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Decision 96-11-060 November 26, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority to (i) Establish its Authorized Rate of Return on Common Equity, (ii) Establish its Authorized Capital Structure, (iii) Adjust its Cost Factors for Embedded Debt and Preferred Stock, and (iv) Establish its Overall Rate of Return for Calendar Year 1997. (Electric and Gas) (U 39 E)	Application 96-05-022 (Filed May 8, 1996)
And Related Matters.	Application 96-05-023 Application 96-05-024 Application 96-05-043

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OPINION

Summary

This decision establishes the costs of capital for calendar year 1997 for four California energy utilities: Pacific Gas and Electric Company (PG&E), Southern California Edison (Edison), Southern California Gas Company (SoCalGas), and San Diego Gas & Electric Company (SDG&E). Sierra Pacific Power Company (SPPC), PacifiCorp, and Southwest Gas (Southwest) have been excused from participation in these proceedings by Commission orders. The rates of return adopted today will be incorporated into rates in other proceedings.

In this decision, we adopt the capital structures, costs of debt, and preferred stock and the rate of return on equity (ROE) proposed in an all party settlement. Each utility's ROE will remain at 11.60%, the same ROE granted in last year's attrition proceeding. However, the separate PG&E pipeline expansion (PG&E Pipeline) ROE will drop from last year's 12.10% to 11.60%, while its long-term debt decreases from 67% to 64%. A 30 basis point increase in preferred stock and corresponding decrease in debt will be made in PG&E's traditional utility operations' capital structure. SoCalGas's equity will increase 60 basis points, its long-term debt will increase 270 basis points and its preferred stock will decrease 330 basis points, due largely to a redemption of preferred shares. Edison's and SDG&E's capital structures remain unchanged. We find the all party settlement reasonable and grant its request that the October 1996 DRI/McGraw-Hill Control Forecast for AA Utility Bonds (DRI Update) not be used to calculate the utilities' costs of embedded debt and preferred stock. Instead, we approve the settlement's agreed cost bases for each utility, which will result in a lower rate of return (ROR) on rate base than produced by use of the DRI Update and will therefore benefit ratepayers. Today's decision should produce revenue neutrality for SDG&E and SoCalGas, while providing for reductions in authorized revenues for PG&E and Edison.

The estimated overall results are summarized in Table 1:

Table 1 Adopted Costs				
Utility	Return on Equity	Return on Ratebase	Estimated Revenue Change (Millions)	
PG&E	11.60%	9.45%	Electric	($5.3)
			Gas	($1.6)
PG&E Pipeline	11.60%	8.99%		$0.0
SCE	11.60%	9.49%		($5.4)
SoCalGas	11.60%	9.49%		$0.0
SDG&E	11.60%	9.35%	Electric	$0.0
			Gas	$0.0

Procedural History

PG&E, SoCalGas and Edison filed their cost of capital applications on May 8, 1996 in accordance with the Commission's modified Rate Case Plan in 30 CPUC 2d 576 (1989). Due to a request for exemption from this year's proceeding then pending before the Commission, SDG&E was granted an extension of time for the filing of its application. SDG&E's application was filed on May 24, 1996. On June 19, 1996, SDG&E was denied its requested exemption in Decision (D.) 96-06-055.

SPPC was granted an exemption from this year's cost of capital proceeding pending FERC consideration of its upcoming merger with Altus Corporation. (D.96-05-059 mimeo. at 2-3 (May 23, 1996).) If the merger is implemented, due to the rate freezes incorporated in its terms, SPPC will be exempt from cost of capital proceedings until 1999. (Id.) PacifiCorp has an exemption from cost of capital proceedings through 1999 as a result of a settlement adopted in its last general rate case. (52 CPUC2d 317, 321 (1993).) Southwest has been exempted through 1998 as a result of an alternative ratemaking approach in a settlement adopted in its last general rate case. (57 CPUC2d 646, 649 (1994).)

The proceeding was assigned to Commissioner Henry M. Duque and Administrative Law Judge (ALJ) Ann Watson. A prehearing conference (PHC) was held on June 3, 1996. At the PHC, the ALJ consolidated the four applications into one proceeding pursuant to Rule 55 of the Commission's Rules and Practice and Procedure (Rules). Evidentiary hearings were set for August 26 through 30, 1996. On the first day of hearings, the parties notified the Assigned Commissioner and the ALJ that settlement talks were successful and requested a recess until August 27 in order to finalize the Joint Recommendation of the Agreeing Parties (Joint Recommendation). On August 27, 1996, the ALJ accepted into evidence the Joint Recommendation (Exhibit 2), supported by testimony from the Division of Ratepayer Advocates' (now Office of Ratepayer Advocates (ORA)) Edwin Quan.[1] All prepared testimony was also received into evidence. Proofs of compliance with all notice provisions of Rules 24 and 52 were filed. Opening briefs were filed on September 16, 1996.[2] The proceeding was submitted upon the filing of reply briefs by ORA and CPI on September 23, 1996, with the provision for late filed Exhibits 19 and 20 after issuance of the DRI Update. Late-filed Exhibits 19 and 20 were filed October 9, 1996.

All active parties support the Joint Recommendation. Those parties are: PG&E, Edison, SoCalGas, SDG&E, ORA, Federal Executive Agencies (FEA), City of Los Angeles (Los Angeles), the Cities of Burbank, Glendale, and Pasadena (Cities) and CPI.[3]

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[1] Because the Joint Recommendation sets the utilities' costs of embedded debt and preferred stock, the parties request that the Commission not utilize the DRI Update to calculate these final numbers as is our usual course. Therefore, the Joint Recommendation requests a waiver of the filing of the DRI Update. On September 3, 1996, Assigned Commissioner Duque issued a Ruling denying the waiver request due to the multiple uses of the DRI Update, including its use in assessing the reasonableness of the Joint Recommendation. Thus ORA was directed to file the DRI Update and an update of ORA's comparison of the parties' positions and joint recommendation of the agreeing parties (Exhibit 1) as late filed Exhibits 19 and 20 by October 4, 1996. Due to a delay in release of the figures necessary to prepare the DRI Update, the ALJ granted ORA's request to extend the time for filing late-filed Exhibits 19 and 20 until October 11, 1996.

[2] Consumers for the Public Interest (CPI) served, but failed to file, its opening brief timely. Since none of the parties were prejudiced by the failure to file, CPI was granted permission to file its brief late.

Toward Utility Rate Normalization (TURN) and CPI filed notices of intent to claim compensation (NOIs). TURN was granted eligibility by ALJ Ruling on August 7, 1996.[4] In that Ruling, CPI's NOI was held in abeyance until a decision was issued on the intervenor filings of its designated representative Economic and Technical Analysis Group (ETAG) in last year's proceeding.[5] CPI's NOI was contested by TURN, Utility Consumers' Action Network (UCAN) and ORA. On October 3, 1996, the Assigned Commissioner and the ALJ jointly issued a ruling requiring CPI to supplement its showing on eligibility and financial hardship. CPI was given until November 4, 1996 to file its amended NOI. The record on this matter will not close until after the issuance of our final decision in this year's proceeding. Although Energy Consulting Group (ECG) appeared at the PHC, it did not file an NOI nor did it appear at the hearings or file briefs.

