The primary disadvantage of this method is that IRC § 420 provides for limited transfers of excess pension assets to a § 401(h) account only for the years 1991 through 1995, and only if the pension plan is in full funding and if assets exceed 125% of the current liability. This method would also require acceptance by the unions.

The second method could be applicable to only those utilities that have surplus pension assets as defined by the IRS. Most do not. To date, only the major telephone utilities, such as GTEC and Pacific Bell, are alleged to have surplus pension assets. However, even DRA acknowledged that the conditions imposed in the Omnibus Budget Reconciliation Act of 1990 make it unlikely that the utilities with surplus pension funds will transfer pension funds to pay for PBOP. Finally, an analysis of the cause of the surplus situation would be necessary to obtain reasonable assurance that the surplus situation will not be reversed in a subsequent year, resulting in additional or excessive costs to the ratepayers. Such assurances are unlikely to be available.[17]

DRA has recommended that PBOP costs be used only to pay for PBOP. If DRA's recommendation is to be adopted, consistency should prevail. Similar to restricting PBOP costs to pay for only PBOP, pension costs should be restricted to pay for only pension benefits. Surplus pension assets, as they occur, should be investigated and, if necessary, adjusted in GRC or other rate proceedings. The use of surplus pension assets is not a viable alternative source of funding PBOP costs at this time. However, we do not want to preclude utilities from using surplus pension assets to fund PBOP expense. Therefore, to the extent that the IRS lifts its restrictions and the employee unions agree to the use of surplus pension assets to fund PBOP expense we fully expect the utilities to do so.

D. Summary of Alternative Sources to Fund PBOP Costs

None of the alternative funding sources is a viable option to ratepayer funding. However, except for stockholder funding, the alternative sources along with the tax deductible funding plans identified in Ordering Paragraph 4 of D.91-07-006 can be used to supplement and reduce ratepayer funding.

17 Generally, surplus and deficit pension assets result from volatile changes in the investment markets which cannot be predicted with any accuracy. Just such a situation occurred on October 19, 1987, more commonly known as Black Monday, the day which the Dow Jones Industrial Average dropped 508 points, the largest single drop, both numerically and as a percentage, in its history, 27 CPUC 2d at 550. Similarly, Pacific Bell explained that its pension assets experienced a $1 billion loss in 1990 due to highly volatile investment markets.

XI. Regulatory Accounting and Ratemaking Adoption

Cost of service is an indispensable factor in setting fair and reasonable rates for regulated service. Even the rates for telecommunication utilities under the NRF are based on cost of service. Specifically, NRF adopted a form of incentive regulation based on the utilities' cost of service. In addition, a Z factor adjustment was implemented to reflect exogenous factors which could affect utility costs to an extent warranting an explicit rate adjustment, decreases as well as increases. Therefore, if we are to adopt the Statement for regulatory accounting purpose, we must find that the Statement meets the Commission's cost of service criterion, which distributes the cost equitably over time among the ratepayers who benefit from the service being performed.

A. Regulatory Accounting

There was no dispute that PBOP costs are a legitimate cost of providing service. The dispute, fostered by DRA, was that only the cash basis of accounting would reflect how PBOP are being provided by the utilities.

According to DRA, the contracts between the utilities, their unions, and PBOP providers, stipulate that PBOP claims must be paid as incurred, on the cash basis. More specifically, DRA contended that PBOP are deemed to be earned upon retirement and not over the working life of the employee, and that employees are not entitled to receive PBOP until they retire and incur claims. Further, unlike pensions, employees do not earn additional benefits for each additional year worked nor are the employees legally entitled to receive the benefit until they retire and incur costs.

However, DRA did not substantiate its assertions. Excerpts from the utilities' retiree's benefit handbooks (attached to DRA's Exhibit 75 as Appendix 6) did not confirm DRA's conclusion that PBOP are earned upon retirement. On the contrary, the appendix confirmed that employees do not qualify for PBOP unless they specifically provide service for a specific minimum period of time.

"To earn" is defined as "to gain or [to] deserve for one's service, labor or performance."[18] In other words, nothing is given for free. In the case of Edison, employees who retire from Edison on or after January 1, 1991 who were hired prior to August 1, 1983, or who complete at least 10 years of service prior to retirement will receive medical, dental, and vision care coverage. Therefore, Edison employees must dedicate a minimum of 10 years of their working life to receive any PBOP.

Employees may not be entitled to receive PBOP until they retire and actually incur cost. However, except for the incurrence of cost, the same principle is applicable to employees receiving pensions. The incurrence of cost is a different matter. Although PBOP do not provide for a defined payment, the benefits are based on actuarial assumptions very much like pension benefits. As a matter of fact, the PBOP actuarial reports offered into evidence, such as PG&E's, applied actuarial assumptions consistent with the actuarial assumptions used in their pension reports.

We find DRA's argument that employees do not earn additional PBOP for each additional year worked as they do for pension benefits to be a red herring. If DRA considered the above-mentioned Edison example, it would find that the longer the employees work for Edison, the lower cost the provision of benefits by Edison's ratepayers. That is, if every Edison employee retired after 20 or 30 years of service instead of after 10 years of service, the cost of PBOP, assuming no reduction in work force and no change in benefits, would substantially decrease to the ratepayers because the same cost would be spread over an additional 10 or 20 years depending on whether the employees retire upon 20 or 30 years, respectively.

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18 1976 edition of the New College Edition of the American Heritage Dictionary of the English Language.

DRA also pointed out that PBOP are difficult to determine because a majority of the utilities' plans allow the utilities to amend or even terminate the plans. For example, Edison provided in its collective bargaining agreements that Edison may modify the PBOP plans to provide any benefits prescribed by law, or to minimize the adverse impact on cost imposed by law, tax, or regulatory authority. The agreement also provided that such modifications would not, except as provided in its plans, increase the cost of such benefits to retirees. Similarly, Pacific Bell reserved its right to modify the plans at any time.

Although the benefit plans may be subject to change, approximately one-third of the TBO, as testified to by SoCal Gas, represents benefits for retirees. Edison testified that approximately one-third of its 1993 accrued expense would relate to its retirees. As explained in DRA's exhibit, there are a number of court decisions that have held that postretirement welfare benefits are "status" benefits which, in fact, do vest upon retirement and therefore, employers are unable to terminate or modify plan benefits for retired employees. This means that benefits applicable to one-third of the TBO would not be affected by a change in plan benefits.

The remaining two-thirds and the yearly accrual applicable to current employees could be subject to change. However, similar to the determination of pension benefits, actuarial reports would be performed on a periodic basis to reflect changes in actuarial assumptions, including plan benefits, inflationary factors, and mortality rates. With the results of periodic actuarial reports PBOP costs may be adjusted within a reasonable period of time to fairly accurately reflect the cost of current PBOP.

The utilities argued that, in the past, the cash basis of accounting for PBOP costs was the acceptable practice because the obligation was not a significant amount of money. However, with the recent escalation in health care costs and increased longevity of retirees it became very apparent to them that there was a need to recognize these obligations on a current (accrual) basis to more accurately represent the net periodic PBOP costs and liability in a consistent manner. The utilities believe that the Statement must be adopted for accounting purposes if their regulatory financial statements are to properly reflect the periodic PBOP costs and liability in a manner consistent with its cost to provide utility service.

Absent evidence to the contrary, we must conclude that the Statement's method of accounting for PBOP on the accrual basis meets the cost of service criterion. Therefore, the Statement should be adopted for regulatory accounting purposes to properly reflect cost of service in the utilities' financial statements.

B. Ratemaking Recovery Procedure

Although the Statement is being adopted for regulatory accounting purposes, there is no requirement that PBOP be funded on a basis consistent with the Statement. The Statement specifically concluded that the decision on how or when to fund the PBOP obligation is a financing decision and not an accounting issue.

Therefore, we may require the utilities to fund PBOP on the cash basis as recommended by DRA or the accrual basis as recommended by the utilities. The Department of Navy did not clearly explain its position on whether the cash basis or accrual basis of accounting should be adopted.[19] To the extent that full

19 In its brief, the Department of Navy recommended that rate recovery be restricted to the cash basis until "much of the uncertainty is resolved" concerning developments affecting health care. However, its witness testified under oath that ratepayers should pay for PBOP costs on the accrual basis to the extent that the utilities are able to use tax-advantaged funding methods. Its

(Footnote continues on next page)

funding is not authorized, the Statement acknowledged that regulated utilities may establish a regulatory asset and/or liability as identified in FASB's Statement No. 71 (Statement No. 71), accounting for the effects of certain types of regulation.

