ALJ/MEG/jva

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Decision 98-06-023 June 4, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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| Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation. | Rulemaking 94-04-031 (Filed April 20, 1994) |
| Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation. | ORIGINAL<br>Investigation 94-04-032 (Filed April 20, 1994) |

# OPINION

## Summary

This decision addresses the issue of whether Southern California Edison Company (Edison) should implement a revenue adjustment to account for the conservation effects of demand-side management (DSM) programs, as directed by Decision (D.) 96-09-092. We find that subsequent Commission decisions and policies have superseded D.96-09-092 with regard to the applicability of a conservation adjustment mechanism in a restructured electric industry.

Accordingly, we deny Edison's request for approval of Advice Letter (AL) 1246-E, which presents Edison's recommended methodology for the conservation adjustment mechanism. In addition, we modify D.97-10-057 to clarify that the elimination of Electric Revenue Adjustment Mechanism (ERAM) accounts ordered therein applies to Edison's existing ERAM, including the conservation adjustment authorized but not yet implemented as of the date of that order. Today's decision also makes moot the issue of whether to include the

conservation adjustment in the Streamlining Residual Account, as requested by Edison in AL 1255-E-A.

**Procedural History**

On September 20, 1996, the Commission issued D.96-09-092 adopting a Performance-Based Ratemaking (PBR) mechanism for Edison for recovery of its nongeneration (transition and distribution) base rate revenue requirements. The nongeneration PBR took effect on January 1, 1997. Anticipating that a transition from a nongeneration PBR to a distribution-only PBR would occur during 1997, the Commission authorized a distribution-only PBR to be in effect after the date of that transition until December 31, 2001.

In general, PBRs attempt to give the utility a financial incentive to control and lower costs and to increase revenues. In a simple version of a PBR, this incentive is created by setting a benchmark level of performance (i.e., expected costs and revenues or rates) and allowing the utility to retain gains or bear losses (net revenues or rates measured against the benchmark) within a certain range of outcomes. When the outcomes fall outside that range, the resulting extra gains or losses are shared between ratepayers and shareholders.

As part of their PBR proposals, several parties recommended that Edison's ERAM balancing account for nongeneration revenues be eliminated or modified. ERAM allows the electric utility to recover its authorized level of base rate revenue requirement when actual and forecasted sales differ; this recovery occurs through a subsequent year rate adjustment in the Energy Revenue Adjustment Billing Factor (ERABF). In D.96-09-092, the Commission modified Edison's ERAM as follows:

> "We order Edison to develop and include in ERAM an adjustment for the conservation effects of DSM programs. We order Edison to work with other parties in the DSM Rulemaking OIR/OII (I.91-08-003/R.91-08-003) to develop for implementation in rates by

> January 1, 1998, a mechanism which uses the most current ex-post measurement DSM effects to adjust for the impact of DSM through reduced sales on nongeneration base rate revenue requirement.
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> "We order Edison to limit the scope of the ERABF to recover only the difference between the recorded and authorized nongeneration base revenue requirement attributable to the DSM mechanism described above." (D.96-09-092, mimeo. pp. 34-35, see also Ordering Paragraph 10, p. 65.)

On February 5, 1997, the Commission issued D.97-02-014 addressing threshold policy issues regarding the goals and administration of ratepayer-funded public policy programs, including DSM. Among other things, the Commission established an independent advisory board, the California Board for Energy Efficiency (CBEE), to assist the Commission in overseeing the development and implementation of energy efficiency programs. Independent program administrators would be selected based on a competitive bid, developed by CBEE and subject to Commission approval. The utilities could compete to become program administrators, but would no longer be eligible for shareholder incentives.

On July 22, 1997, Edison held a workshop to explain and take comments on its proposed method to calculate the annual conservation adjustment adopted in D.96-09-092. The workshop was attended by the following active parties to the DSM OIR/OII: Office of Ratepayer Advocates (ORA), Natural Resources Defense Council (NRDC), California Energy Commission, Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company. Workshop participants generally agreed that the calculation used to determine the adjustment was technically accurate. However, during the workshop ORA and NRDC questioned the need for a conservation adjustment mechanism.

