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ORIGINAL

Decision 93497 SEP 1 1981

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND)
ELECTRIC COMPANY for authority)
among other things to implement)
a Conservation Financing)
Program and include a procedure)
for a Conservation Financing)
Adjustment of PGandE's electric)
and gas rates in its electric)
and gas Tariffs to provide)
funds for Commission approved)
conservation financing)
program.)

Application 59537
(Filed March 25, 1980)

(Electric and Gas)

Application of PACIFIC GAS AND)
ELECTRIC COMPANY to Increase)
Rates for Electric and Gas)
Service For the Costs of the)
Residential Conservation Service)
(RCS) Program.)

Application 60700
(Filed July 1, 1981)

(Electric and Gas)

Application of PACIFIC GAS AND)
ELECTRIC COMPANY for Authority to)
Increase Its Electric and Gas)
Rates and Charges Effective)
January 1, 1982, in Accordance)
With the Conservation Financing)
Adjustment (CFA) Authorized in)
Application 59537, for Operation)
of a Zero-Interest Program (ZIP))
of Conservation Financing.)

Application 60701
(Filed July 1, 1981)

(Electric and Gas)

SECOND INTERIM OPINION

Introduction

On January 28, 1981, the Commission issued Decision (D.) 92653 which authorized Pacific Gas and Electric Company (PGandE) to implement Phase I of a Zero-Interest Program (ZIP) in its San Joaquin Division and to collect \$10 million to carry out its implementation. Phase I began in April 1981. The decision also ordered further hearings to consider whether ZIP should be expanded systemwide in Phase II. These hearings began on April 7, 1981 and are currently in progress concerning all three consolidated applications.

During the hearings held to consider the propriety of instituting Phase II of its ZIP, PGandE sponsored, in evidence, a specific schedule for systemwide implementation as well as recommended certain Commission actions necessary for rapid expansion of the program.

In order to quickly expand ZIP in accordance with Commission desires and to adhere to its own intended schedule for implementation, PGandE must, in its opinion, receive Commission consideration and approval of various details of the structure of project financing tentatively proposed for the entire program. PGandE contends that these details and elements of project financing represent an indispensable basic structure or framework which the Commission must approve if PGandE is to be able to enter into productive negotiations with the lenders who will ultimately lend the moneys necessary to implement ZIP systemwide.

Accordingly, on July 7, 1981, PGandE filed its Petition for Interim Order Approving Details of Project Financing Structure for System-Wide Expansion of Zero-Interest Conservation Financing. By its petition, PGandE requests an interim order so that it can enter into useful negotiations with lenders. PGandE's petition

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includes proposed Findings of Fact, Conclusions of Law, and Ordering Paragraphs which it thinks are just, reasonable, and substantiated by the record as well as necessary precedents to meaningful negotiations between itself and prospective lenders.

Bank of America National Trust and Savings Association and Crocker National Bank (Banks) and the Commission staff (staff) filed responses to PGandE's petition. We have carefully reviewed the relevant pleadings and are now prepared to issue an interim order.

Position of the Parties

PGandE

Expansion of ZIP systemwide by the end of 1981 is contingent on receipt of an interim decision concerning project financing issues in order for PGandE to conduct negotiations with prospective ZIP lenders. Successful completion of these negotiations is necessary before the project financing structure can be in place as required.

The record reflects that the use of a highly leveraged subsidiary through project financing will be beneficial both for the utility and its ratepayers. Because of the advantages of the increased leverage and lower taxes of the financing subsidiary, project financing offers a method by which the capital necessary for implementation of Phase II can be raised at a cost less than conventional financing. The Commission did acknowledge the validity of this contention in D.92653. However, PGandE requests the Commission to make a specific finding that project financing of ZIP serves the public interest and public convenience and necessity.

Project financing of ZIP will be a novel and atypical application of this financing vehicle. The traditional project financing structure, by which the amounts lent are secured primarily

by the flow of funds from the specific project rather than by the overall credit of the corporation, has never before been applied to conservation financing. Application of project financing to the new area of ZIP conservation financing necessarily will result in lenders being unable to rely on traditional forms of security.

Therefore, to make project financing of ZIP feasible, lenders must be assured of recovery of debt service under all circumstances for the life of any approved debt financing. The lenders will have to rely upon and will insist upon an assured revenue stream over the life of the borrowings through a Conservation Financing Adjustment (CFA) mechanism. If lenders are not assured of recovery of debt service in a timely manner and under all circumstances, ZIP cannot be project financed.