This is the appropriate place to utilize the assurance,[20] cost,[21] flexibility,[22] and equity[23] criteria. OII 86 established four criteria useful to compare the cash basis of revenue recovery with the accrual basis of revenue recovery (Navy and utilities). They are assurance, cost, flexibility, and equity.[24]

Under the cash basis of revenue recovery, there would be no advance provision for PBOP. The cost associated with PBOP would be considered normal utility operating expenses and collected from

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(Footnote continued from previous page)

witness also testified that if PBOP prefunding amounts were included in rates that the recovery of this expense would be on a more consistent basis with the recovery of pension expense and nuclear decommissioning costs.

20 The degree of certainty that the operating utility will have sufficient funds available to pay the cost.

21 The cost which operation of the financing mechanism adds to the total cost of PBOP costs.

22 The ability to respond to changes relevant to factors such as inflation, cost escalation, tax treatment, and the ability to make the best interim use of funds.

23 To charge ratepayers at any given time in relation to the net benefits they are receiving.

24 Although the utilities recommended variations to the accrual basis ranging from the recovery of only tax-deductible cost to recovery of the entire accrual required by the Statement, no differentiation was given to the various accrual levels in the comparison.

the ratepayers in the year that the utilities pay the expense. Adequate funding would be guaranteed only by timely regulatory approval of increased PBOP expenses and by the ratepayers' ability to absorb the additional costs. Clearly, given the parties' agreement that PBOP costs are substantial and increasing, the cash basis of accounting cannot meet the assurance or flexibility criteria.

It could be argued that the cash basis meets the cost criterion. However, this is questionable. As addressed in our time value of money discussion, there was considerable disagreement over the relative present value analysis of the various recovery proposals. Although, as a general principle, the present value of a payment falls if it is postponed further into the future, DRA's present value analyses failed to reflect the substantial accumulated cash investment in trust that would be available to fund PBOP at a future period of time.

Most importantly, the cash basis of recovery ignores equity because it fails to incorporate the cost of service principle of charging ratepayers at any given time in relation to the net benefits they are receiving. Instead, it exacerbates inter-generational inequity.

On the other side, the accrual basis of revenue recovery would meet the assurance criterion and provide a degree of certainty that sufficient funds will be available to pay the utilities' PBOP costs to the extent that such funds were reasonably invested, such as in the Trust plans approved in the first phase of this investigation.

Cost should not be an adverse factor if an accrual revenue recovery mechanism is authorized. Differences may occur depending on whether payment is impacted by the utilities' net-to-gross factor.

The flexibility criterion would also be met because the utilities would be able to assess PBOP on an ongoing basis and make periodic changes in response to components such as inflation, plan changes, cost escalation, and tax treatment. Periodic scrutiny and adjustment of such costs prior to actual incurrence would be possible through actuarial reports and through rate review proceedings.

Most importantly, the accrual recovery method would ensure that the equity criterion is met and that the current inter-generational inequity is resolved. Recovery of the annual accrued PBOP costs in rates would assure that the same generation of utility customers who were the recipients of that employee's service, paid the costs of an employee's benefits. Further, considering the trend toward increasing competition in the energy and telecommunications markets, deferring the payment of PBOP obligations to the future may prove to be a substantial burden to a smaller base of ratepayers.

Upon consideration of the cash and accrual bases in relationship to the financing criteria, we conclude that the cash basis is inequitable. The accrual recovery method would provide a reasonable approach for the recovery of PBOP costs and balance ratepayers' interests with the stockholders' interests. Therefore, the utilities should use the accrual method for ratemaking recovery of PBOP expense effective January 1, 1993.

C. <u>Attribution Method</u>

The Statement requires that the "benefits/years-of-service approach" be used to assign PBOP costs to periods of employee's service. This approach assumes that the total benefit is earned equally over the period from an employee's date of hire to the employee's "full eligibility date," which is the date on which an employee has completed the contractual requirements for eligibility for all PBOP the employee is expected to receive.

For example, under PG&E's medical plan, employees are entitled to retire and to receive PBOP at age 55. If an employee starts working for PG&E at age 25, the Statement's attribution method would require PG&E to recognize the employee's PBOP costs from the date hired through the employee's 55th birthday, even though the employee is expected to work an extra 10 years, until the employee is 65.

The Department of Navy identified industry concerns regarding the Statement's attribution method, including its failure to assign costs of providing the PBOP over the employee's entire expected working life, and its resulting in an unduly accelerated recognition of the PBOP obligation and its corresponding expense.

Although no party presented any testimony on what impact the employee's total expected service life attribution method would have on the utilities' PBOP cost and liability, the Department of Navy does not believe that benefits/years-of-service attribution method would be desirable for ratemaking purposes. Therefore, it recommended that the employee's total service life attribution method be considered in recognition that something less than the full Statement accrual amount would be a more appropriate cost level to reflect in rates.

Although not identical, a similar situation existed in Investigation (I.) 87-02-023 in which we considered whether the Federal Communications Commission's USOA should be adopted for telephone companies under our jurisdiction, 27 CPUC 2d at 550. Specifically, at issue was whether the cost of employees' estimated pension benefits should be recovered over the future working lives of the employees or whether the unit credit method should be adopted. Under the "unit credit method" the cost of employees' pension benefits would increase each year to recognize increased benefits earned. In other words, the cost would increase each year to reflect an increase in age, an additional service year, and any change in pension benefits due to any salary change.

In that investigation, we concluded that employees are promised benefits at retirement and that benefits at retirement are what the employee is actually earning. We also concluded that the assignment of a consistent amount of pension expense from year to year was reasonable and should be adopted.

Similar to the unit credit method, the benefits/years-of-service method would provide for a disproportionate allocation of benefits cost over the employee's working life. However, in this instance, the cost would be front loaded with cost assigned to the employee's early working life with little or no cost assigned to the later years of the employee's working life. Consistent with our USOA investigation, it is reasonable to flow through the cost of the employee's PBOP benefits over the employee's entire working life. Therefore, the utilities should use the employee's total utility service life attribution method of distributing the cost of employees' PBOP for both the TBO and ongoing PBOP costs. The Statement's benefits/years-of-service approach should not be adopted. However, in these instances where the utilities can substantiate to CACD that the benefits/years-of-service approach would result in no differences in expense or would result in minimal[25] differences the benefits/years-of-service approach may be used. Such substantiation should be made prior to January 1, 1993.

D. <u>TBO Amortization</u>

The Statement provided the utilities an option of amortizing the TBO over the average remaining service period of their active employees' service life or over a 20-year time period.

Irrespective of the regulatory method adopted for recovery of the utilities' projected $5 billion TBO, intergenerational inequity will continue to exist until such costs have been fully amortized. However, this inequity will be substantially

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25 Minimal, in this specific instance is defined as 10% (percent) or less than the total utility service life attribution method.

mitigated because the TBO is not applicable solely to retired employees.

According to SoCal Gas's testimony, only one-third of its respective TBO is applicable to retired employees. This means that the remaining two-thirds is applicable to employees currently in their work force and expected to remain in that work force for a number of additional years. Therefore, to the extent that the TBO applicable to current employees is amortized while the active employees continue to work, the inter-generational inequity would be mitigated.

To put this in perspective we considered the inter-generational inequity impact on SoCal Gas, whose current employees were expected to have an average future working life of 20 years. If the 20-year amortization period is adopted, then two-thirds of SoCal Gas's TBO would escape inter-generational inequity, and only one-third, or $88.7 million of its $266 million total TBO would result in inter-generational inequity. This means that if each utility's experience factors matched SoCal Gas's retired employees' TBO ratio of one-third and SoCal Gas's current employees' average future working life of 20 years, then amortization of the $4,742 million total TBO for all utilities would result in a $1,580.8 million inter-generational inequity instead of a perpetual inter-generational inequity under the current cash basis of recovery.

The 20-year TBO amortization method will not eliminate inter-generational inequity. However, it will substantially mitigate the inequity. If the average future working life of the utilities' employees exceeded 20 years, then the inequity would be further mitigated. The record is incomplete on this issue and we find it highly unlikely that such a situation would exist. Therefore, to assure equal treatment among the utilities we will require the utilities to utilize a 20-year amortization period for their respective TBO.

