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ORIGINAL

Decision 83 05 051 MAY 18 1983

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for authority, among other things, to increase its rates and charges for electric and gas service.

Application 82-12-48 (Filed December 20, 1982)

(Electric and Gas)

(See Appendix A for appearances.)

INTERIM OPINION

Summary

The Commission staff (staff) filed a motion requesting that the Commission issue an interim order to revise the accounting treatment previously ordered for the Pacific Gas and Electric Company (PG&E) Humboldt Bay Power Plant Unit No. 3 (Humboldt). The staff requested that the Commission order PG&E to cease the accrual of Allowance for Funds Used During Construction (AFUDC)<sup>1</sup> on the project until the Commission reaches a final decision on the appropriate ratemaking treatment for Humboldt.

In granting the staff's motion, the Commission stated that since there was no likelihood of the operational status of Humboldt being resolved in the near term and since there was reasonable doubt that the plant will be returned to commercial operation, PG&E should cease further accrual of AFUDC.

<sup>1</sup> AFUDC is a utility accounting procedure which recognizes the cost of financing construction of a project prior to the time the project is placed in service and reflected in rates.

The Commission noted that this change in accounting procedures does not prejudge the future ratemaking treatment of the plant; it merely ceases to provide investors with the expectation that such AFUDC will ultimately be recognized in rates.

In any future ratemaking proceeding concerning this plant, all costs related to the period during which the plant was inoperative will be subject to disallowance in the absence of a clear and convincing showing by PG&E as to their reasonableness. This burden is on the utility.

#### Procedural Summary

Staff filed its motion on January 28, 1983, prior to commencement of the evidentiary hearings on PG&E's general rate increase application for test year 1984. Testimony for the staff was presented by K. K. Chew (Exhibit 50) and for PG&E by T. C. Long (Exhibit 37). Following hearing and oral argument before Administrative Law Judge Bertram Patrick, this matter was submitted on April 4, 1983.

#### Background

Humboldt is a 63 MW boiling water nuclear reactor which operated from 1962 to July 1976. In 1976, Humboldt was placed in shut-down status for refueling and maintenance. In that same year, the Nuclear Regulatory Commission (NRC) ordered the plant to remain in cold shut-down status until certain seismic issues were resolved. The Atomic Safety and Licensing Board (ASLB) has directed PG&E to determine within six months after the NRC issues its Final Safety Goals Statement and Implementation Plan whether the economics of meeting all of the backfit safety requirements justify restarting the unit.

Since the shutdown, the increased requirements for reactor safety and engineering required by the NRC and specifically the ASLB have generated some doubt about whether it would be practical or

economical to recondition and retrofit the Humboldt plant for further operation. The substantial increase in such retrofit expenses following the Three Mile Island incident have compounded this problem. In fact, at the present time, PG&E does not have specific information from the ASLB or the NRC describing exactly what modifications to Humboldt would be required before the NRC would permit resumption of the plant's operation.

In Decision (D.) 91107 dated December 19, 1979, PG&E's general rate increase decision for test year 1980, the Commission removed Humboldt from PG&E's rate base. (Finding of Fact 14.)

In the following general rate increase decision, D.93887 dated December 30, 1981 for test year 1982, the Commission directed PG&E to continue to record Humboldt-related expenses in a memorandum account for ultimate disposition when the plant's future was decided. The Commission directed PG&E to continue to accrue AFUDC on such expenses so as not to "prejudge" the Commission's decision on the future ratemaking treatment of Humboldt.

The Commission also stated, "We place PG&E on notice that we expect the question of backfitting or decommissioning of Humboldt to be resolved before the next Notice of Intention (NOI)<sup>2</sup> is filed." (Pages 89-90, mimeo.) Contrary to the Commission's expectation there was no resolution of the operational status of Humboldt prior to PG&E filing its current NOI.

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<sup>2</sup> A NOI is filed by a utility prior to filing a general rate increase application.