PGandE requests the Commission to plainly state that it cannot and will not interrupt the revenue stream on which lenders will have relied in making Commission-approved debt commitments. The Commission should declare in the interim opinion that lenders will rely and are entitled to rely on the Commission's commitment to CFA debt service cost recovery; and that in the event a future Commission decides to cut back or discontinue ZIP as no longer in the public interest, any such change will only affect prospective financings. The Commission should also acknowledge that to avoid confiscation of funds lent in good faith by lenders, CFA debt service recovery for previously approved ZIP financings cannot be reduced or impaired in any way.

To provide lenders the necessary assurances, PGandE proposes that ZIP be accomplished using a two-rate approach. Such an approach would allow the Commission to control ZIP expenses through adjustments to administrative and general (A&G) expenses and return on equity. Under PGandE's proposal, the CFA would function as follows:

The CFA would be subdivided into two rates. The "ZIP Debt Service Rate" would provide for recoupment of debt service. To provide assurances required by lenders, the Commission would commit to timely recovery of all debt service costs (interest, amortization of bad debt and financing fees) under all circumstances, for borrowings made pursuant to ZIP project letters previously approved by the Commission. In order to reflect as quickly as possible actual debt service expense experience, advice letter adjustments to this ZIP Debt Service Rate should be permitted on a quarterly basis. Because the intent would be to track actual debt service cost experience as quickly as possible and, considering that such expenses are easily determinable and noncontroversial, the Commission could and should commit to expeditious translation of these actual costs into rates.

The second CFA rate, 'ZIP Expense Rate,' would recoup all other expenses of the ZIP program, including administration and general expenses, return on PGandE investment in the ZIP subsidiary and income taxes associated with that return. This rate would be adjusted through annual ZIP rate cases. The Commission could carry out a more extensive review of these costs, in order to control ZIP expenses as the Commission indicated it desired to do in D.92653. However, by including these costs in the CFA and requiring PGandE to flow resulting revenues through to its ZIP subsidiary, the lenders would be provided the added assurance of a 'cushion' of revenues which could be relied upon for repayment of debt service costs and principal.

All ZIP-CFA revenues should be promptly transferred to the ZIP subsidiary. Revenues from the ZIP Debt Service Rate would be specially earmarked to the benefit of lenders. Revenue from the 'ZIP Expense Rate' for expenses over and above recoupment

of debt service would serve as a 'cushion' for lenders and would provide them additional assurances. To protect the lender's 'cushion', ZIP-CFA revenues (net of PGandE's franchise fee and uncollectible expenses) would be distributed by the ZIP subsidiary to satisfy debt service costs first, PGandE's administrative and general expenses next, and PGandE's return on its investment in the ZIP subsidiary last. PGandE would also be required to transfer immediately all ZIP principal payments received from its customers to its ZIP subsidiary for the benefit of its lenders. The ZIP subsidiary would then make principal payments to the lenders.

PGandE requests that the entire CFA be handled through a balancing account. Although the Commission authorized ZIP balancing account treatment, it stated its intention to reassess the need for balancing account treatment of ZIP expenses concurrently with the general rate proceedings for PGandE for the 1984 test year.

However, in order to provide lenders the assurances which are necessary to make project financing of ZIP feasible, the Commission must provide that the balancing account will endure for the life of the borrowings. A three-year balancing account is simply inadequate from the lenders' viewpoint; after 1983 the lenders would understandably be concerned that their only real security, particularly with loans already proven to be bad debts, will be through regulatory recovery. At a minimum, the balancing account must exist beyond December 31, 1986, the date adopted by the Commission for concluding ZIP loan offers.

PGandE also asks the Commission to reconsider its decision to exclude PGandE's administrative costs from the balancing account by the end of 1983. PGandE describes the effect of this Commission determination as follows:

"With administrative costs excluded from the balancing account, all ZIP program costs are not clearly identified by means of the CFA mechanism. The ZIP program is not a stand-alone program, and the subsidiary is not a stand-alone entity. In fact, with administrative costs excluded from the balancing account, the possibility exists that PGandE shareholders may end up subsidizing the ZIP program if and when certain administrative costs are disallowed for recovery . . . [T]o the extent administrative or any other costs are disallowed, the amount disallowed necessarily will have to come out of return on equity. The total amount disallowed and not recovered, therefore, is limited by the total return on equity which is in turn limited by the amount of equity invested and the rate of return allowed on that equity investment. In this manner, the subsidiary can remain a stand-alone entity over the life of the ZIP program"

PGandE contends that assurances to lenders that the ZIP program will be soundly funded and that the flow of funds is guaranteed through the stand-alone subsidiary is essential to the continued support by the banking community.