E. Recovery of PBOP Accrual

Two distinct recovery proposals for regulatory ratemaking were recommended if the Statement is adopted. One proposal was that rate recovery be limited to only those contributions made to tax-deductible plans, similar to the authority granted for pre-funded contributions in the first phase of this investigation. Those parties that recommended the tax-deductible proposal included the Department of Navy, PG&E, SoCal Gas, and Southwest Gas. DRA also endorsed the tax-deductible proposal to the extent that such plans would accumulate earnings tax-free.

The other proposal was the full recovery method whereby utilities would recover their entire PBOP contributions currently, whether placed in tax-deductible or taxable plans. Parties that recommended full recovery included Edison, GTEC, Pacific Bell, and SDG&E.

We have already taken steps to mitigate rate shock by requiring the utilities to use the employee's total service life attribution method, except in those instances where the utilities can substantiate that the benefits/years-of-service approach will have minimal impact, in assigning PBOP costs to the periods of time that employees actually provide utility service and by adopting a 20-year amortization period of the TBO. However, to authorize the utilities full recovery would place an unnecessary financial burden on ratepayers. This is because the non-tax-deductible proposal would require ratepayers to compensate the utilities for income taxes applicable to the non-taxable contributions. In other words, ratepayers would be required to pay an additional $670,000 for every $1 million that the utilities contribute to such a plan, according to DRA's net-to-gross calculations, with no additional benefit going to ratepayers.

Clearly, the tax-deductible recovery proposal would better balance the relative interests of shareholders and ratepayers. Ratepayers would be required to pay a reasonable cost of service and shareholders would be given a reasonable assurance that PBOP costs would be recovered from ratepayers. This stockholder assurance would be provided by the establishment of a regulatory asset which would reflect the difference between the utilities' total PBOP liability and the amount currently being paid by ratepayers. Therefore, the water, energy, and telecommunications utilities under traditional ratemaking process and the telecommunications utilities under the NRF should recover their PBOP costs in rates to the extent that they are able to make tax-deductible contributions to tax-deductible plans.

The choice of tax-deductible plans is a management decision which should be made by the individual utility. To provide utility management greater flexibility in funding and controlling PBOP costs and benefits, the utilities should be granted authority to implement trusts whose earnings may be taxable to the trust or to the employees.

F. <u>Regulatory Asset</u>

The utilities generally maintain two sets of financial statements, one for regulatory purposes and the other for external purposes (e.g., for the Securities and Exchange Commission (SEC) and shareholders). For external (non-regulatory) purposes the utilities are required to prepare their financial statements in accordance with the FASB accounting standards. Although FASB allows utilities to reflect a regulatory asset in their external financial statements, financial statements integrity requires regulatory assurance that the regulatory asset will be recoverable in future rates.

1. <u>Regulatory Assurance</u>

FASB's Statement 71 provides specific guidance in preparing general purpose financial statements by regulated utilities. Among other components, Statement 71 allows for revenues intended for the recovery of costs to be provided for in rates either before or after the costs are actually incurred by the utilities. Therefore, in those instances where a regulatory agency, such as this Commission, provides assurance[26] that already incurred costs will be recovered in the future, the utilities are required to capitalize those costs as a regulatory asset. This new asset represents future cash inflow that will result from the ratemaking process.

To qualify as a regulatory asset there must exist probable cause to believe that the full amount of the capitalized regulatory asset will be recovered in future rates. In addition, there must be reasonable assurance that future revenues will be provided for the cost recovery of the regulatory asset, rather than the expected levels of similar future costs. Absent such assurance, the utilities would be required to expense their unfunded PBOP costs for external financial statement purposes thereby reducing their operating incomes which, in turn, would adversely impact their financial positions.

a. <u>Traditional Cost of Service Regulation</u>

DRA believed that the cost-effectiveness standard, which measures the reasonableness of cost, would provide sufficient regulatory assurance to enable utilities to record deferred PBOP costs as a regulatory asset under Statement 71. DRA relied on the minutes of a April 19, 1991 meeting between the SEC and the American Institute of Certified Public Accountants' Public Utilities Committee (AICPA Committee). The minutes read, in part, that the SEC staff believes that if the regulator has indicated it

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26 FASB No. 71 provides for the recording of an asset in those instances where rate actions of a regulator can provide reasonable assurance of the existence of an asset to the extent that it is probable, or believed on the basis of available evidence or logic, but is neither certain nor proved, that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.

will allow the costs in rates on a pay-as-you-go basis, PBOP accruals may qualify as regulatory assets.

DRA does not, however, believe that Commission policy should be driven solely by whether or not utilities can record a regulatory asset under Statement 71. Rather, DRA believes that sound regulatory policy requires that recovery of PBOP costs be driven by economic efficiency, cost-effectiveness, and prudency.

The utilities relied on the same meeting minutes. However, they concluded that the SEC was concerned about the lack of evidence presented by registrants supporting the deferral of incurred costs under Statement 71. Edison explained that DRA overlooked that the minutes of the meeting further stated that the SEC staff recognizes and believes that the PBOP regulatory asset concerns expressed by the AICPA Committee are valid and that the SEC staff indicated they would like to continue discussions with the Committee on this issue.

Subsequent to the April 1991 meeting, the AICPA Committee chairperson informed Edison that a majority of the Committee members had serious problems with allowing the creation of a regulatory asset for the utilities to record the difference between the pay-as-you-go method and the Statement method. However, the chairman indicated that a majority of the members felt that if tax-deductible funding were recoverable in rates and regulatory assurance were provided for future recovery of the excess PBOP expense, strong enough evidence would exist for utilities to set up a regulatory asset under such conditions.

SDG&E further explained that the large dollar amounts, trends, periods covered, and changing regulatory and business environments make it difficult to obtain reasonable assurance that PBOP cost recorded as a regulatory asset will be recoverable in the future.

Both DRA's and the utilities' understanding of what transpired at a meeting between the SEC staff and AICPA Committee are based on incomplete information. However, it is apparent that the SEC has not taken a policy position on what criteria should be used to determine whether a regulatory asset should be allowed or what level of assurance needs to be given by the regulatory agencies.

We find it interesting that the SEC, and not the FASB which established Statement 71 and the mechanism for recording a regulatory asset, is purported to be considering compliance requirements for the establishment of a regulatory asset.

We concur with DRA that Commission policy should not be driven by whether or not utilities can record a regulatory asset under Statement 71. Consistent with our position that rate recovery should not be governed by IRS/ERISA requirements, recovery should not be governed by SEC policy or by SEC staff requirements or review.

The utilities should establish a regulatory asset in their regulatory and external financial[27] statements to reflect their yearly differences, if any, between their PBOP expense determined in accordance with the statement and their tax-deductible contributions recovered in rates. Recovery of tax-deductible contributions in any given year should not increase over the prior year's PBOP expense recovery by more than 1% of the utilities' total prior year's operating revenue to mitigate potential rate shock. The establishment of a definitive level for rate shock in this proceeding is based solely on the facts and circumstances applicable to PBOP. The definitive level is not, and should not be viewed as a precedent for any other proceeding. Additionally, the 1% control is intended to be used as an incentive to the utilities in maintaining management control over the

27 We have no jurisdiction over external financial statements. Our recommendation for such statements is advisory only.

ultimate level of PBOP. Recovery of the regulatory asset should begin during the year when tax-deductible limits exceed PBOP costs and continue until the regulatory asset has reached a zero balance.

Although the parties to this investigation recommended that regulatory assurance language be included in rate orders which address rate recovery of PBOP costs, no witness suggested specific language. The first suggestion came in Edison's brief. Edison provided the following language as intended to meet the FASB regulatory assurance criteria:

> a. Any accrued annual PBOP expense under the Statement in excess of PBOP expense recovered in rates shall be deferred as a regulatory asset.
>
> b. All PBOP expense deferred in the above ordering paragraph shall be recovered in future rates. Recovery of this deferral in rates will begin no later than during the year when tax-deductible limits exceed PBOP expense calculated under the Statement. This recovery would then continue until the regulatory asset is eliminated.

Edison's proposed language is reasonable for the energy, water, and telecommunications utilities under traditional cost of service regulation and should be adopted after being clarified in two respects: First, to reflect that only accrued annual PBOP expense, calculated in accordance with the Statement, resulting from reasonable PBOP costs will be recorded as a regulatory asset in their external financial statements and recovered in future rates. Second, to ensure that the yearly PBOP expense is calculated in accordance with the Statement procedure, as modified in this order to reflect the employees' total utility service life attribution method and a 20-year TBO amortization period.