On August 21, 1997, Edison filed AL 1246-E describing its proposal to calculate the conservation adjustment to nongeneration revenues and revise the currently applicable ERAM to implement the adjustment. On September 10, 1997, protests were filed by ORA and (jointly) by three providers of DSM services: Residential Service Companies' United Effort, Insulation Contractors' Association, and SESCO, Inc. (collectively referred to as RESCUE/ICA/SESCO). Generally, these parties argued that the mechanism proposed in AL 1246-E be considered in light of industry changes implemented in this and other dockets relating to electric industry restructuring.

On October 22, 1997, the Commission issued D.97-10-057 (Streamlining Decision), which, among other things, eliminated ERAM and other regulatory accounts that were no longer useful in light of the electric industry restructuring policies adopted by the Commission and the California Legislature. The Commission also determined that utilities were not permitted under law to accumulate costs incurred during the rate freeze period for the purpose of affecting rates during or following the rate freeze period.[1]

By Administrative Law Judges' ruling dated March 6, 1998, Edison was directed to respond to the following questions concerning its proposed conservation adjustment:

1. How would the proposal in AL 1246-E affect ratemaking and accounting in light of the Commission's policies adopted in D.97-10-057 and related orders?

2. Should the Commission require Edison to retain the transmission and distribution ERAM to account for the items identified in D.96-09-092, including the DSM adjustment? Explain in light of the Commission policy

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[1] This finding was recently reaffirmed in D.98-03-059 in response to a petition to modify D.97-10-057 filed by PG&E.

developed in D.97-10-057 and D.97-02-014. If the Commission were to eliminate the Transmission and Distribution (T&D) ERAM, how if at all would that accounting change be reflected in Edison's Transition Revenue Account (TRA) and other accounting and ratemaking mechanisms adopted pursuant to Assembly Bill (AB) 1890? (Stats. 1996, ch. 854.)

3. Should the Commission eliminate Edison's ERAM for generation? If so, how if at all would that accounting change be reflected in the TRA or other accounting and ratemaking mechanisms adopted pursuant to AB 1890?

4. What procedures should the Commission employ to resolve these matters?

Edison responded to these questions on March 17, 1998. Enron and RESCUE/ICA/SESCO filed comments on Edison's responses on March 24, 1998. Edison replied to those comments on April 1, 1998.

**Edison's Conservation Adjustment Proposal**

Edison proposes to calculate an annual conservation adjustment as follows:

> Annual Adjustment = verified kilowatt-hours (kWh) savings x (weighted class average T&D - short run T&D avoided costs)

Under Edison's proposal, the verified kWh savings would be determined through the Commission's ex-post measurement protocols (first-year load impact studies). Edison recommends that the results of these studies be confirmed by CBEE in the Annual Earnings Assessment Proceeding, or successor proceeding.

In calculating the annual conservation adjustment, Edison proposes that savings be measured for programs implemented during the PBR period (i.e., 1997-2001), including persistence effects. Persistence effects would be determined through use of the Commission's ex post measurement protocols for the second-year earnings claim. For eligible programs that do not have a required measurement study, Edison would use the realization rates from the most recently completed study to calculate the measured savings. Edison's first adjustment to reflect conservation impacts associated with 1997 DSM programs would be effective in rates on January 1, 1999.

**Positions of the Parties**

Edison argues that its proposed conservation adjustment is consistent with Commission policy on public purpose programs. In particular, Edison contends that its proposal reflects the changing role of utilities in energy efficiency in two ways: First, by recommending that the CBEE quantify the savings for qualifying years, Edison argues that its proposal recognizes that an entity other than Edison may be the administrator of DSM programs in Edison's service territory. In Edison's view, it is irrelevant if savings are from DSM programs administered by third parties. In addition, Edison argues that its proposed adjustment mechanism addresses concerns expressed in D.97-02-014 by mitigating some of the disincentives that Edison faces in promoting energy efficiency in a restructured environment.