PGandE further argues that the Commission can readily control the administrative costs by setting the rate of return on rate base representing PGandE's investment in the subsidiary and by prior approval of administrative plans. Administrative costs can be defined in detail for the purpose of obtaining Commission approval before their incurrence. PGandE proposes to submit all agreements between itself and the subsidiary, especially as they relate to the assignment of CFA revenues by PGandE to the subsidiary, to the Commission for prior approval. For all of these reasons, PGandE requests the Commission to reconsider its decision to exclude A&G expenses from the balancing account after 1983.

Finally, PGandE asks that the interim opinion include a conclusion that the Commission has authority to approve ZIP and its financing structure. In view of the petition for writ of review filed with the California Supreme Court by General Motors Corporation seeking to annul D.92653 on grounds, among others, that the Commission has exceeded its lawful authority, PGandE feels that it is important to provide lenders Commission assurance that the ZIP program is duly authorized.

Banks

The Banks agree with all essentials of the petition for an interim opinion filed by PGandE. They recommend quick adoption of PGandE's proposed Findings of Fact, Conclusions of Law, and Ordering Paragraphs so that negotiations for the financing of ZIP can commence. Further, they provided a separate expression of their views about certain Commission determinations required to make the ZIP project financeable, including additional proposed Findings of Fact and a Conclusion of Law.

Given the unique aspects of the proposed ZIP financing, the sole form of security existing for potential lenders is a Commission commitment under all circumstances to timely and full recovery through rates of ZIP debt service costs. Since the value of this form of security is based on the level of Commission commitment to ZIP, lenders must naturally focus attention on what they perceive as "regulatory risk". This risk involves the possibility that some future Commission may delay rate recovery of ZIP debt service costs or reduce or completely disallow recovery of such costs for loans then outstanding.

However, in order to reduce regulatory risk to an acceptable level for potential lenders, the overriding objective of the Banks must be timely and complete recovery of principal and interest, as

well as associated fees, under any and all circumstances, whether foreseen or unforeseen. The Banks recognize that risk, including regulatory risk, cannot be completely eliminated. Yet, if the Commission adopts PGandE's and the Banks' recommendations, the Banks are of the opinion that as a result of negotiations between PGandE and potential lenders any remaining risk can be accommodated.

The Banks have identified regulatory risk as the most critical element of risk in the ZIP project financing. Having thus assessed the risk associated with ZIP financing, the Banks suggest several ways to minimize that risk. In the eyes of the lenders, the following recommendations would serve to reduce exposure to risk:

The recommendations of the GEDA-like project letter approach, the two-rate approach, along with the Commission's long-term commitment to recovery of debt service cost, the balancing account, the CFA rate structure, the A&G expense recovery "cushion", the proposed Findings of Facts and Conclusions of Law regarding public convenience and necessity, public interest, lender reliance, and authority of the Commission, are all designed to reduce this regulatory risk.

With each project letter filing, the Commission will be asked to review its commitment to ZIP and to reassure potential lenders on points of concern. The periodic project letter filings also permit the lenders to control the amounts advanced and to refuse further advances if the outcome of the project letter filings is adverse. Further, such filings provide the Commission with a convenient method of limiting or curtailing the program if it should ever prove desirable to do so, without jeopardizing the CFA revenue stream necessary to repay debts incurred by the subsidiary for a prior financing. Segmenting the financing provides the Commission more control over the program

and provides assurance to lenders that the Commission has approved all financings and weighed its commitment to debt service recovery in a considered manner.

From the Banks' perspective, there are two reasons favoring Commission approval of the two-rate approach which separates debt service cost recovery from recovery of other ZIP costs. First, the debt service rate would have to be capable of more frequent adjustment than the other rate because of the possibility of changes in interest rates and to provide for the possibility of unexpected changes in default rates. Second, occasions may arise in which the Commission would want to examine the reasonableness of PGandE's A&G expenses in a hearing. That could delay adjustments to that part of the CFA rate. Because the Commission will have pre-approved debt service costs when it approves a periodic project letter filing for a particular financing, there will be no reason to review that part of the rate in the CFA filing; and therefore, the debt service CFA rate should work independently of the CFA rate for other expenses.