"Reasonable PBOP costs" will be those applicable to regulated services that meet the Statement criteria as modified by this order, that are invested in tax-deductible plans administered by an independent trust, that the Commission finds are reasonable and necessary to meet funding requirements based on fair actuarial assumptions, contributions, and investments, and that are not used to enhance pension benefits.

b. <u>NRF Incentive Regulation</u>

DRA also recommended that a regulatory asset be established for GTEC and Pacific Bell, both of which are under the NRF.[28] In support of its recommendation DRA explained that these utilities currently have regulatory assets recorded in their financial statements. DRA observed that both utilities intend to record a new regulatory asset resulting from adoption of a different FASB statement, FASB 96.

Pacific Bell clarified that all regulatory assets currently reflected in its financial statements are supported by Commission rate orders that were in place prior to NRF implementation and that future recovery of the deferred costs associated with those orders was built into its start-up revenue adjustment. However, in order to defer new costs under Statement 71, a specific order promising future recovery is needed.

GTEC believes that the recovery issue is much more difficult for utilities operating under incentive regulation because of the limited recovery methods available in the NRF process. To the extent that such new costs are not included in the

28 Under NRF a sharing mechanism is used, whereby any utility earning above a benchmark rate of return set 150 basis points higher than the expected market-based rate of return will be shared equally between shareholders and ratepayers. A cap on returns equal to 500 basis points above the market-based rate of return is also established above which all excess earnings would be returned to ratepayers.

Gross National Product Price Index (GNPPI), it believes that recovery must be specifically granted via the "Z" factor.[29]

GTEC further believes that if Z factor recovery is approved it would be difficult to record a regulatory asset absent specific language as to the recovery amounts and time period, and absent scrutiny of the recovery plan. For example, any further reregulation prior to completion of the deferral period should be evaluated to determine if the PBOP expenses associated with the new deregulated services can continue to be recovered after deregulation occurs. GTEC contends that if recovery cannot continue, then the associated regulatory asset must be written off immediately.

We have already concluded that the Statement should be adopted for regulatory accounting and ratemaking purposes with adjustments, and have established recovery language in our discussion on traditional cost of service regulation. Our consideration of Z factor recovery for NRF utilities follows in Section XIV.

GTEC's deregulation concern is premature. For example, yellow page directory services and inside wire services developed at ratepayers' expense and subsequently detariffed or deregulated are currently reflected in the NRF sharing calculation. Any concern regarding recovery of PBOP costs associated with future deregulated services should be addressed in the proceeding that considers deregulation of those services.

The utilities under NRF should establish a regulatory asset in their regulatory financial statements to reflect yearly differences, if any, between their PBOP expense determined in

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29 Z factor is an adjustment to the price cap formula which reflects cost increases beyond those which will be picked up in the economy-wide inflation factor of the NRF formula.

accordance with the statement and their allowable tax-deductible contributions. We advise these two utilities to provide similar treatment in their external financial statements.

2. Rate Base Consideration

The utilities were divided as to whether the regulatory asset should be given rate base treatment. However, DRA recommended that regulatory assets should not receive rate base treatment and that if we determined it imprudent to fund PBOP costs beyond some level, ratepayers should not be burdened with the responsibility to pay a return on funding PBOP in excess of the prescribed level. DRA took this position because the utilities would not be funding the regulatory asset. According to DRA, its position to exclude the PBOP regulatory asset from rate base was also the position of Edison, PG&E, and SoCal Gas.

Three utilities recommended that rate base treatment be given to the PBOP regulatory asset. The utilities that recommended such treatment were GTEC, Pacific Bell, and SDG&E. However, SDG&E clarified that rate base treatment was dependent on whether its regulatory asset was being funded.

DRA recommended that the utilities be ordered not to include any PBOP regulatory assets in rate base without explicit authorization to do so. There was very little testimony on this issue. However, because the regulatory asset will not impact the utilities' cash flow until the utilities are able to make additional tax-deductible contributions, we concur with DRA and will adopt DRA's recommendation that PBOP regulatory assets not be included as part of rate base.

XII. Legislative Impacts

In opening this investigation we were generally aware that Congress was considering a bill which, if passed, would allow the transfer or use of excess pension assets for PBOP. We immediately recognized that this could be an effective way of funding PBOP because it would not involve additional charges to current ratepayers and it would not result in any loss of tax revenue to the United States Treasury. Therefore, Congressional legislation was identified as an issue and respondent utilities were requested to report the effects of any proposed Congressional legislation related to PBOP in the second phase of this investigation.

Except for SoCal Gas, the respondent utilities were not aware of any Congressional legislation that could potentially affect PBOP. Although SoCal Gas testified that it was aware of several bills that have been introduced which could potentially affect PBOP, it was not able to identify any specific bills or to provide a current status of such bills at the evidentiary hearing. SoCal Gas did testify that because there was no real consensus formed to support any of the bills that any possibility of such bills being passed was pure speculation.

Of the three interested parties participating in this phase of the investigation, only DRA addressed potential legislative impacts. DRA's testimony corroborated the respondents' general consensus that there was no pending legislation. However, DRA did recommend a list of areas that should be explored in considering the effects of proposed Congressional legislation.

DRA's checklist may be helpful in analyzing the effect of future legislation. However, such a checklist is not useful in this proceeding because no party has identified any pending legislation that the checklist could be applied to. DRA apparently agrees with this conclusion because its witness recommended that this proceeding not remain open to consider potential future legislation. Absent any testimony to the contrary, the legislative impacts issue need not be addressed as it has no present impact in this investigation.

XIII. Safeguard Mechanism

An integral part of our PBOP investigation is to address safeguards needed to protect ratepayers' interest upon the adoption of accrual accounting for PBOP. Three safeguard concerns were identified in this phase of the investigation. Two of the concerns are identical to the safeguard concerns addressed in the first phase of this investigation. They are that PBOP funded amounts will be used for only PBOP and the need for necessary monitoring procedures to track plan activities and performance. The third concern (not previously addressed) is whether full recovery of accrued PBOP will reduce incentives for the utilities to aggressively negotiate PBOP with employee unions.

DRA acknowledged that regulators, such as the Commission, are prohibited under the NLRA and by court decisions from "prescribing" outcomes for collective bargaining. However, DRA emphasized that the utilities are given no regulatory assurance of rate recovery for negotiated agreements between the utilities and the unions for unfair or unreasonable arrangements. Such regulatory review of negotiated agreements has traditionally taken place in general rate proceedings. However, DRA is concerned that there is no safeguard to prevent the utilities' management from conducting labor negotiations between test years in order to maximize excess funding. Therefore, DRA concluded that adoption of the Statement for ratemaking purposes may risk unreasonable funding, resulting in both rate shock and rate volatility.

On the other side of this issue, the utilities asserted that full funding of PBOP will not, in any way, compromise good faith negotiations with unions regarding the level of retirement benefits provided to employees.

PG&E's Richard Weingart explained that although the NLRA's good faith bargaining rule does not have a provision which protects ratepayers' interest, the utilities maintain a strong economic motivation to negotiate labor contracts which reduce the overall cost of the utilities' operations. This economic motivation is enhanced by expanded competition within the industry requiring the utilities to keep their rates within a competitive level.

Weingart further explained that it is not appropriate to isolate a single issue, such as PBOP, in the broad context of the collective bargaining process because collective bargaining encompasses a multitude of issues which require the giving and taking of concessions. From the utilities' perspective, a primary interest in the collective bargaining process is controlling the costs of operations. To assess that controlling interest one can not assess the reasonableness of PBOP as a single issue without regard to other provisions agreed upon in the negotiation of a labor agreement.

Irrespective of assessing PBOP as a single negotiation issue, several of the utilities substantiated that they have reduced and are continuing to reduce PBOP costs through the collective bargaining process. For example, PG&E implemented several PBOP plan changes as a result of it's 1991 contract negotiations which resulted in a PBOP cost reduction of approximately $4 million. Pacific Bell's Dennis Evans also testified of PBOP cost containment measures which were implemented by Pacific Bell in the past few years.

There is nothing in the record to demonstrate that the utilities will have any less incentive to aggressively negotiate PBOP benefits in good faith if they are authorized full recovery of accrued PBOP costs. On the contrary, the evidence substantiates that the utilities have every incentive to continue negotiating cost containment to their respective PBOP plans.