In response to other questions posed in the March 6, 1998 ruling, Edison states that its ERAM for nongeneration base rate revenues was eliminated effective January 1, 1997 and that its ERAM for generation-related base rate revenues was eliminated effective January 1, 1998. Commencing January 1, 1998, Edison proposes that the conservation adjustment, previously reflected in the operation of its generation-related ERAM, be tracked and recorded in the Streamlining Residual Account, established by Resolution E-3514.[2] Pursuant to

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[2] On December 16, 1997, the Commission issued Resolution E-3514, which addressed utility compliance filings required by the Streamlining Decision. Resolution E-3514 notes that the Streamlining Decision eliminated ERAM and Electric Cost Adjustment Clause (ECAC) accounts, but recognized that these accounts included a number of sub-accounts that provided tracking for items such as intervenor compensation, Commission fees, etc. The utilities were directed to place these items in a new memorandum account—the "Streamlining Residual Account," the balance of which would be reviewed, authorized and functionalized in the Revenue Adjustment Proceeding. (E-3514, pp. 17-18.) Edison filed AL 1255-E-A on

*Footnote continued on next page*

D.97-08-056, Edison proposes to allocate the conservation adjustment to the public purpose programs revenue requirement component of Edison's distribution revenues.[3] In sum, Edison maintains that ratemaking treatment of the conservation adjustment is easily accommodated by the ratemaking mechanisms that have replaced Edison's nongeneration and generation-related ERAMs as a result of electric industry restructuring and regulatory streamlining.

RESCUE/ICA/SESCO and Enron oppose any allowance of a conservation adjustment, arguing that the concept of a conservation ERAM is obsolete in view of electric restructuring. In particular, RESCUE/ICA/SESCO point out that the utility may not even be serving the load that is reduced by energy efficiency programs. Enron argues that DSM is a competitive risk to all unbundled electric services provided from the integrated system of generation, transmission, and distribution and no utility should be immunized against that risk by ratepayer-funded adjustment mechanisms. To allow the utility (and not other energy service providers) a conservation adjustment mechanism would, in their view, tilt the playing field toward the utility. In any event, Enron argues that no recovery should be permitted for amounts lost due to independent, third-party administration of DSM conservation programs or for losses in transmission revenues.

RESCUE/ICA/SESCO raise concerns over how Edison's conservation adjustment would be funded. They believe that Edison may be seeking to use public goods charge funds for this purpose. Even if the adjustment is funded

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December 24, 1997. Among other things, Edison requests that its newly established Streamlining Residual Account include an adjustment for the conservation impact of DSM programs on nongeneration base rate revenue requirements.

[3] D.97-08-056, Appendix B, Table 3.

from some other source, RESCUE/ICA/SESCO argue that such a mechanism would substantially increase the effective cost of energy efficiency for Edison customers.

In response to comments, Edison argues that neither policy nor ratemaking decisions have rendered the conservation adjustment obsolete. Edison also argues that the conservation adjustment was never intended to apply to variations in sales in the generation market and, thus, it would not apply to other energy service providers. In response to concerns about the magnitude of the adjustment, Edison contends that RESCUE/ICA/SESCO's calculations erroneously included persistence effects for conservation measures installed prior to 1997. Edison states that the proposed conservation adjustment will incorporate only the persistence impact that occurs during the transition period, and only from conservation measures installed from 1997 to 2001.

Finally, Edison responds to RESCUE/ICA/SESCO's concerns about funding sources for the adjustment as follows:

> "The conservation adjustment will not, in any way, impact or utilize the Assembly Bill No. 1890 (AB 1890) mandated Public Goods funding. During the transition period, the conservation adjustment, which restores only lost non-generation revenues, will be recovered through an increase to the Public Goods Charge (PGC) and will not decrease the Public Purpose funds mandated by AB 1890. (D.97-08-056, p. 33; and Appendix B, Table 3.) However, in order to maintain the rate freeze mandated in AB 1890, the increase in the PGC will be offset by an equal and opposite decrease in the Generation Charge, which is determined residually. Thus, the overall rate levels will not change and the adjustment will be funded from competition Transition Charge (CTC) 'headroom.' Absolutely no Public Goods funds will be used to pay the annual conservation adjustment. As such, the speculation by RESCUE/ICA/SESO that the source of funding for the conservation adjustment comes from the Public Goods funds is completely unfounded and should be ignored." (Edison's April 1, 1998 Response, p. 3.)