Additionally, it is important to potential lenders that all ZIP costs, not just debt service costs, be included in the CFA rates to assure that the subsidiary will be able to make payments in a timely manner. Debt service would have first claim to all CFA revenues. Since the balancing account mechanism will involve setting rates on the basis of cost estimates, there will be periods of undercollection. If PGandE underestimates costs during a period, the CFA revenues that would otherwise have been available, for instance, to cover its A&G expenses will instead go for debt service payment to lenders during that period; and PGandE would be made whole from revenue collected after the next advice filing.

This approach provides assurances to potential lenders that the debt service revenue stream would not be impaired and that there would be some cash flow cushion received by the subsidiary over and above recoupment of debt service.

In the Banks' opinion, lending institutions will not participate in the ZIP program on a project financing basis unless they have a clear and strong commitment from the Commission that their loans will be repaid, with interest in a timely manner. The findings proposed by PGandE contain procedural provisions, such as the project letter filing, the bifurcated CFA rate, and the advice letter amendments to the debt service rate, that will help provide this commitment. Similarly, the proposed findings that potential lenders will justifiably rely on these procedures, and that changes detrimental to lenders would be confiscatory, will provide further assurances.

In its decision on this matter, the Commission should discuss and rule on each proposed Finding of Fact, Conclusion of Law and Ordering Paragraph. The Commission also should find that its ability to monitor the workings of the program to identify any imprudent A&G expenditures, its ability to order prospective changes in the program, and its ability to review and adjust the equity component of the tariff charge together constitute adequate means of discharging its responsibility to protect the public interest. If project financing is to be accomplished, the Commission will have to indicate that its monitoring function can be fulfilled without jeopardizing the ZIP Debt Service Rate.

In these proceedings, the Commission has assumed responsibility for determining the standards of cost-effectiveness to be used and has devised a program which, because of the overriding objective of maximum market penetration and maximum energy savings, may result in significant bad debts. The Commission should recognize the implications of its decision. As a part of its decision, the Commission should make a finding to the effect that it has reviewed all the evidence regarding the cost-effectiveness of the ZIP program and has deemed the program to be cost-effective. Because of the difficulty of appraising cost-effectiveness, potential lenders will rely on PGandE and the Commission to make this determination. Even if the program proves not to be cost-effective, the Commission should acknowledge that lenders will be proceeding in good faith and will not suffer adverse consequences.

As a part of its next decision in this proceeding, the Commission should recognize in the appropriate finding that the financing of the ZIP project is totally dependent upon the tariff provisions remaining in effect throughout the life of the debt financing, that the proposed tariff provisions will provide for just and reasonable rates which are necessary to ensure the program, and to provide complete and timely recovery of ZIP debt service through CFA rates on all Commission-approved ZIP financings under all circumstances, whether foreseen or unforeseen, over the life of the financings.

Finally, the Commission should acknowledge that funds will be advanced in reliance, and justifiably so, upon the continued effectiveness of the CFA tariff provisions. We recommend that the Commission address itself to this issue as part of this order. The Banks believe that failure to extend such assurances will jeopardize the availability of funds, both debt and equity, needed to support a ZIP program of the size and scope presently envisaged.

All of the Banks' concerns can be met by summary Commission adoption of the Findings of Fact, Conclusions of Law, and Ordering Paragraphs proposed by PGandE and the Banks.

Staff

Staff agrees with PGandE that the novelty of ZIP and its unique project financing structure requires Commission assurances to potential lenders that there will be complete recovery of debt service in a timely manner throughout the existence of ZIP. However, staff contends that the security lenders need does not require the Commission to adopt all of PGandE's proposals. Most significantly, staff objects to PGandE's attempt to relitigate the issue of the proper treatment of A&G expenses previously decided by the Commission in D.92653 and reaffirmed by D.92978.

Staff feels strongly that the treatment of administrative costs has already been decided and should not be reconsidered. Despite the Commission's warning in D.92653 that it would "not countenance the relitigation of issues already raised, contested, and resolved in this proceeding", PGandE is now attempting to have the Commission reverse its position on administrative costs. Even assuming that PGandE could overcome this legal impediment, it has offered no sound rationale to prompt Commission reconsideration of this issue.

The only reason offered by PGandE for the Commission's reversing itself appears to be the threat that PGandE will be unwilling to go forward with the program unless the Commission capitulates. PGandE has previously indicated in prior testimony that it could not and did not intend to subsidize this program in any manner and that nonsubsidy was a condition to proceeding with a full scale ZIP program.