DRA's and the utilities' testimony on our first two safeguard concerns mirror their respective testimony in the first phase of this investigation. Because we have already found that sufficient FASB, IRS, ERISA, and NLRA reporting, disclosure, and fiduciary requirements are in place to ensure that funds placed in a PBOP plan will be tracked and will be used only for PBOP, there is no need to require redundant safeguards at this time. To require supplemental safeguard procedures will only increase the cost of providing PBOP.

However, this is not meant to preclude in any fashion CACD or DRA from requesting and obtaining additional data from the utilities regarding their PBOP activities. Consistent with our Phase I position, we will take the most conservative approach as it relates to PBOP funding and require that the utilities establish trusts for the receipt, investment, administration, and disposition of any PBOP funds which we may authorize the utilities to recover in rates. As a condition of the recovery process of PBOP costs being authorized in this order, the utilities should continue to be required to make their trust agreements and accounting records[30] readily available to CACD and DRA upon their request.

XIV. Z Factor Treatment

In the first phase of this investigation GTEC and Pacific Bell requested Z factor recovery treatment for their PBOP contributions. However, because of an incomplete record, their request was deferred for consideration to this phase of the investigation. Prior to considering Z factor recovery treatment, it is necessary to review how the Z factor was established and the required criteria to recover cost.

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30 These records shall include but not be limited to revenue requirements authorized, actual amounts contributed to PBOP trusts, statement of expenditures, and actuarial reports.

A. Z Factor Criteria

D.89-10-031, 22 CPUC 2d 43 (1989), established a NRF for GTEC and Pacific Bell. This NRF centered around a price cap indexing mechanism that was designed to provide protection to both ratepayers and shareholders from risks that the indexing method may over- or underestimate revenue changes needed to keep the utilities financially healthy. At the same time, the price cap indexing mechanism placed on GTEC's and Pacific Bell's management more responsibility to control their expenses and to assume more risks in exchange for simplified regulation and an opportunity to earn higher rates of return.

The Z factor was established as the component of the price cap mechanism to protect both the ratepayers and shareholders against exogenous events which affect utility costs but are not reflected in an economy-wide GNPPI.

The NRF decision concluded that only exogenous factors which are not reflected in the economy-wide inflation factor and which are clearly beyond the utility's control should be reflected in the Z factor in the price cap index (22 CPUC 2d at 228). That decision also recognized that the range of exogenous factors which could affect utility costs to an extent warranting explicit rate adjustments through the Z factor cannot be foreseen completely. However, the following factors were accepted as a starting point:

1. Changes in federal and state tax laws to the extent they affect the utilities disproportionately.

2. Mandated jurisdictional separations.

3. Changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission.

4. Changes in regulatory amortizations.

5. The reflection of tax benefits resulting from premature retirements of high coupon bonds.

GTEC and Pacific Bell contend they should be able to recover pre-funded PBOP contributions and future PBOP costs they will incur due to the adoption of the Statement as a Z factor.

B. Recovery of Pre-Funded PBOP Contributions

GTEC pre-funded $27.1 million in a fully tax-deductible bargained VEBA in December of 1991 and anticipated pre-funding an additional $25.2 million in 1992 in order to mitigate the impact on GTEC's ratepayers of implementing the Statement if the accounting change is adopted for ratemaking purposes.

Pacific Bell pre-funded PBOP contributions of $117 in 1989 and $91 million in 1990. However, it discontinued making further pre-funded contributions in 1991 and 1992 because of the uncertainty that it would recover in rates its pre-funded contributions in a timely manner and because of the many demands for its capital resources. Upon assurance that PBOP contributions would be recovered in rates on a timely basis, Pacific Bell would be willing to continue pre-funding in 1992. If the Commission denies recovery of its pre-funded contributions for 1989 and 1990, then Pacific Bell's TBO would need to be re-calculated to reflect a higher obligation. Such a recalculation would not result in retroactive ratemaking because Pacific Bell has yet to expense its 1989 and 1990 pre-funded PBOP contributions. Pacific Bell has recorded its pre-funded contributions as a prepaid asset. Retroactive ratemaking results from the recovery of past expenses in future rates.

DRA opposed both GTEC's and Pacific Bell's request for Z factor recovery of their pre-funded contributions for two reasons. First, DRA believed that such recovery would constitute retroactive ratemaking. Second, DRA does not believe pre-funded contributions satisfy the Z factor criteria established in the NRF decision.

Both GTEC and Pacific Bell exercised good intentions in pre-funding their PBOP costs to minimize the ratepayers' impact associated with the Statement by utilizing tax-deductible trusts which accumulated tax-free earnings. Nevertheless to authorize Z factor recovery, we must first conclude that pre-funding meets the criteria established in the NRF decision.

There is no dispute that the Statement will have a material impact. However, DRA does not believe that GTEC's and Pacific Bell's pre-funding activities meet the criterion that pre-funding is clearly beyond the utility's control.

Pre-funding was authorized in the first phase of this investigation. However, it was authorized on a permissive basis. No utility was required to make pre-funded contributions. Although this permissive pre-funding was effective August 1, 1991, Pacific Bell actually began pre-funding in December 1989.[31] Clearly, Pacific Bell's pre-funding of 1989 contributions was not beyond its control, especially since its contributions were made almost two years prior to Commission authorization and a full year prior to the FASB's adoption of the Statement. Similarly, Pacific Bell's 1990 contributions were made almost eight months prior to Commission authorization.

Pacific Bell's decision to discontinue pre-funding and to not pre-fund in 1991 and 1992 further substantiated that pre-funding was not only permissive but was well within the utilities' control. Pacific Bell's proposal to continue pre-funding in 1992 if assurance is given that rate recovery will be provided on a timely basis continues to substantiate that pre-funding is in the control of the utilities.

Neither GTEC nor Pacific Bell has met its burden of proof to demonstrate that pre-funded contributions were clearly beyond their control. Absent such a finding we must deny GTEC and Pacific Bell authority to recover pre-funded PBOP via the Z factor.

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31 We also note that Pacific Bell's 1989 pre-funded contribution took place within two months after the NRF decision was issued.

Because pre-funded contributions have not met the Z factor criteria, the retroactive ratemaking issue raised by DRA and Toward Utility Rate Normalization (TURN) is moot and need not be addressed further.

C. <u>Recovery of Funded PBOP Contributions</u>

GTEC and Pacific Bell believe that Z factor recovery is applicable for accrued PBOP costs because these costs satisfy the criteria established in the NRF decision. Once again, the criteria consist of exogenous factors which are clearly beyond the control of the utilities and which are not reflected in the economy-wide GNPPI.

The utilities explained that the control factor will be met if we adopt the Statement because they will have no choice but to implement accrued PBOP. DRA agreed with the utilities that the adoption of the Statement is clearly beyond the utilities' control and that such action would be an exogenous factor.[32] However, DRA argued that the utilities do not satisfy the control criterion because the utilities control PBOP costs. For example, the utilities will have the ability to control the amount of funded accrued liability, select the appropriate funding mechanism, and reduce or increase their PBOP expenses.

No party disputed DRA's contention that the utilities have the ability to control the day-to-day management of PBOP costs. However, the same may be true of most other factors that expressly qualify for Z factor treatment. For example, changes in federal and state tax laws, identified in the NRF decision as a Z

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32 DRA went on to provide conflicting testimony on whether such an exogenous factor exists because of the economic nature of PBOP costs. Its direct testimony stated that an exogenous factor does not exist because there are no major changes to the economic cost of providing PBOP, Exhibit 75 page 69. However, DRA's witness subsequently testified that the cost change does exist from an economic standpoint, RT 1105 Line 13.

factor adjustment, are beyond the control of the utilities. At the same time, the utilities will continue to control the actual payment of taxes and the level of taxes resulting from the tax change.

Accordingly, to the extent that the utilities incur costs to comply with Commission required accounting changes, particularly here where the utilities may only recover those sums paid to the independent trusts specifically authorized by this decision, such costs satisfy the Z factor control criterion. Therefore, costs associated with the change from cash to accrual accounting for PBOP not recovered through the GNPPI should be recovered through a Z factor adjustment. Consistent with the 1% cap being imposed on utilities under the traditional cost of service regulation, we will impose a 1% recovery cap on Pacific Bell's and GTEC's net change in their annual price cap revenue base.

Both GTEC and Pacific Bell conducted detailed studies on the impact that the Statement would have on the GNPPI to assure that double recovery would not take place. Although the utilities used consistent economic theory in their studies, they did use a different behavior assumption related to whether firms already considered accrued PBOP costs in their hiring and output decisions.