**Discussion**

The issue before us today is whether we should authorize Edison to implement its proposal for a modified ERAM, in light of industry and regulatory developments that have transpired since our request for such a proposal. We conclude that we should not. We make this determination after considering the context for ERAM and utility DSM programs that existed at the time D.96-09-092 was issued, and how that context has changed in a relatively short span of time. As discussed more fully below, had this issue been clearly identified during the streamlining phase of this proceeding, we would have addressed it earlier in D.97-10-057.

The original purpose of ERAM was to control for sales forecasting errors, so that the utility's recovery of its base rate revenue requirement under cost-of-service ratemaking was not tied to its achieving the forecasted level of sales. In particular, the Commission established ERAM to counter the utility's economic disincentive to initiate and implement DSM and other ways of improving the efficiency of energy use. Successful DSM and efficiency programs decrease sales and, unless accurately forecasted, expose the utility to the risk of less than complete revenue recovery, in the absence of ERAM. When sales are lower than forecasted, ERAM records the resulting shortfall in revenues, and the Commission adjusts subsequent rates to amortize the undercollection, usually during the following year. The same sort of adjustment is also made for other sources of forecasting errors due to weather and business cycles. The mechanism also operates when sales are higher than forecasted to prevent inflated utility earnings.

Until recently, utilities were the monopoly providers of electric generation and played a monopoly role in the administration of ratepayer-funded DSM programs. Given these circumstances, the focus of our DSM policies through the mid-1990s was to create an environment where utilities would be motivated to implement energy efficiency programs as cost-effective alternatives to investing in supply-side resources. We acknowledged that some form of sales adjustment mechanism to account for conservation effects would be reasonable in that context. Otherwise, we reasoned, utilities would be hesitant to promote energy efficiency for fear of losing revenues if actual energy savings were higher than their forecasted levels. In addition, we authorized shareholder incentive mechanisms that would reward shareholders when the utility programs resulted in measurable, verified savings. This mechanism was designed to equalize DSM-related rewards with the financial rewards facing shareholders when the utility invested in generation plant under cost-of-service ratemaking.[4]

This DSM policy framework was still in place when we issued D.96-09-092 on September 20, 1996, but was soon to change as we implemented our Preferred Policy Decision (D.95-12-063, as modified by D.96-01-009) and AB 1890 addressing electric industry restructuring. AB 1890 was signed into law three days after our adoption of D.96-09-092, adding Sections 330 through 397 to the Public Utilities (PU) Code. Among other things, AB 1890 opened the generation market to competition and authorized the electric utilities to recover uneconomic generation-related costs and obligations (referred to as "transition costs") subject to two broad restrictions. The first restriction was that customers would pay a rate for electricity no higher than they paid on June 10, 1996. The second restriction was that the rate freeze would continue until the utilities either 1) fully

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[4] See the Commission's decisions in the DSM Rulemaking 91-08-003 and companion Investigation 91-08-002.

recovered their transition costs or 2) December 31, 2001, whichever came sooner.[5] Each electric utility was required to propose a transition cost recovery plan consistent with these restrictions and other criteria set forth in PU Code § 368.

In D.96-12-077, issued on December 20, 1996, we addressed the utilities' transition cost recovery plans. Under the cost recovery strategy outlined in AB 1890 and reflected in the utilities' plans, transition cost recovery would come from "headroom," i.e., the difference between recovered revenues at the frozen rate levels and the reasonable costs of providing utility services ("authorized revenue requirements"). As we explained in D.96-12-077, the incentives and functions of PBR become somewhat distorted under this new framework:

> "Because of the rate freeze, the utility receives the same amount of total revenue, regardless of its performance. We can affect only the allocation of collected revenues between authorized revenue requirement and headroom revenues. But if we attempt to 'reward' the utility for excellent performance by raising the authorized revenue requirement, we have created an equal and opposite 'punishment' for ratepayers by increasing the authorized revenue requirement (the former basis for rates) and decreasing the headroom revenues available to offset transition costs. Conversely, if we attempt to share losses by lowering the authorized revenue requirement, shareholders will nevertheless benefit from the resulting increase in revenues available for transition cost recovery." (D.96-12-077, mimeo. p.17.)