Staff contends that if the Commission adopts PGandE's recommended rate approach to the treatment of debt service, potential lenders should have virtually no risk that their loans will be unrecovered throughout the existence of ZIP. Given this, the only reason for adopting the balancing account treatment of administrative costs is to protect PGandE's shareholders from the possibility of bearing some administrative costs in the event that the actual costs exceed those authorized by the Commission in a general rate proceeding.

PGandE presented no new evidence from which the Commission can conclude that it should reverse itself on this issue. If anything, the modified ZIP program which the Commission adopted in D.92563 makes PGandE's arguments less persuasive than when originally presented. In that decision, the Commission adopted a sunset date of December 31, 1986 for concluding ZIP loan offers, a provision not contained in PGandE's original application. Thus, PGandE's potential exposure, if the balancing account treatment of administrative costs is not adopted, is essentially from the end of 1983 through the end of 1986, since the majority of administrative costs occur only while loans are being processed.

PGandE's contention that its subsidiary must stand alone is reasonable but only to the extent that it is necessary to support project financing. It is staff's view that there should be no impediment to project financing merely because of the exclusion of administrative costs from the balancing account. If the Commission assures lenders that there will be full debt service recovery through the CFA mechanism proposed by PGandE, and if PGandE's equity investment is also given balancing account treatment, there is no reason potential lenders should hesitate to commit funds to ZIP.

PGandE's attempt to make the program risk-free for its shareholders must be resisted. PGandE, unlike potential lenders, is in the business of accepting both "regulatory risk" and the risks

inherent in prospective test year ratemaking. Administrative costs for the ZIP program will be substantial. Control over these costs can only occur if PGandE has a direct stake in efficiency. A balancing account simply cannot serve this function.

Finally, it is important to mention that at the prior hearing staff recommended that the balancing account be used until there is a realistic basis for estimating the proper level of administrative expenses. Thus, PGandE will lose the balancing account only after there has been considerable experience with ZIP. This should make the risk of underestimating administrative expenses equivalent to that encountered in other parts of the utility operation, a risk compensated for by PGandE's receiving a fair return on its investment.

PGandE contends that by having the A&G expenses included in the CFA, the lenders will be provided with an added assurance of a "cushion" of revenues which could be relied upon for repayment of debt service costs and principal. Staff maintains that this added assurance is not necessary for several reasons. First, since the removal of A&G expenses from the CFA will only occur after program expenses are well-established, it is reasonable to expect that by that time estimates for debt service can be made with accuracy on a quarterly basis, as proposed in PGandE's "ZIP Debt Service Rate." Second, even if A&G expenses were to be treated in the CFA, the so-called "cushion" could exist for only short intervals inasmuch as PGandE would be billing its subsidiary for A&G expenses as they are incurred. There is no reason for the CFA to maintain a large excess fund for anticipated expenses, and without such a fund there would be no significant "cushion". Third, the equity investment of PGandE with its earned return and tax coverage will supply a substantial "cushion" - if any is needed - for any deficiency in the revenue stream needed to provide debt service. Finally, as

loans are repaid by customers there will be an additional source of funds to service the outstanding debt. It therefore appears clear that the only real purpose served by including A&G expenses in the CFA is to provide PGandE with a "cushion" from risk.

With exception of the treatment for A&G expenses, staff endorses PGandE's proposal to assure lenders that their loans will be repaid through Commission adoption of a CFA mechanism. Staff is persuaded by the evidence and testimony during the recent hearings that to properly structure the ZIP program to appeal to potential lenders it will be necessary to create a CFA and a bifurcated rate which will remain for the duration of the ZIP program.

Discussion

We are well aware that the ZIP project requires financing unlike any other that has ever been attempted. We also recognize that the proposed project financing for installation of cost-effective conservation measures, with its innovative and unprecedented characteristics, provides a method by which the necessary capital can be raised at a cost less than conventional financing. As a result, all ratepayers will realize substantial economic benefits if ZIP is project financed. To achieve project financing under the most favorable terms, it is acknowledged that the Commission must provide reasonable assurances to potential lenders that they will recover their loans in a timely manner and under all circumstances. This order is intended to provide lenders with such reasonable assurances.