Instead, on August 20, 1982 PG&E sent a letter to the Executive Director of the Commission advising him of the status of the Humboldt plant, in which PG&E indicated that pending receipt of the NRC's backfit requirements for older plants such as Humboldt, it was not in a position to make a decision on reactivation or decommissioning of the plant. In addition, PG&E advised that it had been ordered by the ASLB to reach a decision on the plant's future no later than six months after NRC reaches "a final determination on the adoption of a reactor safety policy statement and its associated goals and guidelines." PG&E recommended to the Commission that its decision on the future of the plant be made in accordance with the ASLB schedule instead of prior to the filing of the current NOI.

The AFUDC related to Humboldt accrued at year end 1982 is \$21.2 million and the net plant balance (not in rate base) is \$56.6 million. Currently, AFUDC is accumulating at the rate of \$6.8 million per year. PG&E requests continuation of AFUDC accrual in test year 1984.

Staff Position

The staff argues that the special ratemaking treatment allowed by the Commission in this instance was provided on a temporary basis to allow PG&E to resolve the operational status of Humboldt. According to staff the anticipated temporary period of time has run its course. Therefore, staff believes that such treatment should be discontinued since there will be no resolution of this matter in the near future.

Staff submits that the continued accrual of AFUDC on this dormant plant (1) is a misleading representation of PG&E's booked earnings; (2) is contrary to the Federal Energy Regulatory Commission

(FERC) Uniform System of Accounts; (3) is an erroneous indication to PG&E of expected recoverable costs; and (4) is a strong disincentive for PG&E to resolve the situation. According to staff, these concerns significantly outweigh the argument that PG&E has not yet sought recovery for Humboldt's costs.

Staff further argues that earnings reported to the stockholders and potential investors reflect AFUDC as a potential future recovery. Therefore, inclusion of the AFUDC associated with this project is a distortion of PG&E's financial position, especially in view of the possibility that Humboldt may eventually be abandoned.

Specifically staff requests that:

A. For ratemaking purposes:

1. AFUDC be discontinued on Humboldt.
2. Operation and maintenance (O & M) expenses for test year 1984 be recognized and included in the revenue requirements.
3. Humboldt capital expenditures plus unamortized nuclear fuel be excluded from rate base for ratemaking purposes.

B. For accounting purposes:

1. Transfer the Humboldt capital expenditures plus unamortized nuclear fuel to the appropriate plant in service accounts.
2. Transfer the related AFUDC to the Deferred Debits account.
3. Transfer O & M expenses capitalized through December 31, 1983 to the Deferred Debits account with related accrued AFUDC.
4. Expense O & M expenses currently beginning in 1984.

5. Transfer the nonoperative related jobs and related AFUDC to the Deferred Debits account.

C. PG&E be ordered to submit an annual economic feasibility study of Humboldt until final disposition of the plant.

Staff also points out that PG&E plans to update its December 1980 cost/benefit analysis of whether to backfit or decommission the plant. Staff counsel believes that the updated economic analysis should not be distorted by the continued accrual of AFUDC for an indefinite period of time.

#### PG&E's Position

PG&E is waiting for the NRC to issue Final Safety Goals and Guidelines. PG&E states that it has no control over the NRC. The Commissioners of the NRC published a "Policy Statement" on Safety Goals for the operation of Nuclear Power Plants on March 8, 1983. Concurrently, the staff of the NRC issued a "Plan to Evaluate the Commission's Safety Goal Policy Statement." PG&E fully expected the NRC Safety Goals Statement and Evaluation Plan would provide a basis for determining the backfits that would be required for Humboldt. Instead, the Plan proposes a two-year trial period in which the NRC staff would prioritize safety goals and evaluate the Safety Goal Policy Statement. Some time after the two-year period, the value of existing regulations and plant-specific applications will be considered. The draft clearly states that there is no intention to use the Safety Goal Policy Statement in any plant-specific licensing proceeding. Thus, the issuance of the preliminary Safety Goal Policy Statement and Evaluation Plan has not given PG&E the specific guidance it had anticipated in order to ascertain the backfits which are required for Humboldt.