Moreover, the ability of ERAM to dampen utility incentives to increase sales is greatly diminished by the provisions of AB 1890, as we noted in D.96-12-077:

> "...the rate freeze will indirectly supplant some of ERAM's function of controlling for sales variation. As long as headroom exists, i.e.,

[5] Recovery of certain specified costs can be extended to March 31, 2002, pursuant to PU Code § 367(a).

total collected revenues exceed authorized revenue requirement, the utility will collect its exact authorized revenue requirement, including base revenues. All other collected revenues (the headroom) will be allocated to transition cost recovery, with the exception of refunds. Variation in sales will affect only the amount of the allocation to headroom: higher sales result in greater offsets to transition costs, and lower sales mean lower offsets.

"...the introduction of competition for generation will render ineffective our past approach of supporting DSM by using ERAM to counter the utility's economic incentive to increase sales. Many companies other than the utilities will be in the business of selling energy at retail, and we have no inclination to thwart their desire to compete. In anticipation of these market realities, we have shifted our emphasis in the area of DSM toward creating positive financial incentives for the utilities to carry out effective and efficient DSM programs...

"We discussed the implications of the restructured industry in the Policy Decision and suggested that continued financial incentives should be concentrated on market transformation and education. (See Preferred Policy Decision, slip op. at 155-156.) We also urged the Legislature to consider adopting a nonbypassable surcharge applied to retail sales to fund energy efficiency programs. (Id. at 157.) AB 1890 requires such a surcharge." (Id., pp. 20-21.)

We specifically did not consider in D.96-12-077 how best to preserve the intended incentives of PBR or whether or not ERAM should be applied to the distribution revenue requirement. Instead, we stated that parties should examine Edison's PBR in light of the issues discussed above "as the PBR is implemented." We also acknowledged that adjustments to base revenues to account for the effects of energy efficiency programs may not need to continue once the nonbypassable surcharge is in place. (Id., pp. 18, 21 and 22, n. 8.) We embarked on a streamlining phase of this proceeding by directing the Energy Division to hold workshops to explore these and related ratemaking issues in further detail.

Before the workshops were held, we issued a decision that fundamentally altered the utility's role in energy efficiency in the restructured electric industry. By D.97-02-014, issued February 5, 1997, we reaffirmed the Preferred Policy Decision language which called for a shift in focus to "market transformation programs," i.e., programs that transform the market for energy efficient products and services. We further clarified that the mission of market transformation was to "ultimately privatize the provision of cost-effective energy efficiency services so that customers seek and obtain these services in the private, competitive market." (D. 97-02-014, mimeo. p. 21.)

To this end, we established CBEE to assist us in overseeing the development and implementation of market transformation programs. Independent program administrators would be selected based on a competitive bid, developed by CBEE and subject to Commission approval. In considering the alternatives, we determined that utilities would not be motivated to create an independent energy efficiency industry that would directly compete with the electricity services they provide. We also rejected proposals to create such motivation through continued shareholder incentives and "some form of sales adjustment mechanism," stating:

> "...our goals for future energy efficiency activities in California are now quite different. No longer is our primary focus to influence utility decisionmakers, as monopoly providers of generation services. Rather, we now seek to transform the market so that individual customers and suppliers in the competitive generation market will be making rational, energy service choices. In our view, continuation of an administrative structure dependent upon utility shareholder incentives is incompatible with these objectives, particularly when we have the option of vesting responsibility for these programs in entities that can embrace our articulated mission without conflict..." (Id., p. 26.)

We did not prohibit utilities from competitively bidding to be program administrators, but stated that there would be no shareholder incentives authorized for any winning utility bidder:

> "It is up to the utility to assess the value of bidding for energy efficiency administrative functions, in light of its competitive interests in a restructured industry. Any further refinements or wholesale changes to sales adjustment mechanisms that we consider in our restructuring or performance-based ratemaking proceedings should reflect this changing role of utilities in energy efficiency." (Id., p. 26.)