Pacific Bell's study assumed that competitive firms were already making their hiring and output decisions on the basis of accrued PBOP while GTEC took the conservative approach and assumed the opposite of Pacific Bell. Their results were similar. GTEC concluded that the GNPPI would recover 0.73% of the additional cost while Pacific Bell concluded that the GNPPI would recover 0.12%.

DRA concluded that some degree of rate recovery already exists in the GNPPI because health care, dental care, and life insurance components are components of the GNPPI. It was apparent that GTEC and Pacific Bell did not disagree with DRA because they quantified the impact, although not material, in their respective studies. Pacific Bell further clarified that the Z factor adjustment is necessary to reflect accrual accounting while the GNPPI reflects the change in inflation for PBOP gross national output price increases.

In this instance we have the benefit of two different economic studies which demonstrate that the GNPPI will not be impacted to any significant degree. Although economic studies, such as the ones used by GTEC and Pacific Bell, are objective, the results are dependent on the subjective inputs. From these subjective inputs the parties advance arguments in support of their respective analyses and in criticism of the input assumptions used by other parties. In the final analysis, it is the application of judgment, not the precision of these economic studies, which is the key to determining the extent of impact.

Our analysis of the evidence shows that the GNPPI will be impacted minimally, as demonstrated by the utilities' economic studies. This analysis of the evidence also leads us to conclude that the recovery of the accrual required by adopting the Statement with modification through the Z factor will not provide the utilities with any measurable double recovery through the GNPPI adjustment. Based on our judgment, the NRF utilities should be authorized to use the Z factor adjustment to recover accrual impacts from adopting the Statement as modified by this order.

In relation to Pacific Bell's economic study, GTEC's study was very conservative. In fact, GTEC attempted to determine whether adoption of the Statement would impact other components of the GNPPI. Based on its additional analysis, GTEC concluded that some of the costs associated with the change in GNPPI may influence wage rates in the national economy. If the wage rate in the national economy is reduced in relative terms due to the impact of the Statement, an additional 14.38% of the PBOP costs may be recovered by GTEC in the GNPPI due to a reduction in the wages that

GTEC pays to its employees relative to what it would have paid in the absence of the Statement.

Although GTEC's study shows that it could receive additional recovery benefits through the wage component of the GNPPI, there is no evidence in the record to substantiate or to sway our judgment that NRF utilities will, in fact, receive any additional recovery benefits. Because there is a possibility that the NRF utilities may receive ancillary benefits to the detriment of ratepayers, we do not want to foreclose future consideration of GTEC's speculative result. It would be best to consider this issue after the Statement has been implemented and after a period of time has lapsed so that we may draw upon historical data. Therefore, as part of their October 1993 price cap filing, GTEC and Pacific Bell should include studies to demonstrate whether the wage component of the GNPPI has been affected by adoption of the Statement and recommendations on how the impacts, if any, should be reflected in rates.

We must consider whether NRF utilities should make a one-time Z factor filing or annual Z factor filings to reflect PBOP costs. We note that pay-as-you go costs are projected to increase over time. Furthermore, if we retained pay-as-you go accounting, any increase in pay-as-you-go costs would not be entitled to Z factor treatment. Therefore, the NRF utilities' additional recovery for PBOP costs through the Z factor should be limited to the difference between what is required by accrual accounting and what their pay-as-you-go costs otherwise would have been. It appears that the difference between the amount required for PBOP costs under accrual accounting and the amount required under pay-as-you-go accounting may decrease over time. Indeed, we have earlier noted evidence that the cost of an accrual funded plan would eventually be less expensive than a pay-as-you-go plan. Therefore, we should not authorize NRF utilities to recover as a <u>permanent</u> Z factor the increase in rates for PBOP necessary during the <u>first</u> year. If we did that, the NRF utilities might realize a windfall. Accordingly, it appears that yearly adjustments to the Z factor recovery for PBOP costs will be required. Our decision today will order such annual adjustments. We are, however, concerned that such annual adjustments not involve excessive litigation of the reasonableness of costs, contrary to the spirit of our NRF decision. Accordingly, we will hold further hearings to determine the simplest method for annually revising the amount of recovery without extensive litigation.

XV. <u>311 Comments</u>

The ALJ's proposed decision on this matter was filed with the Docket Office and mailed to all parties of record on October 5, 1992, pursuant to Rule 77 of the Commission's Rules of Practice and Procedure.

Comments from AT&T Communications of California, Inc., the Department of Navy, DRA, Edison, GTE, Pacific Bell, Permit Group, Inc., PG&E, SDG&E, SoCal Gas, Southwest Gas, and TURN were timely filed with the Docket Office on October 26, 1992.

Reply comments received from appearances of record such as AT&T Communications of California, Inc., the Department of Navy, DRA, GTE, Pacific Bell, SoCal Gas, and TURN were timely filed with the Docket Office and timely received by the ALJ.

We have carefully reviewed the comments and reply comments filed by the parties to this proceeding that focused on factual, legal or technical errors in the proposed decision and in citing such errors made 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 re-argued positions taken in briefs or presented information not in the record were not considered.

Findings of Fact

1. Our intent in this investigation was to consider the ratemaking effects of PBOP and to establish consistent general policies and procedures to be applied to all utilities that provide PBOP.

2. The funding of PBOP with tax-deductible trusts is in the ratepayers' best interest.

3. The utilities have been given permissive authority to fund and to recover their PBOP costs prior to the Statement's effective date.

4. The Statement requires all entities to replace the prevalent practice of recording PBOP benefits on the cash basis of accounting with the accrual basis of accounting for financial accounting and reporting purposes.

5. The Statement will become applicable to California regulated utilities effective January 1, 1993.

6. GTEC's, Pacific Bell's, and SDG&E's average residential customer's bill will increase $0.38, $0.75, and $0.19 per month if the Statement is adopted without modification.

7. SoCal Gas was granted authority to fund PBOP and to implement rates to recover PBOP costs in its Test Year 1990 GRC.

8. It is not feasible for the utilities that are pre-funding PBOP to true-up their PBOP costs in this investigation.

9. Standard and Poor's and Moody's already factor in the effect of PBOP liabilities.

10. The additional PBOP reporting required by the Statement would be helpful for the rating agencies to fine-tune their assessments and could even reveal a significantly smaller burden than previously assumed by the rating agencies.

11. The higher, or more favorable, the rating given to the utilities' debt by rating agencies, the lower the costs, or interest rate, to service debt.

12. A correlation exists between debt and common equity risk.

13. There is no basis to conclude that the Statement would have any measurable impact on the companies' ability to access capital markets.

14. Inter-generational inequity will not be resolved by adopting the Statement without modification.

15. Adoption of the Statement would place the recovery of PBOP on a more consistent basis with the recovery of pension and nuclear decommissioning costs.

16. PBOP, pensions, and nuclear decommissioning funding must currently recognize the expense of liabilities that will not come due for a considerable period of time.

17. The absence of a specific code requirement for the recovery of PBOP costs is not a basis to treat PBOP costs differently from the recovery of decommissioning cost.

18. Code sections that mandated a funded accrual basis of cost recovery for nuclear decommissioning were not added to the code until 5 years after we authorized energy utilities to implement an accrual basis of accounting for decommissioning costs.

19. The Nuclear Decommissioning Act did not come into existence until 3 years after utilities were authorized to fund their decommissioning cost on an accrual basis of accounting.

20. PBOP are currently being paid to retirees in a manner similar to pension benefits.

21. The funding of pensions in advance of the utility's payment of benefits is a proper cost of service.

22. The USOA Rewrite decision was applicable to only regulated telephone utilities and did not automatically adopt future GAAP changes for regulatory purpose.

23. Rate shock, as it relates to PBOPs, represent an increase of 1% or more of total operating revenue. This definitive level is not and should not be viewed as a precedent for any other proceeding.

24. Procedures can be implemented to mitigate any rate shock.

25. The basic cost of service policy dictates that the utilities should have the opportunity to recover in rates reasonable operating expenses, including PBOP costs, taxes, and a fair return on invested capital.

26. The controlling element in fixing rates is what it costs the utility to perform service.

27. The utilities have already taken steps to contain and to reduce PBOP costs.

28. Shareholder and employee funding of PBOP is not a viable funding alternative at this time.

29. Utilities need union approval to use excess pension assets of union employees for PBOP.

30. IRC § 420 provides for the limited transfer of excess pension assets to a § 401(h) account for only the years 1991 through 1995 and only if the pension plan is fully funded.