PG&E points out that it has continually pursued the resolution of Humboldt with the ASLB and the NRC. Further, PG&E argues its management obviously (1) has an interest in cash recovery

of its investment in Humboldt and (2) is aware of potential Commission disallowance of AFUDC. Therefore, management has every incentive to resolve the status of Humboldt. Indeed, PG&E has been waiting until federal requirements become known. According to PG&E it has thus prudently waited to see if an economic benefit for ratepayers could be obtained from returning Humboldt to operation.

PG&E argues that continued accrual of AFUDC on Humboldt is not a misleading representation of its earnings since the primary objective of accruing AFUDC is to recognize financing costs as a future recoverable cost. PG&E believes that as long as there is a reasonable expectation of recovering such costs, then the continued accrual of AFUDC is not misleading, nor is it an erroneous indicator of expected recoverable costs. According to PG&E the accrual of AFUDC would only be misleading if the Commission had already decided, for some reason, that PG&E should not be authorized to recover the AFUDC.

PG&E disputes staff's contention that the continued accumulation of AFUDC makes this project more and more expensive for the ratepayers. According to PG&E, the AFUDC represents the time value of money invested in Humboldt. To the extent that the time value of money is the same for ratepayers and PG&E, ratepayers should be indifferent as to when PG&E seeks to recover the previously incurred costs related to Humboldt. According to PG&E, AFUDC does not increase the total investment, but rather it keeps it constant.

PG&E argues that by recommending against the continued accrual of AFUDC, staff is prejudging the recoverability of future carrying costs. According to PG&E this is precisely contrary to the Commission's stated rationale for accruing AFUDC on Humboldt in order to both protect ratepayers and not prejudge the rate treatment of the investment. PG&E points out that in D.93887 dated December 30, 1981 the Commission stated:

"While we are concerned with the continuing delay in resolving the operating status of Humboldt, we do not believe the staff proposal to discontinue AFUDC on Humboldt is reasonable in that it prejudices our decision on the future ratemaking treatment to be accorded Humboldt. The resolution of the future status of Humboldt should be determined in a separate proceeding. Should such proceeding prove that it is feasible to continue the necessary modifications to reopen Humboldt, then such AFUDC is a proper cost. If it is determined not feasible, the Commission has the right to make its determination as to allow or disallow such carrying costs based on such proceeding." (Page 90.)

Finally, PG&E argues that the ratepayers are not at risk, whereas the shareholders have to accept the risk inherent in accrual of AFUDC. PG&E submits that the Commission has twice considered the appropriate accounting treatment for Humboldt and there is no reason for change.

#### Discussion

The Commission's policy on AFUDC is reflected in D.82-10-023 dated October 6, 1982 (pages 16-20, mimeo) related to construction of a liquefied natural gas (LNG) terminal in California. We shall not repeat the long discussion but set forth the following paragraph since it does reflect some of the same concerns we have on Humboldt.

"The accumulation of AFUDC on the LNG project is troubling given our doubts that it is viable. If the project is not completed, at least in the near term, then the Commission must ultimately decide whether the AFUDC costs will be borne by ratepayers or shareholders. Whoever bears the cost, the continued accumulation of AFUDC only makes the ultimate burden greater." (Page 17, mimeo.)



We agree with staff that a factor to be considered regarding AFUDC is its inclusion in the earnings statement of the utility and the general expectation by investors that eventually the AFUDC will be recognized for ratemaking purposes. Therefore when the Commission authorizes accrual of AFUDC there must be a reasonable expectation, based on evidence available at the time, that the plant in question will be placed in commercial operation on a specified date. On the other hand, once having authorized accrual of AFUDC, we would be remiss in our duty if we allowed AFUDC to continue accruing when we no longer had that reasonable expectation.

Turning to PG&E's contention based on our language in D.93887 (page 90, mimeo) that discontinuance of AFUDC at this time "would prejudice the rate treatment of its investment in Humboldt", we find that our language needs to be clarified to properly reflect our intentions. What we intended by our language in D.93887 was that we wanted to decide all issues related to Humboldt in one proceeding and because resolution of the plant's operational status was apparently imminent, we saw no need to order a change to the accounting treatment as recommended by staff. However, the resolution of the plant's status did not occur as we had anticipated.