We then turned to the streamlining issues initiated by our cost recovery plan decision, D.96-12-077. The Energy Division's workshop notice framed the issues in this phase of the proceeding by posing several questions for the parties' consideration:[6]

1. What tracking and/or balancing accounts are currently included in utilities' ERAM/ECAC applications or proceedings?

2. Please describe the function and purpose of each of the accounts listed in Question 1 above. (a) How are each of these functions impacted by the rate freeze?, (b) Will any of these functions continue to be needed during 1997 and/or the transition period 1998 through 2001? Why?

3. For those functions that you believe will be needed, what are the proper proceedings to address them?

4. How do PBR incentives interact with ERAM? Given the rate freeze, what incentives are appropriate?

5. For PG&E and SDG&E, should the ERAM for T&D be eliminated?

6. When tracking ERAM/ECAC costs, are there issues that the Commission should consider for market power abuse?

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[6] D.97-10-057, mimeo. pp. 6-7.

We addressed these issues in Streamlining Decision, issued on October 22, 1997. In response to the question of whether or not ERAM is needed" during 1997 and/or the transition period 1998 through 2001," we again discussed the interaction between the rate freeze, transition cost recovery, and ERAM:

> "D.96-12-077 finds that the 'introduction of competition for generation will render ineffective our past approach of supporting DSM by using ERAM to counter the utility's economic incentive to increase sales.' The ERAM was conceived during a period when the utility was the sole provider of power and a primary provider of conservation technologies and information. The ERAM was designed to reduce the conflict between the Commission's policy objectives to promote conservation and the utilities' objective to increase revenues and profits through higher sales. When generation markets are competitive, a distribution utility would not be able to affect the level of power sales. To the extent distribution rates are designed to be insensitive to usage, that is, 'flat,' the utility would be indifferent to the amount of electricity a customer uses. Where distribution rates are sensitive to the amount of electricity a customer uses, the main purpose the ERAM would serve would be to protect utility shareholders from variations in revenues. Competing electricity providers will promote electricity sales without regard to the distribution utility's ratemaking mechanisms. During the transition period, the utilities may also have an incentive to promote electricity sales notwithstanding the presence of an ERAM because increased sales will reduce the risk that the utilities will be unable to recover their uneconomic generation costs in the time allotted by AB 1890.
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> "Several parties proposed the elimination of the ERAM accounts for the reasons we have addressed here. Energy Division's workshop report also recommends elimination, but proposes to explore alternatives in utilities' distribution PBR application. We appreciate the parties' concern for continued conservation efforts and other types of demand-side management. Their comments in this proceeding, however, do not suggest ways to overcome the inevitable conflict between policy objectives to dampen demand and the compulsion of competitive electric providers to promote more sales. In subsequent proceedings, we will invite the parties to

address this matter and possible alternatives to ERAM for the period following the transition period." (D.97-10-057, mimeo. pp. 14-15.)

Based on this discussion, the Commission eliminated ERAM for PG&E and SDG&E, effective January 1, 1998. However, the Streamlining Decision erroneously assumed that Edison did not have any ERAM in effect (nongeneration or generation) at that time, and was therefore silent on its disposition. (D.97-10-057, mimeo. pp. 4 and 15.) As discussed above, Edison had a modified ERAM in place pursuant to D.96-09-092. The confusion apparently stemmed from differing uses of the term "ERAM" by the Commission and by Edison's witness.[7]

Had this confusion not occurred, we would have explicitly addressed Edison's existing ERAM mechanism, as modified by D.96-09-092, along with Edison's pending AL 1246-E in the Streamlining portion of this proceeding. As discussed above, all of the developments since our issuance of D.96-09-092 lead us to the conclusion that the original purpose and justification for ERAM no longer apply in a restructured electric industry.