31. A majority of the utilities do not have surplus pension funds.

32. Surplus pension assets generally result from volatile changes in the investment markets which cannot be predicted with any accuracy.

33. Surplus pension assets are not a viable funding alternative for PBOP costs.

34. Cost of service is an indispensible factor in setting fair and reasonable rates for regulated service.

35. Employees do not qualify for PBOP unless they specifically provide utility service for a minimum period of time.

36. Similar to the receipt of pension benefits, employees are not entitled to receive PBOP until after they retire from utility service.

37. The longer that employees work, the less expensive the cost of PBOP paid for by ratepayers.

38. Approximately one-third of the TBO represent PBOP applicable to current retired employees.

39. Similar to pension benefits, PBOP actuarial reports would be performed on a periodic basis to reflect changes in actuarial assumptions including plan benefits, inflationary factors, and mortality rates.

40. The Statement's method of accounting for PBOP on the accrual basis of accounting meets the cost of service criterion.

41. The cash basis of PBOP recovery fails to incorporate the cost of service principle.

42. The accrual basis of revenue recovery meets the assurance criterion and provides a degree of certainty that sufficient funds will be available to pay the utilities' PBOP costs.

43. Adoption of the Statement would give the utilities flexibility to assess PBOP on an ongoing basis.

44. Employees are not earning an incremental increase in PBOP as the employees age.

45. The Statement's benefits/years-of-service method can provide for a disproportionate allocation of benefits cost over the employees' working life.

46. It is reasonable to flow through the cost of the employees' PBOP over the employees' entire working life.

47. The Statement's 20-year amortization method of TBO benefits will substantially mitigate inter-generational inequity.

48. Ratepayers would be required to pay an additional $670,000 for every $1 million that the utilities contribute to taxable PBOP funded plans.

49. The funding of PBOP with tax-deductible contributions enhances a balance of interest between shareholders and ratepayers.

50. The FASB allows utilities to reflect a regulatory asset in their external financial statements with the assurance that such costs will be recovered through rates in the future.

51. The SEC has not taken a policy position on what criteria should be used to determine whether a regulatory asset should be allowed.

52. Reasonable PBOP costs are defined to be those PBOP costs applicable to regulated services that meet the Statement criteria as modified by this order and are invested in tax-deductible plans administered by an independent trust, that are necessary to meet funding requirements based on fair actuarial assumptions, contributions, and investments, and that are not used to enhance pension benefits.

53. The regulatory asset will not impact the utilities' cash flow until the utilities are able to make additional tax-deductible contributions.

54. The utilities have every incentive to continue negotiating cost containment to their respective PBOP plans.

55. There are sufficient FASB, IRS, ERISA, and NLRA reporting, disclosure, and fiduciary requirements in place to ensure that funds placed in a PBOP plan will be tracked and will be used for only PBOP.

56. A Z factor was established as a component of the price cap mechanism for NRF utilities to protect both ratepayers and shareholders against exogenous events.

57. Only exogenous factors which are not reflected in the GNPPI and which are clearly beyond the utility's control can be reflected as a Z factor adjustment.

58. The first phase of this investigation authorized pre-funded PBOP contributions on a permissive basis.

59. Pacific Bell began pre-funding PBOP in December 1989, almost 2 years prior to Commission authorization and a full year prior to the FASB's adoption of the Statement.

60. Pacific Bell chose not to pre-fund PBOP in 1991 and 1992.

61. Pacific Bell will continue to pre-fund PBOP in 1992 if assurance is given that rate recovery will be provided on a timely basis.

62. The adoption of the Statement is clearly beyond the control of the utilities.

63. To the extent that the utilities incur administrative costs to comply with the accounting changes required by this decision, and recover only those sums paid to the independent trusts specifically authorized by this decision, such costs satisfy the Z factor control criterion.

64. The Z factor adjustment is necessary to reflect accrual accounting while the GNPPI reflects the changes in inflation for PBOP gross national output price increases.

65. Economic studies demonstrate that the GNPPI will not be impacted to any significant degree by adoption of the Statement.

66. It is possible that the NRF utilities may receive ancillary benefits to the detriment of ratepayers through the GNPPI wage factor with the adoption of the Statement.

67. In order to implement the Statement by January 1, 1993, this order should be effective on the date signed.

<u>Conclusions of Law</u>

1. Affected utilities should true-up their PBOP costs as part of their next GRC filing or price cap filing.

2. The recovery of PBOP costs for regulatory accounting and ratemaking purposes should be based on consistent cost of service policy and cost recovery mechanisms.

3. The Statement as modified by this order should be adopted for regulatory accounting and ratemaking purposes.

4. The Statement's benefits/years-of-service approach should not be adopted for regulatory accounting and ratemaking purposes unless such approach will not result in more than a 10% difference in cost over the total utility service life attribution method.

5. The utilities should use the employees' total service life attribution method to distribute the cost of employees' PBOP benefits for both the TBO and ongoing PBOP cost unless the use of the benefits/year-of-service approach results in minimal increase in costs.

6. The utilities should amortize the TBO over 20 years.

7. The utilities under traditional ratemaking and the telecommunications utilities under the NRF process should recover their PBOP costs in rates to the extent that they are able to make contributions to tax-deductible plans.

8. Commission policy should not be governed by whether or not utilities can record a regulatory asset under Statement No. 71.

9. Regulatory accounting and ratemaking should not be governed by IRS, ERISA, or SEC requirements.

10. The utilities should establish a regulatory asset for regulatory accounting purposes.

11. The recovery of tax-deductible contributions in any given year should not increase over the prior PBOP expense recovery by more than 1% of the utilities' prior year's total operating revenue for traditional cost of service regulated utilities.

12. Recovery of the regulatory asset should begin during the year when tax-deductible limits exceed PBOP costs and continue until the regulatory asset has reached a zero balance.

13. Regulatory assurance language should be included in rate orders which address rate recovery of PBOP costs.

14. Any concern regarding recovery of PBOP costs associated with future deregulated services should be addressed in the proceeding that considers deregulation of those services.

15. The PBOP regulatory asset should not be a component of rate base subject to a return on investment.

16. The utilities should establish trusts for the receipt, investment, administration, and disposition of PBOP for any PBOP funds which we may authorize the utilities to recover in rates. Earnings of such trust may be taxable to the trust or to the employees.

17. The utilities under the NRF should not be allowed to recover their pre-funded PBOP contributions through the Z factor adjustment because they have not demonstrated that funding PBOP prior to adoption of the Statement with modification was beyond their control.

18. Effective January 1, 1993 with the adoption of the Statement as modified by this order, NRF utilities should be allowed to recover reasonable costs associated with the change from cash to accrual accounting through the Z factor adjustment.

19. NRF utilities should include as part of their October 1993 price cap filing a study to demonstrate whether the wage component of the GNPPI has been affected by the Statement and should make recommendations on how such impact, if any, should be reflected in rates.

20. Yearly adjustments to the Z factor recovery for PBOP costs should be required.

O R D E R

IT IS ORDERED that:

1. The Financial Accounting Standards Board Statement of Accounting Standards No. 106 (Statement), Employers' accounting for post-retirement benefits other than pensions (PBOP), shall be adopted with the following modifications, as discussed in this order, for regulatory accounting and ratemaking purposes and shall be effective January 1, 1993, the effective date of the Statement.

   a. The employees' total service life attribution method shall be used to distribute the cost of employees' PBOP for both the transition benefit obligation (TBO) and ongoing PBOP costs. However, if a utility can demonstrate to the Commission Advisory and Compliance Division prior to January 1, 1993 that the benefits/years-of-service approach will result in a minimal increase as defined in this order, the utility may opt for the benefits/years-of-service approach.

b. The Statement's benefits/years-of-service approach shall not be used for regulatory accounting and ratemaking purposes unless it results in minimal increase in cost (10%) over the employees' total service life attribution method.

c. The TBO shall be amortized over a 20-year time period beginning January 1, 1993.