A proposed decision in this matter was mailed on October 25, 1996. Comments on the proposed decision were filed by PG&E, SDG&E, SoCalGas, ORA, and CPI. Changes have been made to correct technical errors set forth in the comments. No reply comments were filed.

Introduction

In this generic annual proceeding, we establish rates of return on ratebase (ROR) and ROE with regard to differences among the energy utilities. For this reason, we analyze each utility separately. Three United States Supreme Court decisions establish the legal criteria for determining appropriate rates of return. (Bluefield Water Works and Improvement Company v. West Virginia Public Service Commission (1923)

[3] CPI began its participation in this proceeding under the name California Public Interest Ratepayer Group (CAPIRG). Just prior to the hearings, CAPIRG changed its name to CPI.

[4] On August 13, 1996, TURN notified the ALJ that it would not participate in the hearings and that it was unlikely it would file briefs or comments. TURN did not file any briefs.

[5] The proposed decision on this issue was placed on the Commission's October 9, 1996 agenda but was held.

262 U.S. 679, 43 S. Ct. 675; Federal Power Commission v. Hope Natural Gas Company (1944) 320 U.S. 591, 64 S. Ct. 281; and Duquesne Light Co. v. Barasch (1989) 488 U.S. 299, 109 S.Ct. 609.) Hope states that, as long as a rate enables a company to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risk assumed, it will not be judged invalid even though it produces a meager return. (320 U.S. at 605.) The return should be equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties. (Bluefield, 262 U.S. at 692-693.) However, a rate may not be so low as to be confiscatory, and in making this analysis, the focus is whether the rate is unjust or unreasonable, to some extent, based on what is a fair rate of return given the risks under a particular ratesetting system and the amount of capital upon which investors are entitled to earn that return. (Duquesne, 488 U.S. at 310.) However, Duquesne declares: "The constitution, within broad limits, leaves the states free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public." (488 U.S. at 316.)

Under our Constitutional guidelines, we are concerned with, among other things, reasonable compensation to utility investors for the risks they assume. "[W]e must identify the risks for which investors require compensation, evaluate the relative magnitude of these risks on the utility over the test period, and quantify these observations into an authorized rate of return on common equity and total capital." (33 CPUC2d 525, 538 (1989).) In so doing, we combine the qualitative assessments of risk with quantitative model results in arriving at a final judgment on required returns on equity. (Id.)

Each utility's cost of capital is composed of 4 elements--the cost of embedded, or long term, debt, the cost of preferred stock, and the cost of equity, or ROE, as they integrate into its capital structure. The three costs multiplied by the capital structure produce the rate of ROR. This in turn produces a revenue requirement for each utility.

This discussion recognizes longstanding Commission precedent on setting the cost of capital. In this proceeding, where more than ROE was contested, the parties were able to arrive at an all party settlement.

Applications

The applications are summarized in Table 2 which shows the authorized capital structures, cost factors for debt, preferred stock and equity, and the ROR for 1996 and the requested amounts for 1997. Table 2 also demonstrates the approximate revenue impacts in millions of dollars, if the applicants' requests were granted.

Table 2
Application Summaries

	1996 Authorized	1997 Requested	Difference	Estimated Rev. Req. Impact (M$)
PG&E				
Debt	46.50%	46.20%	-0.30%	
Preferred	5.50%	5.80%	0.30%	
Equity	48.00%	48.00%	0.00%	
ROE	11.60%	11.85%	0.25%	
ROR	9.49%	9.56%	0.07%	$17.4
PG&E Pipeline				
Debt	67.00%	64.00%	-3.00%	
Equity	33.00%	36.00%	3.00%	
ROE	12.10%	13.50%	1.40%	
ROR	9.03%	9.66%	0.63%	$8.9
Edison				
Debt	47.00%	47.00%	0.00%	
Preferred	5.00%	5.00%	0.00%	
Equity	48.00%	48.00%	0.00%	
ROE	11.60%	11.90%	0.30%	
ROR	9.55%	9.63%	0.08%	$17.0
SoCalGas				
Debt	42.90%	45.60%	2.70%	
Preferred	9.70%	6.40%	-3.30%	
Equity	47.40%	48.00%	0.60%	
ROE	11.60%	11.95%	0.35%	
ROR	9.42%	9.74%	0.32%	$11.8
SDG&E				
Debt	44.50%	44.50%	0.00%	
Preferred	5.75%	5.75%	0.00%	
Equity	49.75%	49.75%	0.00%	
ROE	11.60%	11.85%	0.25%	
ROR	9.37%	9.52%	0.15%	$6.5

Each utility requests a ROE that is greater than last year's authorized ROEs. Each utility's request will produce a higher ROR than authorized last year and increased revenue requirements. PG&E requests minor changes to its traditional utility operations' capital structure to decrease debt by 30 basis points and increase preferred stock by 30 basis points. The PG&E Pipeline capital structure request would decrease debt by 300 basis points and correspondingly increase equity by 300 basis points.

Edison and SDG&E request no changes in capital structure. SoCalGas requests a 270 basis point increase in debt, 330 basis point decrease in preferred stock and 60 basis point increase in equity.

The interested parties in this proceeding advocated a range of ROEs for applicants, as shown in comparison Tables 9, 11, 13, 15, and 17 infra. These ranged from 11.25% to 11.75% for PG&E's traditional utility operations, 11.25% to 11.75% for Edison, 11.20% to 11.75% for SDG&E, 11.35% to 11.72% for the PG&E Pipeline, and 11.15% to 11.75% for SoCalGas.[6]

Joint Recommendation

The Joint Recommendation is an all party settlement, albeit one that does not comply technically with all of our rules on settlements and stipulations, Rules 51 through 51.10. As are most settlements, it is to be taken as a whole or the parties are not bound by it. ORA presented one witness to support the Joint Recommendation, and he was not cross examined. The ALJ received all prepared testimony into evidence, but there was no cross examination. In their briefs, the parties addressed only the reasonableness of the settlement.

Our Rule 51.10(e) states that the Commission will not approve a settlement unless it "is reasonable in light of the whole record, consistent with law, and in the public interest." However, in In Re San Diego Gas and Electric Co. (1992) 46 CPUC2d 538, we adopted a policy on all party settlements, consistent with this standard, stating:

"As a precondition to our approval the Commission must be satisfied that the proposed all party settlement:

> "a. commands the unanimous sponsorship of all active parties to the instant proceeding;
>
> "b. that the sponsoring parties are fairly reflective of the affected interests;

[6] While Los Angeles produced model results for all four utilities which are reflected in comparison tables in this decision, Los Angeles only advocated an ROE for SoCalGas.

> "c. that no term of the settlement contravenes statutory provisions or prior Commission decisions; and
>
> "d. that the settlement conveys to the Commission sufficient information to permit us to discharge our future regulatory obligations with respect to the parties and their interests." (46 CPUC2d at 550-551.)