Although ZIP does not provide security in the traditional sense of project financing in that it does not provide a pledged assets form of security, PGandE's proposal to create a CFA mechanism with a bifurcated rate provides a reasonable means by which the Commission can guarantee potential lenders recovery of their debt

service. Our approval of such a mechanism will entitle lenders to rely on the Commission's commitment to CFA debt service cost recovery.

While acknowledging our inability to bind the actions of a future Commission, we nevertheless state that any decision by a future Commission to cut back or discontinue ZIP as no longer in the public interest can properly apply only to prospective financings. To avoid confiscation of funds provided in good faith by lenders, we will not interrupt the revenue stream on which lenders will have relied in making Commission-approved debt commitments.

In D.92653, we authorized the ZIP balancing account but stated our intention to reassess the need for balancing account treatment of ZIP expenses concurrently with the general rate proceedings for PGandE for the 1984 test year. We now recognize that lenders must be assured that the balancing account itself will endure throughout the life of the debt financing. Today's order will reflect that recognition.

Along with our approval of a bifurcated tariff, consisting of a debt service rate and an expense rate, we will also authorize filing by advice letter on a quarterly basis for adjustment to the debt service rate. Adjustments to the expense rate will be treated in the annual review of PGandE's ZIP.

We concur with staff that our adoption of PGandE's recommended rate approach and balancing account treatment of debt service makes the lenders' risk that any portion of their loans will be unrecovered throughout the existence of ZIP virtually non-existent. Since our action today commits the full body of ratepayers as ultimate guarantors of the lenders' debt service recovery, we expect the interest rate negotiated between PGandE and the Banks to reflect the almost complete minimization of lender risk.

With respect to PGandE's request that administrative costs of ZIP be included in the CFA throughout the life of the balancing account, we find no compelling reason to reconsider our original decision. Our decision to exclude administrative costs from the balancing account by the end of 1983 while assuring lenders that there will be full debt service recovery through the CFA mechanism should impinge in no way upon the viability of project financing.

We are unconvinced that the project financing structure is contingent either upon the existence of a "cushion" of funds in the CFA resulting from the inclusion of A&G expenses in the balancing account or upon mere averments that PGandE's subsidiary must exist as a stand-alone entity. Traditional project financing may require a "cushion" or a stand-alone subsidiary. However, all parties acknowledge that the ZIP financing is unique. It is this very uniqueness which prompts us to take the extraordinary step of guaranteeing debt service recovery with ratepayer funds.

We find staff's arguments more persuasive. After 1983, PGandE is the entity best situated to efficiently monitor potentially substantial administrative costs. Furthermore, balancing account treatment of A&G expenses will terminate only after PGandE has realized significant experience with ZIP operations. PGandE's risk associated with making a reasonable forecast of A&G expenses for test year 1984 is one normally attendant to utility operations.

Furthermore, we will reiterate our intention regarding PGandE's return on its equity investment in its subsidiary. Initially, such recovery will be authorized through the balancing account procedure. However, this return will be subject to review in the first annual ZIP cost offset proceeding.

Finally, before we conclude it is necessary to resolve an outstanding procedural matter. On May 11, 1981, the Natural Resources Defense Council (NRDC) propounded a series of data requests

and interrogatories to PGandE. PGandE objected to the data requests and interrogatories on grounds that they were overbroad, oppressive, irrelevant, and ambiguous.

We concur with PGandE that the information requested by NRDC involves matters beyond the scope of Phase II of these proceedings. An ambiguity in D.92653 prompted NRDC's misapprehension that Phase II would address the question of the overall level of effort which PGandE should be authorized to undertake in a system-wide ZIP project.

D.92653 has already outlined the exact program which would be implemented systemwide if Phase II approval is granted. The Commission is not currently considering changes to the structure of the program nor is it reviewing different levels of investment by PGandE. In Phase II, we are simply determining whether to go forward with ZIP, as defined in D.92653, on a systemwide basis.

Accordingly, the request for data and answers to interrogatories filed by NRDC will be denied. Such data will more properly be a subject during subsequent annual reviews of PGandE's ZIP.

In order to allow negotiations for project financing to commence immediately, this order will become effective today.

Findings of Fact

1. ZIP is estimated to require borrowing of hundreds of millions of dollars by PGandE's financing subsidiary in the first five years of operation of the ZIP program.
2. Project financing for a conservation financing program on the scale of ZIP is innovative and unprecedented.
3. Project financing provides a means to finance ZIP which is attractive both for the utility and its ratepayers. The higher leverage resulting from project financing will result in relatively

low cost financing and lower income taxes. Project financing also should not impinge on PGandE's ability to meet its other capital requirements and thus will enable it to conduct the ZIP program and simultaneously meet its other obligations to provide adequate service to its customers.