The record in this proceeding shows that a decision on the NRC backfit requirements is now at least two to five years down the road. This will cause a commensurate delay in the resolution of the plant's status so long as PG&E contends that it cannot evaluate the plant's potential for backfitting without the NRC requirements. Also, there are strong indications that the plant will not be put back in service because high retrofit costs will no longer make it commercially viable.

Our concerns stem from PG&E's status report filed on December 31, 1980 which stated that:

"...the economic justification for returning the plant to service is a closer question than previously thought. Whereas the Company's previous economic analysis (August 1980) indicated that for the various scenarios developed, the level annual cost of replacement power [for the Humboldt plant] would be from 26% to 132% higher than Humboldt's cost of power, the December 1980 economic analysis shows that the level annual cost of replacement power would be from 94% higher to 5% cheaper than Humboldt's cost of power." (Emphasis added.)

This analysis was made with the benefit of a study performed by the Bechtel Power Corporation which estimated that as of December 1980 retrofit costs for the Humboldt plant could be expected to range between \$92 million and \$172 million depending upon the stringency of backfit requirements adopted by the NRC. This analysis has not been updated to account for the effect of inflation on the backfit costs.

We also note that on December 31, 1980, PG&E filed a motion with the NRC to withdraw its application to restart the plant. PG&E indicated that the potential cost of additional equipment and operating personnel are high when measured against the size of the facility and its remaining useful life. However, a substantial portion of the cost contained in the Bechtel report, \$40 million to \$80 million, represents a judgment of potential costs of items that are not currently backfit requirements on operating plants, but might become backfit items depending on future NRC policy.

We further note PG&E intends to reflect the latest NRC staff pronouncements in a status report on Humboldt which it expects to file by July 1, 1983. We await the report with interest but see no reason to delay decision on the appropriateness of continuing AFUDC accrual on this project.

We are concerned that Humboldt has now reached a position where the AFUDC accrued on the project exceeds the initial net plant balance (\$21.2 million vs. \$16.9 million). The AFUDC is accumulating at the rate of \$6.78 million per year. This will accelerate as additional costs for maintenance and security of the inoperative facility are accrued and as the compounding of interest continues.

We are well aware that the Commission has the right to subsequently disallow AFUDC for ratemaking purposes, as we did in D.92497 dated December 5, 1980 related to the abandoned WESCO coal venture and D.90405 related to the Sundesert project. Where there is substantial doubt concerning a project's viability, the preferred course is not to allow accrual of AFUDC. If contrary to expectations the project does become commercially viable, we can subsequently recognize all proper costs related to the construction period. Such rate treatment avoids the chilling effect on investors and the shock to the utility caused by a potential massive disallowance of AFUDC following abandonment of a project.

In view of the foregoing discussion, it would be imprudent to authorize further accrual of AFUDC on Humboldt.

Our decision does not "prejudge" the ratemaking treatment of Humboldt. As we stated in the prior decisions, all the costs related to Humboldt will be considered in one proceeding when PG&E makes a decision regarding the plant's future. While cessation of further accrual of AFUDC at this time does not predetermine any future ratemaking treatment, costs related to the period during which the plant was inoperative will be subject to disallowance in the absence of a clear and convincing showing by PG&E as to their reasonableness. This burden is on the utility as has always been true.

We note that staff in its motion requested that accrual of AFUDC cease during the pendency of PG&E's general rate increase application. We see no reason to limit our decision on AFUDC to the pendency of the general rate increase application; however, we will consider related O & M expenses for test year 1984 in the general rate increase application.

Findings of Fact

1. In authorizing AFUDC for Humboldt in D.91107 and D.93887, the Commission authorized special ratemaking treatment in the expectation that resolution of the operating status of Humboldt was imminent.

2. The resolution of the operating status of Humboldt has been deferred by PG&E for at least two more years.

3. Due to the high cost of retrofitting, there is reasonable doubt that Humboldt will be commercially viable and be returned to full operation.

4. Authorization of AFUDC accrual implies that there is reasonable expectation that the plant in question will be placed in commercial operation and such AFUDC will be reflected in rates.