2. Regulated utilities under traditional cost-of-service ratemaking and the new regulatory framework (NRF) shall be authorized to recover their PBOP costs associated with the adoption of the Statement and actually paid to independent trusts to the extent that the utilities:

a. Establish and use independent trusts for the receipt, investment, administration, and disposition of PBOP.

b. Make tax-deductible contributions which do not need to be grossed up by a net-to-gross multiplier. Earnings to the trust may be tax-free or taxable to the trust or employees.

c. Use PBOP trust funds for only PBOP.

d. Incur PBOP costs that the Commission finds are reasonable and necessary to meet funding requirements based on fair actuarial assumptions, contributions, and investments.

e. Do not use PBOP to enhance pension benefits.

f. Recovery of tax-deductible contributions in any given year shall not increase over the prior year's PBOP expense recovery by more than 1% of the utilities total prior year's operating revenue. For those utilities under NRF, the 1% limit shall be applied to the net changes in their annual price cap revenue base.

g. The utilities shall, to the extent allowed by the Internal Revenue Service (IRS) and employee unions, apply surplus pension assets (as defined by the IRS) to fund their PBOP expense.

3. To the extent that PBOP trust assets cannot or are not used for PBOP obligations, then those assets shall be returned to ratepayers as allowable by law. Utility rates are hereafter made subject to refund, but only to the extent necessary to allow such a return to ratepayers of any PBOP assets that cannot be used for PBOP expenses or that have been used for other purposes.

4. The utilities shall establish and maintain a regulatory asset pursuant to Financial Accounting Standards Board's Statement No. 71 and as discussed in this order. The recovery of such regulatory asset in future rates shall begin during the year when tax-deductible limits exceed PBOP costs and shall continue until the regulatory asset has reached a zero balance.

5. The regulatory asset required by this order shall not be considered a rate base component subject to a return on investment.

6. GTE California Incorporated (GTEC) and Pacific Bell shall not be authorized to recover their pre-funded PBOP costs through the Z factor adjustment provided for under the new regulatory framework.

7. Effective January 1, 1993 GTEC and Pacific Bell shall be authorized to recover through a Z factor adjustment their PBOP costs associated with the change from cash to accrual accounting as provided for in this order. To effect this recovery in the first year, GTEC and Pacific Bell shall make a compliance filing to the

Commission Advisory and Compliance Division's Telecommunications Branch Chief no later than three business days after the date of this decision. This filing shall set forth the revenue requirement impact of this decision and the incremental surcharge adjustment necessary to recover their respective revenue requirement in the 1993 annual price cap index. Copies of this compliance filing shall be served upon I.90-07-037 and I.87-11-033 service lists. Recovery of future years PBOP cost shall be accomplished in each subsequent years price cap filing, as further described in the following ordering paragraph.

8. In addition to the requirements of Ordering Paragraph 2, NRF utilities shall recover through annual Z factor filings only the amount required to be accrued that year to cover future PBOP payments, <u>minus</u> their pay-as-you-go costs. Furthermore, the Z factor should only recover this amount to the extent it is actually put into a trust. The Z factor treatment of PBOP costs shall be trued up in each subsequent years' Z factor filings to ensure compliance with these requirements. Further hearings shall be held in this or other more appropriate proceeding to determine the simplest possible method for ensuring compliance with these requirements in Z factor filings without extensive litigation.

9. GTEC and Pacific Bell shall include as part of their October 1993 price cap filing a study to demonstrate whether the wage component of the Gross National Product Price Index has been affected by PBOP and to recommend how such impact, if any, should be reflected in rates.

10. Those utilities that are tracking their pre-funded PBOP contributions in an interest-bearing memorandum account pursuant to Ordering Paragraph 5 of Decision 91-07-006 shall be authorized to continue inputing interest on such contributions up to January 1, 1993, the effective date of the Statement. Interest shall not continue to accrue after the effective date of the Statement.

11. Utilities operating in other jurisdictions with their California operations being 10% or less of their total utility operations based on the four-factor method shall be exempted from the accrued PBOP requirements imposed by this order. However, for ratemaking purpose, such utilities shall be required to impute the effect of accrued PBOP, as explained in this order, as a part of future general rate filings. Such utilities shall also assume that their funding begins on January 1, 1993 and that earnings on their imputed PBOP contributions will be set at their authorized weighted cost of capital rate.

12. Pacific Gas and Electric Company's PBOP issue left open in Application (A.) 88-12-005 and Investigation (I.) 89-03-033 which was consolidated into this investigation has been resolved. Accordingly, A.88-12-005 and I.89-03-033 are no longer consolidated with this investigation.

13. This decision disposes of the issues in our PBOP investigation, except the matter addressed in Ordering Paragraph 8. Accordingly, this proceeding shall remain open.

This order is effective today.

Dated December 3, 1992, at San Francisco, California.

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

I will file a partial dissent.

/s/ PATRICIA M. ECKERT
Commissioner

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

Neal J. Shulman

NEAL J. SHULMAN, Executive Director

PB

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; Vicki L. Thompson and David R. Clark, Attorneys at Law, for San Diego Gas & Electric Company; William A. Ettinger, Attorney at Law, for AT&T Communications, Inc.; E. Garth Black, Attorney at Law, for Roseville Telephone Company; Orrick, Herrington & Sutcliffe, by Robert Gloistein, Attorney at Law, for Contel of California, Inc.; Robert B. Keeler and John R. Fallon, 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 and Gregory L. Castle, Attorneys 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 José E. Guzman, Jr., Attorney at Law, for Westport Management Services, Inc.; Thomas Long and Michel Florio, Attorneys at Law, for Toward Utility Rate Normalization; and Norman J. Furuta, Attorney at Law, for the Department of Navy and Federal Executive Agencies.

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

(END OF APPENDIX A)

APPENDIX B

List of Abbreviations and Acronyms

AICPA Committee	- American Institute of Certified Public Accountants' Public Utilities Committee
ALJ	- Administrative Law Judge
ARA	- Attrition Rate Adjustment
CACD	- Commission Advisory and Compliance Division
Code	- Public Utilities Code
D.	- Decision
DRA	- Division of Ratepayer Advocates
Edison	- Southern California Edison Company
ERISA	- Employee Retirement Income Security Act
FASB	- Financial Accounting Standards Board
FCC	- Federal Communications Commission
GAAP	- Generally Accepted Accounting Principles
GNPPI	- Gross National Product Price Index
GRC	- General Rate Case
GTE	- GTE California Incorporated
I.	- Investigation
IRC	- Internal Revenue Code
IRS	- Internal Revenue Service
LEC	- Local Exchange Companies
Moodys	- Moody's Investigators Services, Inc.
NLRA	- National Labor Relations Act
NRF	- New Regulatory Framework
OII	- Order Instituting Investigation
PBOPs	- Post-Retirement Benefits Other Than Pensions
PG&E	- Pacific Gas and Electric Company
PU	- Public Utilities
Roseville	- Roseville Telephone Company
SDG&E	- San Diego Gas & Electric Company
SEC	- Securities and Exchange Commission
SFAS 106	- Statement of Financial Accounting Standards No. 106
SoCal Gas	- Southern California Gas Company
Southwest Gas	- Southwest Gas Corporation
Statement	- Statement of Financial Accounting Standards No. 106
TBO	- Transition Benefit Obligation
USOA	- Uniform System of Accounts
VEBA	- Voluntary Employee Benefit Association

(END OF APPENDIX B)

I. 90-07-037
D. 92-12-015

Commissioner Patricia M. Eckert, Dissenting in part:

I dissent from the majority's opinion, with respect to Pacific Bell and GTEC, regarding recovery of pre-funded contributions of post-retirement benefits other than pensions (PBOP's).

Since my appointment to this Commission in 1989, I have supported pre-funding of PBOP's. I believe that pre-funding is a sensible business decision when an accounting change creates a balance sheet impact in the hundreds of millions of dollars. To mitigate such a financial shock to both ratepayers and investors by prefunding was both prudent and responsible. It also followed logically from our statements in D. 91-07-006.

The majority rests its decision on the fact that Pacific Bell pre-funded in 1989 and 1990, but stopped pre-funding in 1991. Therefore, the decision concludes Pacific Bell's discretion regarding pre-funding disqualified their pre-funded contributions from Z factor treatment. Since Z factor requires that an event be "clearly beyond the utility's control," the majority reasoned that pre-funding did not deserve Z factor treatment.

I believe that the majority's rationale rests on too fine a technical point and overlooks the overall system in which Pacific Bell and GTEC operate. Because pre-funding was a sound and reasonable business decision, and D.91-07-006 signaled that such pre-funding was permissive, I believe that GTEC and Pacific should be allowed to recover pre-funded PBOP's contributions.

To now change regulatory signals is once again inconsistent policy making which interferes with reasonable business strategic planning.

PATRICIA M. ECKERT
Commissioner

December 3, 1992
San Francisco, California