4. Project financing is a form of financing in which lenders lend money for the development of a specific project or program rather than for the overall operation of a corporation, and amounts lent are secured primarily by the flow of funds from specific projects.

5. In addition to the security of a flow of funds, project financing often is secured by the pledging of the assets of a single cohesive project with ownership limited to a small number of entities. In the event of default, the assets of such a project can be taken over by lenders, completed and operated, or sold to recoup debt investment.

6. ZIP does not represent a traditional application of project financing in that it does not provide a pledged assets form of security. The funds will be devoted to hundreds of thousands of individual projects, all separately owned, which lenders could not realistically take over in the event of default and which would not produce revenue for the lenders.

7. PGandE's subsidiary will use borrowed and PGandE funds to make loans not to exceed \$3,500 total to any individual PGandE customer participating in ZIP. To achieve the Commission's goal of maximum market penetration, it is necessary to make ZIP available and attractive to low income, elderly, non-English speaking and landlord and tenant customers. As a result, the Commission recognizes that many loans will be made to ZIP participants who ordinarily would not qualify for home improvement loans from conventional lending sources.

8. PGandE's subsidiary will be permitted to secure ZIP loans by liens. While the liens may aid collection, they will be of questionable value for purposes as collateral security for borrowing from lenders.

9. Because of the nature of the underlying assets (such as insulation, weatherstripping, caulking, etc.), the questionable value of the security and the lack of traditional lender credit standards, lenders cannot be expected to rely on enforcement of the notes and liens to insure loan repayment.

10. It is necessary to have an assured revenue stream large enough to cover, at a minimum, the recoupmnt of debt service in a timely manner under all circumstances in order to attract lenders to advance the large borrowings envisaged for ZIP. In the absence of such security, ZIP may not be project financed under terms most favorable to the ratepayers' interest in minimizing the cost of capital.

11. Debt service is defined to include principal not recovered from participants in a timely manner, interest whether at a variable or fixed rate, and associated fees.

12. Lenders will advance the debt funds required by PGandE's subsidiary only if the lenders can rely on the ZIP-CFA procedure to guarantee, at a minimum, a debt service revenue stream over the life of the borrowings from the lenders, and on the agreement between PGandE and its subsidiary relating to the assignment of CFA revenues and PGandE's investment to provide a "cushion" for the debt service.

13. The public interest and public convenience and necessity require that the Commission institute a ZIP-CFA procedure similar to PGandE's GEDA procedure.

14. The ZIP-CFA procedure will entail periodic financing project letter filings by PGandE describing proposed financings.

15. If the Commission approves a ZIP financing project letter, it will be with the understanding that as to the ZIP financing, PGandE will be authorized to recoup through CFA rates, at a minimum, the actual debt service cost of such financing over its lifetime.

16. The CFA should be subdivided into two separately computed rates. The first rate ("ZIP Debt Service Rate") will cover the recoupment of debt service and will be subject to the Commission's commitment of full recovery. The second rate ("ZIP Expense Rate") will cover taxes and the return on PGandE's investment in the subsidiary. The ZIP Debt Service Rate may be adjusted quarterly by advice letter filings to reflect changes in applicable costs. The ZIP Expense Rate may be adjusted annually and will be subject to Commission review of the reasonableness of such expenses in PGandE's annual ZIP rate case.

17. The debt service costs collected by PGandE under the ZIP Debt Service Rate and ZIP Expense Rate are to be accounted for separately, deposited in a special account for the ultimate benefit of the lenders, and are to be transferred to the subsidiary immediately.

18. CFA revenues (net of PGandE's franchise fee and uncollectible expenses) will be distributed by the subsidiary so that debt service costs will be satisfied first, and PGandE's return on its investment in the subsidiary last.

19. A balancing account, established concurrently with the CFA, will allow for the balancing of CFA amounts received with costs incurred and thereby provide security to ZIP project lenders. PGandE shall be entitled to adjustments in the CFA Debt Service Rate by advice letter filings quarterly for the purpose of bringing the debt service portion of the balancing account to zero.

20. Principal amounts collected from ZIP participants are to be accounted for separately, deposited in a special account for the benefit of the lenders, and will be transferred to PGandE's subsidiary immediately.