We assess the Joint Recommendation as an all party settlement under these criteria.

<u>Sponsorship</u>

The Joint Recommendation has the unanimous sponsorship of all active parties. While TURN and ECG are still on the service list of this proceeding, each notified the ALJ after the PHC that they would not actively participate in the hearings. Neither has filed a brief nor commented on the Joint Recommendation. Therefore, this criterion is met.

<u>Affected Interests Represented</u>

The parties in this annual proceeding are the four major energy utilities, our ORA which represents the interests of ratepayers as a group in this proceeding, FEA which represents the interests of large ratepayers under the aegis of the Department of Defense, the Cities and Los Angeles which represent large municipal customers of the applicants, and CPI which represents ratepayer interests. Therefore, we conclude that a broad representation of ratepayer interests is covered by the sponsoring parties, and that the sponsoring parties fairly reflect all the affected interests.

<u>Content</u>

The Joint Recommendation proposes that the applicants' cost of capital be as set forth below in Table 3:

Table 3 Joint Recommendation					
	Capitalization	*Cost*	*Weighted Cost*	*ROR*	*Estimated Rev. Req. Impact (Mil)*
PG&E					
Debt	46.20%	7.52%	3.47%		
Preferred	5.80%	7.04%	0.41%		
Equity	48.00%	11.60%	5.57%		
ROR				9.45%	
Gas					($5.3)
Electric					($1.6)
PG&E Pipeline					
Debt	64.00%	7.52%	4.81%		
Equity	36.00%	11.60%	4.18%		
				8.99%	$0.0
Edison					
Debt	47.00%	7.64%	3.59%		
Preferred	5.00%	6.62%	0.33%		
Equity	48.00%	11.60%	5.57%		
ROR				9.49%	($5.4)
SoCalGas					
Debt	45.60%	7.71%	3.52%		
Preferred	6.40%	6.35%	0.40%		
Equity	48.00%	11.60%	5.57%		
ROR				9.49%	$0.0
SDG&E					
Debt	44.50%	7.09%	3.16%		
Preferred	5.75%	7.37%	0.42%		
Equity	49.75%	11.60%	5.77%		
ROR				9.35%	
Gas					$0.0
Electric					$0.0

We note that, except for the PG&E Pipeline, the Joint Recommendation freezes the utilities' ROEs at the rate set in last year's attrition proceeding, even though interest rates have increased as shown, infra, in Table 6. For the PG&E Pipeline, the ROE is 50 basis points lower than last year, although the amount of equity in its capital structure increases by 300 basis points over last year due to a decrease in long-term debt. The evidence entered into the record at the hearings shows a range of forecast revenue requirements by the utilities from $6.5 million to $17.4 million.

The recommendations of the parties for ROEs ranged from 11.15% to 11.95% for traditional utility operations. The parties' litigation positions are as follows. The applicants allege that the cost of common equity has risen. FEA supports a smaller, modest increase in ROE. CPI finds only minor incremental changes in the cost of equity which do not warrant any change in ROE. ORA and Los Angeles call for modest declines in ROE. The Cities assert a 75 basis point decrease in the PG&E Pipeline's ROE is warranted.

Each year the Commission relies on three financial models for forecasting ROE. These are the discounted cash flow (DCF) model, the risk premium (RP) model, and the capital asset pricing model (CAPM). While we do not look to the absolute values of outputs from these models to set ROE, they provide a valuable guide in our analysis, which is tempered with a great deal of judgment. (46 CPUC2d 319, 357 (1992).) As noted in 57 CPUC2d 525, 542 (1994), "Our approach is to begin with the last authorized ROE for a utility, then use models to gain information about the direction and magnitude of ROE changes that are appropriate in light of current conditions." Thus, the models produce for us a range of reasonable values. (46 CPUC2d at 357.) Because even minor changes to a financial model's inputs can produce major changes in the output ROEs, we have stressed the need for consistent bare bones models with inputs that do not change markedly from year to year. (57 CPUC2d at 542; 46 CPUC2d at 358; 33 CPUC2d 525, 574 (1989).)

In assessing modeling results, the Commission looks to consistency and use of an incremental approach. The average results of the parties' 1997 model forecasts are shown the Tables 4, 4.1, 5 and 5.1 below. Table 4 displays the average model results for ROE for 1997 for traditional utility operations. Table 4.1 gives the same information for the PG&E Pipeline. Table 5 demonstrates the incremental change of the results for

1997 as compared to 1996 for traditional utility operations. Table 5.1 shows the incremental change for the PG&E Pipeline.

Table 4
Results of Financial Models (%)

	Utility 1997	Utility 1996	ORA 1997	ORA 1996	FEA 1997	FEA 1996	CPI 1997	CPI 1996	Los Angeles 1997	Los Angeles 1996
PG&E										
DCF	9.11	9.70	9.02	9.87	10.77	10.98	13.18	12.48	10.72	N/A
CAPM	11.77	12.38	10.20	10.50	11.52	11.20	12.13	12.16	11.15	N/A
RP	11.06	11.59	9.21	10.22	10.95	10.97	13.56	11.98	11.19	N/A
Edison										
DCF	9.61	10.33	9.02	9.87	9.82	9.95	11.34	10.89	10.25	N/A
CAPM	12.09	13.21	10.80	10.70	11.28	11.01	11.90	11.51	11.54	N/A
RP	11.50	11.82	9.21	10.22	11.00	11.15	11.51	10.81	10.99	N/A
SoCalGas										
DCF	9.17	10.31	8.83	9.71	10.18	10.04	13.39	13.04	10.81	N/A
CAPM	11.32	11.50	10.75	10.90	11.26	10.85	10.96	11.95	11.29	N/A
RP	10.39	11.25	10.20	10.99	11.01	10.81	10.74	10.48	10.74	N/A
SDG&E										
DCF	9.45	10.37	9.40	10.05	10.07	10.22	12.98	13.04	10.00	N/A
CAPM	11.75	11.94	9.55	10.25	10.78	10.80	10.97	11.66	11.42	N/A
RP	11.19	11.38	9.21	10.22	10.69	10.81	13.47	12.23	10.79	N/A

Note: The 1996 CAPM and the RP models for Edison and the 1997 DCF model for SoCalGas were recast to conform with last year's modeling conventions. Results for the City of Los Angeles for 1996 could not be presented because the City of Los Angeles did not furnish the results of its analysis in the 1996 proceeding in the same format as in the 1997 proceeding. While CPI contested the percentages shown in this table and Table 5, they have been recast to provide consistency and comparability with last year's results which were also recast similarly as called for by 57 CPUC2d 533, 549.

Table 4.1
PG&E Pipeline Financial Model Results (%)

	DCF 1997	DCF 1996	CAPM 1997	CAPM 1996	Risk Positioning 1997	Risk Positioning 1996	Risk Premium 1997	Risk Premium 1996	FERC Method 1997	FERC Method 1996	Comparable Earnings 1997	Comparable Earnings 1996
PG&E	10.33	15.60	9.25	13.60	9.33	N/A	N/A	15.00	N/A	N/A	N/A	N/A
Cities	9.80	10.69	13.69	12.65	N/A	N/A	N/A	N/A	9.90	10.51	12.16	11.63

Notes:
PG&E's and Cities' model results for 1997 reflect the average of the Broad Sample group.

Table 5
Financial Models
Incremental Change from 1996

	Utility	ORA	FEA	CPI	Los Angeles
PG&E					
DCF	-0.59%	-0.85%	-0.21%	0.70%	N/A
CAPM	-0.61%	-0.30%	0.32%	-0.04%	N/A
RP	-0.53%	-1.01%	-0.02%	1.58%	N/A
Edison					
DCF	-0.73%	-0.85%	-0.13%	0.45%	N/A
CAPM	-1.12%	0.10%	0.27%	0.39%	N/A
RP	-0.32%	-1.01%	-0.15%	0.70%	N/A
SoCalGas					
DCF	-1.14%	-0.88%	0.14%	0.35%	N/A
CAPM	-0.18%	-0.15%	0.41%	-0.99%	N/A
RP	-0.86%	-0.79%	0.20%	0.26%	N/A
SDG&E					
DCF	-0.92%	-0.65%	-0.15%	-0.06%	N/A
CAPM	-0.19%	-0.70%	-0.02%	-0.70%	N/A
RP	-0.19%	-1.01%	-0.12%	1.24%	N/A

Note: The 1996 CAPM and the RP models for Edison and the 1997 DCF model for SoCalGas were recast to conform with last year's modeling conventions. Results for the City of Los Angeles for 1996 could not be presented because the City of Los Angeles did not furnish the results of its analysis in the 1996 proceeding in the same format as in the 1997 proceeding.

Table 5.1
Pipeline Financial Models
Incremental Change from 1996

	DCF	CAPM	Risk Positioning	RP	FERC Method	Comparable Earnings
PG&E	-5.28	-4.35	N/A	N/A	N/A	N/A
Cities	-0.89	1.04	N/A	N/A	-0.61	0.53

Although we have repeatedly stressed the need to see the model results run on a consistent method from year to year (57 CPUC2d at 542, 46 CPUC2d at 358), this year several parties gave us uncomparable results. SoCalGas added the Value Line Earnings Forecast to its 1997 DCF models as a data source for expected dividend growth. This affected its average of DCF model results. Therefore, Tables 4 and 5 recast the SoCalGas model results by eliminating this data source in order to provide consistency and comparability. Edison also made changes in the way data was presented requiring it to be recast in Tables 4 and 5. Los Angeles's models this year used the applicants' 1996-1997 model results as a base, then calculated the incremental change in the DCF, CAPM and RP models and, using the 1996 authorized ROEs as a baseline, deducted the incremental differences from each model to arrive at three incrementally determined ROEs. Los Angeles then averaged these three ROEs to arrive at a final ROE recommendation. Last year, Los Angeles did not summarize and average the results of their analysis as was done this year. Therefore, there was no way to recast results to provide for consistency as was done with Edison and SoCalGas.[7]

As we have done in prior proceedings, we also look to the difference in the April DRI control forecast for AA utility bonds (April DRI), used as an input in the models in Tables 4 through 5.1, and the DRI Update to assess whether the results of the models run using the DRI Update would produce results higher or lower than those originally presented. (46 CPUC2d at 358.) Since the April DRI was 7.36% (Late-Filed Exhibit 19) and the DRI Update shows an increase of 56 basis points, with a forecast interest rate of 7.92%, we conclude that the models would produce higher results if run

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[7] We have previously stated, "The DCF, RPM and CAPM financial models are useful in establishing a range of required returns to consider in selecting the authorized return and in evaluating trends of investor expectations when consistent assumptions and data sets are used in the analysis." (33 CPUC2d 525, 574 (1989).) Therefore, in 46 CPUC2d at 358 we required that requests to introduce new models or to make methodological adjustments in the bare bones DCF, RP, and CAPM models be clearly segregated from bare-bones computations. Thus each year, the three models must be submitted in the bare-bones forms of a nominal yield annual compound growth version of the DCF model without other adjustments and one version each of the RP and CAPM models using the same April DRI Control Forecast for AA utility bonds, adjusted as required by 38 CPUC2d at 238. In the RP and CAPM models, either only the DRI Control Forecast or versions using each one of the four DRI forecasts must be used. (33 CPUC2d at 553.) When the RP model uses the DCF model as a base, it must be the bare-bones annual model. (46 CPUC2d at 358.) Because of our incremental analysis from year to year, this same consistency is essential so that accurate comparison tables of average model results can be produced and analyzed. Therefore, we caution the parties once again to follow our prior admonitions.

today. As we observed in 57 CPUC2d at 549, the model results increase by the number of basis points equal to one-half to two-thirds of the basis point spread between the April DRI and the DRI Update. This year, that equates to model results 28 to 37 basis points higher than shown in Tables 4 through 5.1. While the incremental change shows a decrease in results from last year, we observe that, factoring in the DRI Update, almost all incremental change falls to less than 1%, with most changes in the range of 0.25% to 0.50%. Our review of Tables 4 through 5.1 leads us to conclude that due to the small movement in model results, no change in ROEs is warranted. Therefore, the Joint Recommendation is consistent with our evaluation.

We also observe that Tables 4 through 5.1 show average model results. The record contains a range of individual model results demonstrating modest increases in the cost of common equity as well as modest decreases over the last year. This also supports our finding that the cost of common equity has remained essentially constant as is reflected in the Joint Recommendation.

In addition, we consider the impact of interest rate changes from last year to this year. In particular we look to nondiversifiable business risks, such as the state of the economy and general interest rates over risks associated with individual utilities or utility industries. (D. 95-11-062 mimeo. at 16, citing 57 CPUC2d at 549-550.) Table 6 demonstrates the interest rate changes over the last seven years in comparison to our adopted ROE changes. Our consistent practice has been to moderate changes in interest rates relative to changes in ROE in order to increase the stability of ROE over time. (Id. at 17.)

Table 6 Interest Rate Changes Compared to ROE Changes				
Year	Forecast Interest Rate (%) (*)	Int. Rate Change (Basis Points)	Authorized ROE (%) (**)	ROE Change (Basis Points)
1991	9.76	-	12.85 - 13.00	-
1992	9.10	-66	12.65	-20 to -35
1993	8.32	-78	11.80 - 11.90	-75 to -85
1994	6.76	-156	10.85 - 11.00	-80 to -100
1995	8.37	161	12.00 - 12.10	100 to 120
1996	7.29	-108	11.60	-40 to -50
1997	7.92	63	11.60	0

Notes: *DRI interest rate forecasts for AA utilities, October report
**ROE ranges do not include PG&E Pipeline.

We must assess utility returns against our continuing policy to not let utility ROEs be driven in lock step with the interest rate. (46 CPUC2d at 369.) We have recognized that it would be unwise to attempt to adjust rates every time interest rates rise or fall. We must set the rate of return at the lowest level that meets the test of reasonableness. (46 CPUC2d at 369; 78 CPUC at 722-723.)