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[7] When responding to the assigned Administrative Law Judge's (ALJ) question of whether Edison still had an ERAM, Edison witness Jazayeri repeatedly stated that Edison did not have a distribution (nongeneration) ERAM. (D.97-10-057, Reporters' Transcript Volume 38, pp. 5421, 5428.) Apparently, Jazayeri's response was based on his unique use of the term. By December, 1996, Edison's accounting description of ERAM had been revised to reflect only generation-related sales adjustments and other miscellaneous adjustments pursuant to Commission decisions, including a placeholder for the nongeneration conservation adjustment authorized by D.96-09-092. Jazayeri apparently considered this revised ERAM to be properly termed a "generation" ERAM, even though it included the conservation adjustment mechanism that was designed to adjust nongeneration sales revenues. The assigned ALJ and the Commission, on the other hand, were using the term "nongeneration ERAM" in the broader sense utilized by the Commission in prior decisions and rulings, i.e., to refer to any ERAM mechanism that adjusted nongeneration revenue requirements to account for sales fluctuations, modified or otherwise.

Edison did not petition for modification of D.97-10-057 in order to clarify its applicability to Edison's existing ERAM. Apparently, Edison interpreted the Commission's silence on the issue to mean that only the component of ERAM related to generation revenue requirements should be eliminated. This is evidenced by the fact that, on November 3, 1997, Edison filed modified tariffs to eliminate the generation component of ERAM even though the Commission had not ordered Edison to do anything with regard to ERAM in D.97-10-057. (See AL 1255-E).

Moreover, we can only speculate why Edison would desire to implement the remaining nongeneration component of its adjusted ERAM, in view of Edison's acknowledgment that the impact of adjusting for conservation effects would be to reduce headroom. As discussed above, reducing headroom reduces the amount of funds available to Edison to pay down transition costs. We have previously stated that it is in the interest of both ratepayers and shareholders that the greatest amount of revenues be available to collect transition costs. (D.97-06-060, mimeo., p. 37.)

For the reasons stated above, we do not approve Edison's proposal for a conservation adjustment, as set forth in AL 1246-E. Further, consistent with today's discussion, we modify D.97-10-057 to clarify that the elimination of ERAM accounts ordered therein applies to Edison's existing ERAM, including the conservation adjustment authorized but not yet implemented as of the date of that order. Today's decision makes moot the issue of whether to include the conservation adjustment in the Streamlining Residual Account, as requested by Edison in AL 1255-E-A.

## Findings of Fact

1. The purpose of ERAM has been to control for sales forecasting errors, so that the utility's recovery of its base rate revenue requirement under cost-of-

service ratemaking would not be tied to its achieving the forecasted level of sales. ERAM was established to counter the utility's economic disincentive to initiate and implement DSM and other ways of improving the efficiency of energy use.

2. Three days after the Commission issued D.96-09-092 directing Edison to develop and include in ERAM a conservation adjustment, AB 1890 addressing electric industry restructuring was signed into law. Among other things, AB 1890 established a rate freeze and transition cost recovery strategy that significantly affected ERAM.

3. At least during the rate freeze period, the provisions of AB 1890 renders ineffective the Commission's past approach of supporting energy efficiency by using ERAM to counter the utility's economic incentive to increase sales. Variations in forecasted and actual sales will affect only the allocation of utility revenues to headroom, rather than recovery of the utility's authorized revenue requirement. Moreover, competing electricity providers will promote electricity sales in the restructured industry without regard to the distribution utility's ratemaking mechanism.

4. Three months after the issuance of D.96-09-092, the Commission embarked on a streamlining phase of this proceeding to examine various ratemaking and accounting issues in light of restructuring, including the issue of whether the utilities' existing ERAM balancing accounts should continue during 1997 and/during the transition period 1998 through 2001.

5. Five months after the Commission directed Edison to develop and include in ERAM a conservation adjustment, and several months before Edison held a workshop with interested parties to consider Edison's proposed methodology, the Commission issued D.97-02-014. Among other things, the Commission determined in D.97-02-014 that utilities would not be motivated to create an independent energy efficiency industry in the restructured environment. The

Commission also rejected proposals to create such motivation through continued shareholder incentives and some form of sales adjustment mechanism.

6. Shortly after Edison filed AL 1246-E describing its proposal to calculate a conservation adjustment to nongeneration revenues, the Commission issued D.97-10-057 (Streamlining Decision). In the Streamlining Decision, the Commission eliminated ERAM for PG&E and SDG&E, but was silent on the disposition of Edison's ERAM. The decision language erroneously states that Edison did not have any ERAM in place, even though Edison had at the time both 1) an ERAM related to generation revenue requirements and 2) Commission authorization to develop an ERAM adjustment for conservation effects related to nongeneration revenue requirements.