5. Since there is no likelihood of the operational status of Humboldt being resolved in the near term, and since there is reasonable doubt regarding the economic viability of Humboldt, it is reasonable to cease further accrual of AFUDC.

6. Termination of further accrual of AFUDC on Humboldt does not prejudice the ratemaking treatment of the project; it merely ceases to provide investors with an expectation that such AFUDC will ultimately be recognized in rates.

7. Should Humboldt be returned to viable commercial operation, all costs related to the period during which the plant was inoperative will be subject to disallowance in the absence of a clear and convincing showing by PG&E as to their reasonableness. This burden is on the utility.

8. For ratemaking purposes, commencing January 1, 1984 and thereafter, reasonable O & M expenses related to Humboldt should be reflected in 1984 and subsequent test year revenue requirements.

9. For ratemaking purposes, Humboldt capital expenditures plus unamortized nuclear fuel should be excluded from rate base.

10. To the extent that PG&E has not already complied with the following accounting changes, PG&E should:

1. Transfer the Humboldt capital expenditures plus unamortized nuclear fuel from Construction Work in Progress accounts to the appropriate plant in service accounts.
2. Transfer the related AFUDC to the Deferred Debits Account.
3. Transfer O & M expenses capitalized through December 31, 1983 to the Deferred Debits Account with related accrued AFUDC.
4. Expense all reasonable O & M expenses currently beginning in 1984.
5. Transfer the nonoperative related jobs and related AFUDC to the Deferred Debits Account.

11. Commencing with the July 1, 1983 report to be furnished, PG&E should submit an annual economic feasibility study on Humboldt until final resolution of the operational status of the plant.

Conclusion of Law

1. The staff's motion should be granted.
2. This order should be effective today since the accounting changes set forth should be implemented without delay.

INTERIM ORDER

IT IS ORDERED that Pacific Gas and Electric Company cease further accrual of AFUDC on Humboldt Bay Power Plant Unit No. 3 and implement the accounting changes set forth in this opinion.

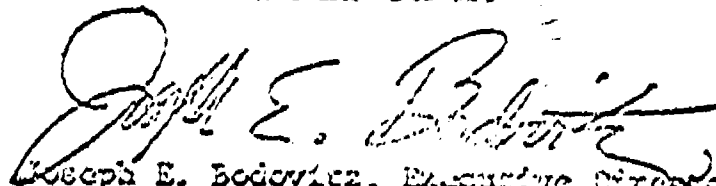
This order is effective today.

Dated MAY 18 1983, at San Francisco, California.

LEONARD M. GRIMES, JR.  
President

VICTOR CALVO  
PRISCILLA C. GREW  
DONALD VIAL  
Commissioners

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

  
Joseph E. Bodovick, Executive Director

APPENDIX A  
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LIST OF APPEARANCES

Applicant: Peter W. Hanschen, William E. Edwards, Michael S. Hindus, and Gail A. Greely, Attorneys at Law, for Pacific Gas and Electric Company.