21. The balancing account and the ZIP-CFA procedure approved are intended to assure lenders of full recovery of debt service in a timely manner and to encourage their investments in the ZIP program under terms favorable to both lenders and ratepayers.

22. Until A&G expenses are removed from the CFA at the end of 1983, the Commission can control PGandE's administration of ZIP through setting of rates for the allowed return on PGandE's investment in the subsidiary and by reviewing and approving PGandE's administrative plans for ZIP.

23. Lenders justifiably will be acting in reliance on the Commission's commitment to CFA debt service cost recovery whenever lenders make loans to PGandE's subsidiary to fund Commission-approved ZIP financings.

24. While the Commission finds that ZIP is in the public interest and serves public convenience and necessity, it recognizes that a future Commission could determine that further ZIP financings no longer would be in the public interest and public convenience and necessity. If this should occur, to avoid confiscation of funds already lent in good faith by lenders, the Commission finds that only prospective financings can be affected and that CFA debt service recovery for previously approved ZIP financings will not be reduced or impaired in any way.

25. An important component of the ZIP-CFA procedure will be the agreements between PGandE and its subsidiary, particularly as they relate to the assignment of the CFA revenues to the subsidiary

by PGandE for costs incurred for ZIP financings. In further phases of this proceeding, the Commission expects PGandE to submit such agreements for approval. Likewise, the Commission expects PGandE to submit for approval any credit agreements between its subsidiary and lenders concerning borrowing of ZIP funds.

26. In negotiations with lenders, PGandE is expected to use best efforts to achieve an 80/20 debt-to-equity ratio in the subsidiary, although a higher equity contribution by PGandE may be necessary in order to obtain favorable financing terms.

Conclusions of Law

1. The Commission is authorized by Public Utilities (PU) Code Section 2789 to "permit or require any electrical or gas corporation subject to its jurisdiction to institute energy conservation programs for its customers, including related financial assistance at terms found reasonable by the commission."

2. ZIP is a conservation program of financial assistance which the Commission is authorized to approve under PU Code Section 2789.

3. If the Commission authorizes PGandE to expand the ZIP program systemwide at the conclusion of the current proceedings, PGandE will have legal authority to offer ZIP financing throughout its service territory.

4. It is in the ratepayers' interest to project finance ZIP and thereby achieve a lower cost of capital.

5. The details of the project financing structure described in the findings of fact stated above are fair, reasonable, and serve the ratepayers' interest.

6. The Commission has authority to assure complete and timely recovery of ZIP debt service through CFA rates on all Commission-approved ZIP borrowings under all circumstances over the life of

the borrowing. Debt is financing of an expenditure so that the cost of the expenditure is spread over a number of years, and to the extent ZIP expenditures and financings are approved by the Commission, debt service costs related to such financings should be assured complete recovery.

7. Failure to immediately approve details of the project financing structure proposed for PGandE's systemwide implementation of ZIP will unnecessarily delay the program and its attendant benefits for ratepayers. These circumstances constitute an emergency, which requires action although this decision was not noticed on the Commission's public agenda seven days prior to today's public conference.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PGandE) is authorized to incorporate a California corporation as its subsidiary to undertake the Zero-Interest Program (ZIP).
2. PGandE shall project finance the ZIP subsidiary and use its best efforts to achieve at least an 80/20 debt-to-equity ratio.
3. PGandE is authorized to assign the CFA tariff revenues to the subsidiary.
4. The subsidiary, through PGandE, is authorized to recover 100% of the debt service in a timely manner and under all circumstances through the CFA tariff for all Commission-approved subsidiary borrowings over the life of the borrowings.
5. For debt service only, PGandE is authorized to make rate changes through advice letter filings for all Commission-approved subsidiary borrowings. Once a specific borrowing has been approved by project letter and committed, subsequent hearings will not be initiated by the Commission relating to that specific borrowing. ✓
6. The Conservation Financing Adjustment (CFA) balancing account will not be terminated so long as subsidiary borrowings remain outstanding.

7. PGandE shall file an annual ZIP rate case for nondebt-related costs.

8. PGandE shall accrue a rate of return on its investment in the subsidiary equal to the rate of return on rate base adopted in PGandE's most recent general rate case; this return will be subject to review in the first annual ZIP cost offset proceeding.

This order is effective today.

Dated SEP 1 1981, at San Francisco, California.

John E. Bryan President
Richard D. Bussell
Samuel M. Spier
Victor Calvo
Francis A. Green Commissioners