We believe the Joint Recommendation's freeze of ROEs at 1996 levels is consistent with this policy. It reflects the minimal increase of only 63 basis points in interest rates since last year as shown in Table 6.

Finally, it has been our practice to look to credit risk of the applicants in setting the cost of capital. Our concern is the impact our adopted ROEs and capital structures will have on the utilities' times-interest coverage. A significant impact would affect their credit ratings by the major rating agencies. One reason to retain a strong credit rating is borrowing reserve capability, which is access to capital markets under the broadest circumstances. The borrowing potential of utilities may be restricted at times by either general market conditions or company-specific conditions. The second reason for maintaining a good credit rating is that higher debt costs are associated with lower ratings. The spreads between one credit rating and another, or the spreads between a specifically rated debt issue of a company relative to government securities, vary at different times. When total debt costs are low, then the spread tends to narrow because there is some floor. When interest rates go up, that spread widens. The third reason for maintaining high credit ratings is the maintenance of operating and financing flexibility. This financial and operational flexibility must be shown to inure to the benefit of the ratepayers as well as the utility. When reviewing impacts of ROE on credit risk, we have declared that "our overriding concern is that the equity ratios we adopt 'are no greater than required to maintain reasonable credit ratings.... '" (46 CPUC2d at 348, citing 42 CPUC2d 105, 109 (1991).)

Table 7 sets forth the current pre-tax interest coverage and bond ratings for each applicant from each of the major rating agencies. As a guide we look to the Standard and Poor's (S&P) Guidelines included in Table 7.1 to assess where each applicant falls within its rating system.

Table 7
Pretax Interest Coverage Without Short-term Debt

Utility	*Interest Coverage (x's)*	*Bond Ratings*	
		S & P	*Moody's*
PG&E	3.91	A Low Average	A2
Edison	3.78	A+ Low Average	A2
SoCalGas	3.87	AA- High Average	A2
SDG&E	4.31	A+ Low Average	A1

Note: Bond Ratings as of August, 1996.

Table 7.1 S & P Guidelines (x's)				
	Electric		*Gas*	
	AA	*A*	*AA*	*A*
Above Average	3.50	2.75	3.75	3.00
Average	4.00	3.50	4.25	3.75
Below Average	----	4.50	----	4.25

We recognize that the applicants' ratings are not set merely by capital structure and ROE considerations. Other factors do come into play. However, we can conclude from Tables 7 and 7.1 that the ROEs set forth in the Joint Recommendation will not impact negatively the current bond ratings of the applicants.

While the Joint Recommendation resolves ROE for the PG&E Pipeline, it does not constitute a resolution of several other outstanding issues regarding the PG&E Pipeline. In last year's proceeding, PG&E filed testimony supporting an unbundled cost of capital for the PG&E Pipeline as a separate line of business. The Commission found the record to be insufficient to assess the merits of such an approach. Therefore, in D.95-11-062, the Commission deferred for consideration in this year's proceeding the methodology for estimating the business risk, and therefore the cost of equity capital, of an unbundled part of a business and how to adjust the ROE for different capital structures. This year PG&E filed testimony on these issues and ORA, FEA, Edison and the Cities filed responsive testimony. The Joint Recommendation states that it does not constitute a resolution of any of those issues, including, without limitation, whether PG&E met its burden of proof as to the appropriate methodology for determining the ROE or capital structure of an unbundled line of business. Also reserved for future proceedings is the issue of the magnitude of an ROE adjustment, if any, necessary due to a high percentage of debt in the capital structure of the PG&E Pipeline.[8]

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[8] Usually the utilities maintain capital structures with approximately 48% to 50% equity ratios. The PG&E Pipeline proposes a 64% debt ratio versus a 36% equity ratio. In last year's proceeding, it had a 67% debt ratio. In 57 CPUC2d 533 (1994), the Commission had adopted an adder of 100 basis points to the PG&E Pipeline's ROE to

The Joint Recommendation also does not resolve any modeling or methodological issues advocated by any of the parties in this proceeding and removes them to appropriate future proceedings.

We conclude that the exclusion of the PG&E Pipeline and modeling and methodological issues is reasonable and does not prejudice their future resolution in other proceedings.

Finally, the Joint Recommendation recommends that the embedded costs for the various applicants' long-term debt and preferred stock be established for 1997 without updating based on the DRI Update, as has been the standard in past proceedings. The parties declare that by relying on the recommended embedded costs of debt and preferred stock, the adopted costs of capital for each utility will be at least revenue neutral or result in a decrease in authorized revenues. For Edison's and PG&E's traditional utility operations, use of the April DRI forecast results in a revenue reduction, for the PG&E Pipeline there is no change, and for SoCalGas and SDG&E the result is revenue neutrality.

On September 3, 1996, Assigned Commissioner Duque issued a ruling requiring the parties to comply with the requirement that the DRI Update be filed. The Commissioner noted that the models used in this proceeding traditionally use the April DRI forecast and that the Commission utilizes the DRI Update to determine how many basis points higher or lower the DRI Update is from the April forecast to make a judgment whether the results of the models in October would produce results higher or lower than those originally presented. He noted the use of the DRI Update in comparing the interest rates found in Table 6. He observed that the DRI Update would be useful to the Commission in assessing the reasonableness of the settlement by comparing the Joint Recommendation figures to those that would have been adduced

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reflect the higher level of debt in its capital structure as opposed to PG&E's traditional utility operations. In D.95-11-062, the Commission lowered the risk premium to 50 basis points and stated that it would remove it entirely in this year's proceeding if PG&E could not provide sufficient evidence and interpretation to support such a risk premium. (Id. mimeo. at 31.) The Joint Recommendation preseves this issue for future proceedings.

with the use of the DRI Update. These comparisons are set forth below in Table 8 and disclose that the use of the April DRI figures and waiver of the DRI Update's use in this year's proceeding will benefit ratepayers.

Table 8
Joint Recommendation Costs Updated By October DRI

	Debt (%)		Preferred Stock (%)		ROR (%)	
	Joint Rec.	With Update	Joint Rec.	With Update	Joint Rec.	With Update
PG&E	7.52%	7.55%	7.04%	7.04%	9.45%	9.46%
Edison	7.64%	7.66%	6.62%	6.62%	9.49%	9.50%
SoCalGas	7.71%	7.83%	6.35%	6.35%	9.49%	9.54%
SDG&E	7.09%	7.25%	7.37%	7.37%	9.35%	9.42%

Adoption of the Joint Recommendation with the waiver of the DRI Update will produce revenue requirement reductions of approximately $6.9 million for PG&E and $5.4 million for Edison. Revenue neutrality is produced for the PG&E Pipeline, SoCalGas and SDG&E. The original applications all requested increases in ROE which would have produced revenue increases ranging from $6.5 million to $17.5 million.

A review of Table 8 demonstrates that use of the DRI Update would increase the cost of debt which, in turn, would increase each utility's ROR from 1 to 7 basis points, translating into increased revenue requirements. We cannot quantify the dollar amount of revenue impact, since the figures necessary to do so are not in the record before us. But it is clear that use of the DRI Update would imperil the revenue reductions and revenue neutrality fostered by the Joint Recommendation without use of the DRI Update.

Although this one facet of the Joint Recommendation seems to contravene prior Commission precedent, we do not believe this means the Joint Recommendation fails the third prong of the all party settlement test. As we stated when adopting this portion of the criteria, "In formulating this criteria we do not intend to preclude the sponsoring parties from suggesting changes in established Commission policy or precedent or proposing policy in areas we have yet to address." (46 CPUC2d at 763 n.

5.) The parties have complied with our requirement that such a departure from Commission policy be clearly identified. (Id.) We note that the Joint Recommendation requests the waiver for this year's proceeding only and does not seek to establish precedent for doing so. Therefore, we find that, due to the benefit to California ratepayers, the Joint Recommendation's request to waive the use of the DRI Update to establish adopted costs of long-term debt and preferred stock should be granted and does not contravene statutory provisions or Commission precedent.

Regulatory Obligations

We find the Joint Recommendation is consistent with our duty to discharge our future regulatory obligations with respect to the applicants. The Joint Recommendation sets specific capital structures and rates of return which can be blended into our ongoing proceedings to establish applicants' rate components for 1997. Therefore, we find it contains sufficient information and specificity for us to fulfill our oversight role for applicants.

Conclusion

We find that the Joint Recommendation meets all four criteria for the approval of an all party settlement consistent with our exercise of proper regulatory oversight of applicants. We find the Joint Recommendation represents a fair balance of the interests of ratepayers and shareholders, while eliminating the risk and expense of litigation. Therefore, we adopt the Joint Recommendation as set forth below as to each applicant.

PG&E

Table 9 sets forth the original positions of the parties relative to the ROE for PG&E's traditional utility operations, contrasted with the Joint Recommendation.

Table 9 PG&E Comparison							
	1996 Authorized	1997 Requested	ORA	FEA	City of (*) Los Angeles	CPI	Joint Recommendation
Debt	46.50%	46.20%	46.20%	46.20%			46.20%
Debt Cost	7.52%	7.50%	7.52%	7.50%			7.52%
Preferred	5.50%	5.80%	5.80%	5.80%			5.80%
Preferred Cost	7.79%	7.04%	7.04%	7.04%			7.04%
Equity	48.00%	48.00%	48.00%	48.00%			48.00%
ROE	11.60%	11.85%	11.25%	11.75%	10.68%	11.60%	11.60%
ROR	9.49%	9.56%	9.28%	9.51%			9.45%

Note: Los Angeles's ROE for PG&E represents results from models shown in Exhibit 13, page 33. Other estimations are presented by Los Angeles in Exhibit 14, Table 32. Los Angeles only made a recommendation on SoCalGas's ROE, but did posit model results for the other three utilities, shown in Table 9 and Tables 13 and 17, infra.

We also observe that the Joint Recommendation grants PG&E's request for a 30 basis point increase in preferred stock with a corresponding 30 basis point decrease in debt.

We find the Joint Recommendation reasonable as to PG&E's traditional utility operations and adopt the cost of capital set forth below in Table 10.

Table 10 PG&E Adopted (%)				
	1996 Authorized	1997 Requested	Adopted	Difference From 1996
Debt	46.50	46.20	46.20	(0.30)
Debt Cost	7.52	7.50	7.52	0.00
Preferred	5.50	5.80	5.80	0.30
Preferred Cost	7.79	7.04	7.04	(0.75)
Equity	48.00	48.00	48.00	0.00
ROE	11.60	11.85	11.60	0.00
ROR	9.49	9.56	9.45	(0.04)
Estimated Revenue Requirement Change (Millions)			Electric	($5.3)
			Gas	($1.6)

PG&E Pipeline

Table 11 sets forth the original positions of the parties relative to the ROE for the PG&E Pipeline, contrasted with the Joint Recommendation.

Table 11
PG&E Pipeline Comparison

	1996 Authorized	1997 Requested	ORA	Cities of Burbank	Joint Recommendation
Debt	67.00%	64.00%	64.00%	64.00%	64.00%
Debt Cost	7.52%	7.50%	7.52%	7.50%	7.52%
Equity	33.00%	36.00%	36.00%	36.00%	36.00%
ROE	12.10%	13.50%	11.72%	11.35%	11.60%
ROR	9.03%	9.66%	9.03%	8.89%	8.99%

We also observe that the Joint Recommendation grants the PG&E Pipeline's request to decrease debt by 300 basis points and increase equity correspondingly.

We find the Joint Recommendation reasonable as to the PG&E Pipeline and adopt the cost of capital set forth below in Table 12.

Table 12
PG&E Pipeline Adopted (%)

	1996 Authorized	1997 Requested	Adopted	Difference From 1996
Debt	67.00	64.00	64.00	(3.00)
Debt Costs	7.52	7.50	7.52	0.00
Equity	33.00	36.00	36.00	3.00
ROE	12.10	13.50	11.60	(0.50)
ROR	9.03	9.66	8.99	(0.04)
Estimated Revenue Requirement Change (Millions)				$0.0

Edison

Table 13 sets forth the original positions of the parties relative to the ROE for Edison, contrasted with the Joint Recommendation. The Joint Recommendation contains no capital structure changes for Edison.

Table 13
Edison Comparison

	1996 Authorized	*1997 Requested*	*ORA*	*FEA*	*City of Los Angeles*	*CPI*	*Joint Recommendation*
Debt	47.00%	47.00%	47.00%	47.00%			47.00%
Debt Cost	7.77%	7.64%	7.64%	7.64%			7.64%
Preferred	5.00%	5.00%	5.00%	5.00%			5.00%
Preferred Cost	6.69%	6.62%	6.62%	6.62%			6.62%
Equity	48.00%	48.00%	48.00%	48.00%			48.00%
ROE	11.60%	11.90%	11.25%	11.75%	10.92%	11.60%	11.60%
ROR	9.55%	9.63%	9.32%	9.56%			9.49%

We find the Joint Recommendation reasonable as to Edison and adopt the cost of capital set forth below in Table 14.

Table 14
Edison Adopted (%)

	1996 Authorized	*1997 Requested*	*Adopted*	*Difference From 1996*
Debt	47.00	47.00	47.00	0.00
Debt Cost	7.77	7.64	7.64	(0.13)
Preferred	5.00	5.00	5.00	0.00
Preferred Cost	6.69	6.62	6.62	(0.07)
Equity	48.00	48.00	48.00	0.00
ROE	11.60	11.90	11.60	0.00
ROR	9.55	9.63	9.49	(0.06)
Estimated Revenue Requirement Change (Millions)				($5.4)

SoCalGas

Table 15 sets forth the original positions of the parties relative to the ROE for SoCalGas, contrasted with the Joint Recommendation.

Table 15 SoCalGas Comparison							
	1996 Authorized	1997 Requested	ORA	FEA	City of Los Angeles	CPI	Joint Recommendation
Debt	42.90%	45.60%	45.60%	46.10%	45.60%		45.60%
Debt Cost	7.84%	7.87%	7.87%	7.87%			7.71%
Preferred	9.70%	6.40%	6.40%	6.50%	6.40%		6.40%
Preferred Cost	5.76%	6.35%	6.35%	6.35%			6.35%
Equity	47.40%	48.00%	48.00%	47.40%	48.00%		48.00%
ROE	11.60%	11.95%	11.15%	11.75%	11.20%	11.60%	11.60%
ROR	9.42%	9.74%	9.35%	9.61%	9.37%		9.49%

We also observe that the Joint Recommendation approves SoCalGas's request for a 270 basis point increase in debt, a 330 basis point decrease in preferred stock and a 60 basis point increase in equity. The request is based primarily on a redemption of preferred stock.

We find the Joint Recommendation reasonable as to SoCalGas and adopt the cost of capital set forth below in Table 16.

Table 16 SoCal Gas Adopted (%)				
	1996 Authorized	1997 Requested	Adopted	Difference From 1996
Debt	42.90	45.60	45.60	2.70
Debt Cost	7.84	7.87	7.71	(0.13)
Preferred	9.70	6.40	6.40	(3.30)
Preferred Cost	5.76	6.35	6.35	0.59
Equity	47.40	48.00	48.00	0.60
ROE	11.60	11.95	11.60	0.00
ROR	9.42	9.74	9.49	0.07
Estimated Revenue Requirement Change (Millions)				$0.0

<u>SDG&E</u>

Table 17 sets forth the original positions of the parties relative to SDG&E, contrasted with the Joint Recommendation. The Joint Recommendation contains no capital structure changes for SDG&E.

Table 17 SDG&E Comparison							
	1996 Authorized	1997 Requested	ORA	FEA	City of Los Angeles	CPI	Joint Recommendation
Debt	44.50%	44.50%	44.50%	44.50%			44.50%
Debt Cost	7.21%	7.19%	7.19%	7.19%			7.09%
Preferred	5.75%	5.75%	5.75%	5.75%			5.75%
Preferred Cost	6.87%	7.37%	7.37%	7.37%			7.37%
Equity	49.75%	49.75%	49.75%	49.75%			49.75%
ROE	11.60%	11.85%	11.20%	11.75%	10.80%	11.60%	11.60%
ROR	9.37%	9.52%	9.19%	9.47%			9.35%

We find the Joint Recommendation reasonable as to SDG&E and adopt the cost of capital set forth below in Table 18.

Table 18 SDG&E Adopted (%)				
	1996 Authorized	1997 Requested	Adopted	Difference From 1996
Debt	44.50	44.50	44.50	0.00
Debt Cost	7.21	7.19	7.09	(0.12)
Preferred	5.75	5.75	5.75	0.00
Preferred Cost	6.87	7.37	7.37	0.50
Equity	49.75	49.75	49.75	0.00
ROE	11.60	11.85	11.60	0.00
ROR	9.37	9.52	9.35	(0.02)
Estimated Revenue Requirement Change (Millions)			Electric	$0.0
			Gas	$0.0

Findings of Fact

1. Southwest, SPPC, and PacifiCorp have received exemptions from participation in this year's cost of capital proceeding.

2. Each utility requests a ROE that is greater than last year's authorized ROEs. Each utility's request will produce a higher ROR than authorized last year and increased revenue requirements.

3. The interested parties in this proceeding advocated ROEs for applicants ranging from 11.25% to 11.75% for PG&E's traditional utility operations, 11.25% to 11.75% for Edison, 11.20% to 11.75% for SDG&E, 11.35% to 11.72% for the PG&E Pipeline, and 11.15% to 11.75% for SoCalGas.

4. On the second day of hearings the parties presented a Joint Recommendation which is an all party settlement.

5. All active parties to the proceeding support the Joint Recommendation.

6. A broad representation of ratepayer interests is covered by the sponsoring parties.

7. Because even minor changes to a financial model's inputs can produce major changes in the output ROEs, we have stressed the need for consistent bare bones models with inputs that do not change markedly from year to year. (57 CPUC2d at 542; 46 CPUC2d at 358; 33 CPUC2d 525, 574 (1989).)

8. In assessing modeling results, the Commission looks to consistency and use of an incremental approach.

9. We also look to the difference in the April DRI and the DRI Update to assess whether the results of the models run using the DRI Update would produce results higher or lower than those originally presented. (46 CPUC2d at 358.) Since the April DRI was 7.36% (Late-Filed Exhibit 19) and the DRI Update shows an increase of 56-basis points, with a forecast interest rate of 7.92%, we conclude that the models would produce higher results if run today. Our review of Tables 4 through 5.1 leads us to conclude that due to the small movement in model results, no change in ROEs is warranted. Therefore, the Joint Recommendation is consistent with our evaluation.

10. The record contains a range of individual model results demonstrating modest increases in the cost of common equity as well as modest decreases over the last year. This also supports our finding that the cost of common equity has remained essentially constant as is reflected in the Joint Recommendation.

11. The Joint Recommendation's freeze of ROEs at 1996 levels is consistent with our policy not to let utility ROEs be driven in lock step with interest rates.

12. We also look to credit risk of the applicants in setting the cost of capital. We find that the Joint Recommendation will not impact negatively the current bond ratings of the applicants.

13. The Joint Recommendation's exclusion of the PG&E Pipeline and modeling and methodological issues is reasonable and does not prejudice their future resolution in other proceedings.

14. Adoption of the Joint Recommendation with the waiver of the DRI Update will produce revenue requirement reductions of approximately $6.9 million for PG&E and $5.4 million for Edison. Revenue neutrality is produced for the PG&E Pipeline, SoCalGas and SDG&E. The original applications all requested increases in ROE which would have produced revenue increases ranging from $6.5 million to $17.5 million.

15. A review of Table 8 demonstrates that use of the DRI Update would increase the cost of debt which, in turn, would increase each utility's ROR from 1 to 7 basis points, translating into increased revenue requirements. It is clear that use of the DRI Update would imperil the revenue reductions and revenue neutrality fostered by the Joint Recommendation without use of the DRI Update.

16. Although this one facet of the Joint Recommendation seems to contravene prior Commission precedent, we do not believe this means the Joint Recommendation fails the third prong of the all party settlement test. The parties have complied with our requirement that such a departure from Commission policy be clearly identified.

17. The Joint Recommendation requests the waiver of the DRI Update for this year's proceeding only and does not seek to establish precedent for doing so. Therefore,

we find that, due to the benefit to California ratepayers, the Joint Recommendation's request to waive the use of the DRI Update to establish adopted costs of long-term debt and preferred stock should be granted and does not contravene statutory provisions or Commission precedent.

18. The Joint Recommendation contains sufficient information and specificity for the Commission to fulfill its oversight role for applicants.

19. The Joint Recommendation represents a fair balance of the interests of ratepayers and shareholders, while eliminating the risk and expense of litigation.

20. A return on equity of 11.60% for PG&E's 1997 traditional utility operations and its PG&E Pipeline operations is reasonable.

21. PG&E's change in revenue requirement resulting from its cost of capital shall be used in conjunction with its pending Energy Cost Adjustment Clause (ECAC) proceeding, Application (A.) 95-04-001 for the purpose of calculating revised electric rate components for 1997 and shall be allocated to gas rates as set forth in its Annual True-Up of Gas Balancing Accounts Advice Filing for 1997.

22. A return on equity of 11.60% for Edison's 1997 utility operations is reasonable.

23. The revenue changes resulting from Edison's cost of capital shall be effective as of January 1, 1997, and shall be used in conjunction with its 1997 attrition year advice letter filing, its performance based ratemaking (PBR) filing and its pending ECAC proceeding (A.96-05-045) for the purpose of calculating revised rate components for 1997.

24. A return on equity of 11.60% for SoCalGas' 1997 utility operations is reasonable.

25. SoCalGas' change in revenue requirement resulting from its cost of capital shall be effective as of January 1, 1997 and shall reflect the cost allocation and

rate design adopted in its consolidated year-end advice letter filing for the purpose of calculating revised rates for 1997.[9]

26. A return on equity of 11.60% for SDG&E's utility operations is reasonable.

27. The revenue changes resulting from SDG&E's cost of capital shall be used in conjunction with its 1997 attrition year advice letter filing and, for gas rate changes, concurrent with other gas rate changes anticipated to be implemented at that time, and, for electric rate changes, coincident with SDG&E's PBR filing and its scheduled ECAC rate change, for the purpose of calculating revised rate components for 1997.

<u>Conclusions of Law</u>

1. Southwest, PacifiCorp, and SPPC are exempt from participation in this year's cost of capital proceeding.

2. The applicants complied with the Commission's notice requirements in Rules 24 and 52.

3. The Joint Recommendation commands the unanimous support of all active parties to this proceeding.

4. The sponsoring parties of the Joint Recommendation are fairly reflective of the affected interests.

5. No term of the Joint Recommendation contravenes statutory provisions or prior Commission decisions.

6. The Joint Recommendation conveys to the Commission sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties and their interests.

7. The Joint Recommendation is reasonable in light of the whole record, consistent with law and in the public interest.

8. PG&E's proposed 1997 capital structure for both its traditional utility and PG&E Pipeline operations should be adopted.

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[9] D.95-04-072 's Ordering Paragraph 1d approved the suspension of the requirement SoCalGas file a test year 1997 GRC and therefore SoCalGas is not authorized to file an attrition year advice letter filing.

9. PG&E should be authorized an 7.52% cost of long-term debt and an 7.04% cost of preferred stock for 1997 for its traditional utility operations and 7.52 % cost of long-term debt for its PG&E Pipeline operations.

10. An 11.60% return on common equity on traditional utility operations and the PG&E Pipeline, which results in an overall 9.45% return on rate base on traditional utility operations and an overall 8.99% return on rate base on the PG&E Pipeline, should be adopted as just and reasonable for PG&E in 1997.

11. Edison should be authorized an 7.64% cost of long-term debt and a 6.62% cost of preferred stock for 1997.

12. An 11.60% return on common equity, which results in an overall 9.49% return on rate base, should be adopted as just and reasonable for Edison in 1997.

13. SoCalGas' proposed 1997 capital structure should be adopted.

14. SoCalGas should be authorized a 7.71% cost of long-term debt and a 6.35% cost of preferred stock for 1997.

15. An 11.60% return on common equity, which results in an overall 9.49% return on rate base, should be adopted as just and reasonable for SoCalGas in 1997.

16. SDG&E should be authorized an 7.09% cost of long-term debt and a 7.37% cost of preferred stock for 1997.

17. An 11.60% return on common equity, which results in an overall 9.35% return on rate base, should be adopted as just and reasonable for SDG&E in 1997.

ORDER

IT IS ORDERED that:

1. Pacific Gas & Electric Company's (PG&E) adopted cost of capital for 1997 is as follows:

PG&E Traditional Utility Operations' Adopted 1997 Cost of Capital

Component	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	46.20%	7.52%	3.47%
Preferred Stock	5.80	7.04	0.41
Common Equity	48.00	11.60%	5.57
Total	100.00%		9.45%

PG&E Pipeline's Adopted 1997 Cost of Capital

Component	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	64.00%	7.52%	4.81%
Common Equity	36.00%	11.60	4.18
Total	100.00%		8.99%

2. PG&E's adopted 1997 test year rate of return, as shown in Ordering Paragraph 1, shall be effective January 1, 1997 and shall be used in conjunction with its pending Energy Cost Adjustment Clause (ECAC) proceeding, Application (A.) 95-04-001 for the purpose of calculating revised electric rate components for 1997 and shall be allocated to gas rates as set forth in its Annual True-Up of Gas Balancing Accounts Advice Filing for 1997.

3. Southern California Edison Company's (Edison) adopted cost of capital for 1997 is as follows:

Edison's Adopted 1997 Cost of Capital

Component	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	47.00%	7.64%	3.59%
Preferred Stock	5.00	6.62	0.33
Common Equity	48.00	11.60%	5.57
Total	100.00%		9.49%

4. Edison's adopted 1997 rate of return, as shown in Ordering Paragraph 3, shall be effective as of January 1, 1997, and shall be used in conjunction with its 1997 attrition year advice letter filing, its performance based ratemaking (PBR) filing, and its pending ECAC proceeding (A.96-05-045) for the purpose of calculating revised rate components for 1997.

5. Southern California Gas Company's (SoCalGas) adopted cost of capital for 1997 is as follows:

SoCalGas' Adopted 1997 Cost of Capital

Component	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	45.60%	7.71%	3.52%
Preferred Stock	6.40	6.35	0.40
Common Equity	48.00	11.60	5.57
Total	100.00%		9.49%

6. SoCalGas' adopted 1997 rate of return, as shown in Ordering Paragraph 5, shall be effective as of January 1, 1997 and shall reflect the cost allocation and rate design adopted in its consolidated year-end advice letter filing for the purpose of calculating revised rates for 1997.

7. San Diego Gas & Electric Company's (SDG&E) adopted cost of capital for 1997 is as follows:

SDG&E's Adopted 1997 Cost of Capital

Component	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	44.50%	7.09%	3.16%
Preferred Stock	5.75	7.37	0.42
Common Equity	49.75	11.60	5.77
Total	100.00%		9.35%

8. SDG&E's adopted 1997 rate of return, as shown in Ordering Paragraph 7, shall be effective as of January 1, 1997 and shall be used in conjunction with its 1997 attrition year advice letter filing and, for gas rate changes, concurrent with other gas rate changes anticipated to be implemented at that time, and, for electric rate changes, coincident with SDG&E's PBR filing and its scheduled ECAC rate change, for the purpose of calculating revised rate components for 1997.

This order is effective today.

Dated November 26, 1996, at San Francisco, California.

P. GREGORY CONLON
President
DANIEL Wm. FESSLER
JESSIE J. KNIGHT, JR.
JOSIAH L. NEEPER
Commissioners

Commissioner Henry M. Duque, being necessarily absent, did not participate.