Interested Parties: Susan L. Steinhauser, John R. Bury, Charles R. Kocher, H. Robert Barnes, David N. Barry, III, Richard K. Durant, Frank J. Cooley, and Donald M. Clary, Attorneys at Law, for Southern California Edison Company; Robert M. Loch and Thomas D. Clarke, Attorneys at Law, for Southern California Gas Company; Biddle & Hamilton, by Richard L. Hamilton, Attorney at Law, for Western Mobilehome Association; Robert Kihel, by Thomas Vargo, for Naval Facilities Engineering Command; Bruce J. Williams, for San Diego Gas & Electric Company; Major Robert J. Soonstoppel and David A. McCormick, for Consumer Interest of U.S. Department of Defense and other affected Federal Executive Agencies; Downey, Brand, Seymour & Rohwer, by Philip A. Stohr, Attorney at Law, for Nabisco Brands, Inc., General Motors Corporation, and Union Carbide Corporation (under the designation "Industrial Users"); McCracken & Antone, by Michael D. McCracken, Attorney at Law, for California Street Light Association; Brobeck, Phleger & Harrison, by Richard C. Harper and Gordon E. Davis, Attorneys at Law, for California Manufacturers Association; Greve, Clifford, Diepenbrock & Paras, by Thomas S. Knox, Attorney at Law, for California Retailers Association; George Agnost, City Attorney, by Leonard Snaider, Deputy City Attorney, for the City and County of San Francisco; Gary D. Fay and Gregg Wheatland, Attorneys at Law, for California Energy Commission; William L. Knecht, Attorney at Law, for California Association of Utility Shareholders; Walters, Bukey & Shelburne, by Diana D. Halpenny, Attorney at Law, for Schools Committee for Reducing Utility Bills (SCRUB); Sara M. Hoffman, Energy Coordinator, for Contra Costa County; Randy Baldschun and Donald E. Maynor, Attorneys at Law, for City of Palo Alto; Michel Peter Florio, Attorney at Law, for Toward Utility Rate Normalization (TURN); Nancy R. Teater and William E. Swanson, for Stanford University; Anita F. Arriola, Attorney at Law, and Dan Becker, for Public Advocates; Brobeck, Phleger & Harrison, by William E. Booth, Attorney at Law, and Jane S. Kumin, Attorney at Law, for Natomas Company; Mark R.

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Farman, for Resource Management International, Inc.; Stephen S. Slauson, for Independent Electrical Contractors of Alameda County; Harry K. Winters, for University of California; William B. Marcus, for California Hydro Systems, Inc. and Independent Energy Producers Association; John W. Krautkraemer, Thomas J. Graff, and David B. Roe, for Environmental Defense Fund; Craig Merrilees, for Campaign for Economic Democracy; Nicholas R. Tibbetts, for Congressman Douglas H. Bosco; Douglas M. Grandy, for State Government Energy Task Force; Antone S. Bulich, Jr. and Allen R. Crown, Attorneys at Law, for California Farm Bureau Federation; Wayne L. Meek, for Simpson Paper Company; Barbara Kyle, for Citizens Action League; Rita Norton, for the City of San Jose; John T. Owens, for Williams Brothers Engineering Company; James F. Sorensen, for Friant Water Users Association; E. D. Yates, for California League of Food Processors; Robert G. MacFarlane and Richard Owen Baish, Attorney at Law, for El Paso Natural Gas Company; Norman J. Furuta, Attorney at Law, for the U.S. Department of the Navy; Susan L. Rockwell and Wayne L. Emery, Attorneys at Law, for United States Steel Corporation; Donald G. Salow, for Association of California Water Agencies; Hanna & Morton, by R. Lee Roberts, Attorney at Law, and Douglas K. Kerner, for Ultrasystems, Inc. and Occidental Geothermal, Inc.; John F. Powell, Attorney at Law, for Bay Area Air Quality Management District; John R. Vickland, Attorney at Law, for San Francisco Bay Area Rapid Transit District; Morrison & Foerster, by John M. McWer and Charles R. Farrar, Jr., Attorneys at Law, for United States Borax & Chemical Corporation; and Matthew V. Brady, Attorney at Law, Graham & James, by James D. Scueri, Attorney at Law, Lee Martin Lambert, and Robert B. Innes; for themselves.

Commission Staff: Michael Day and Thomas Corr, Attorneys at Law, Bruce DeBerry, and Martin J. O'Donnell.

(END OF APPENDIX A)





The Commission noted that this change in accounting procedures does not prejudice the future ratemaking treatment of the plant; it merely ceases to provide investors with the expectation that such AFUDC will ultimately be recognized in rates.

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Findings of Fact

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2. The resolution of the operating status of Humboldt has been deferred by PG&E for at least two more years.

3. Due to the high cost of retrofitting, there is reasonable doubt that Humboldt will be commercially viable and be returned to full operation.

4. Authorization of AFUDC accrual implies that there is reasonable expectation that the plant in question will be placed in commercial operation and such AFUDC will be reflected in rates.

5. Since there is no likelihood of the operational status of Humboldt being resolved in the near term, and since there is reasonable doubt regarding the economic viability of Humboldt, it is reasonable to cease further accrual of AFUDC.

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