7. Implementing Edison's proposed conservation adjustment under the rate freeze and cost recovery provisions of AB 1890 would serve to reduce headroom.

## Conclusions of Law

1. Because the Commission's direction to Edison to develop an ERAM that includes a conservation adjustment has been superseded by subsequent events and policies, AL 1246-E should be denied.

2. Edison's request to include a conservation adjustment in the Streamlining Residual Account is made moot by today's decision; therefore, that request as set forth in AL 1255-E-A should be denied.

3. D.97-10-057 should be corrected to reflect the fact that, at the time of its issuance, Edison had a generation ERAM in place as well as Commission authorization to implement a nongeneration ERAM for conservation effects. D.97-10-057 should be modified to eliminate Edison's ERAM, including the nongeneration conservation adjustment that was authorized by D.96-09-092, but not yet implemented.

4. In order to put closure on the issue of Edison's ERAM as soon as possible, this order should be effective today.

**O R D E R**

IT IS ORDERED that:

1. Advice Letter (AL) 1246-E filed on August 21, 1997 by Southern California Edison Company (Edison) is denied.

2. Edison's request to include a conservation adjustment for nongeneration revenue requirements in the Streamlining Residual Account, as set forth in AL 1255-E-A, is denied.

3. Decision (D.) 97-10-057 is modified as follows:

a. On page 4, the sentence beginning "Edison no longer has an ERAM since the initiation of its Performance-Based Ratemaking..." should be replaced in its entirety with the following:

> "In D.96-09-092, as part of Edison's Performance-Based Ratemaking (PBR) mechanism, the Commission directed Edison to limit ERAM to 1) sales variation impacts on generation base revenue requirements and 2) the conservation effects of demand-side management (DSM) programs on nongeneration base revenue requirements. The ERAM adjustment to account for conservation effects was to be implemented in rates by January 1, 1998. On August 21, 1997 Edison filed Advice Letter 1246-E describing its proposed methodology for calculating this conservation adjustment for 1997 energy efficiency programs, and requested that the resulting adjustment be reflected in rates January 1, 1999. Edison's request is still pending before the Commission."

b. On page 15, the sentence "Edison no longer has an ERAM" should be replaced in its entirety with the following:

> "For similar reasons, Edison should also eliminate its ERAM, including the conservation adjustment we directed Edison to develop and implement in D.96-09-062. Our earlier consideration of such an adjustment was made in an industry and regulatory environment that no longer exists. As described above, events and policies have superseded D.96-09-062 to render ineffective the use of sales adjustment mechanisms as we envisioned them in the past. Edison's request to calculate such an adjustment for implementation in rates effective January 1, 1999 and throughout the transition period should be denied."

c. The following language should be added to Finding of Fact 4:

> "Edison has an ERAM that adjusts rates under its PBR to account for sales variation impacts on generation base revenue requirements and has been authorized to develop and implement an ERAM for nongeneration base revenue requirements that would account only for the conservation effects of demand-side management (DSM) programs."

d. Conclusion of Law 2 should be modified to read:

> "The Commission should direct PG&E, SDG&E, and Edison to eliminate their ERAMs."

e. Ordering Paragraph 3 should be modified to read:

> "PG&E , SDG&E, and Edison shall modify their tariffs by filing advice letters no later than November 3, 1997 which eliminate their Electric Revenue Adjustment Mechanisms (ERAM) effective January 1, 1998. Edison's Advice Letter 1246-E, filed on August 21, 1997, is denied."

f. Ordering Paragraph 9 should be modified to read:

"Nothing in this decision authorizes or implies any changes to the performance-based ratemaking (PBR) mechanisms of SDG&E or Edison, except that the conservation adjustment to nongeneration revenue requirements authorized for Edison during the PBR period shall not be implemented in light of events and policies that have superseded D.96-09-062."

This order is effective today.

Dated June 4, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners