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Decision 99-04-021 April 1, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Gas and Electric Company for the Authority to Adopt a Revenue-Sharing Mechanism and Other Prerequisites for New Non-Tariffed Products and Services.

Application 98-05-007
(Filed May 4, 1998)

INTERIM OPINION

Summary

In Decision (D.) 97-12-088, the Commission approved Affiliate Transaction Rules governing the relationships between regulated energy utilities and their affiliates. Those rules were revised in D.98-08-035. Rule VII.D. contains certain conditions precedent to a utility offering new non-tariffed products and services. The utility must first gain Commission approval of a mechanism to ensure the prevention of cross-subsidies, a mechanism for the treatment of any resulting benefits and revenues, a proposal for periodic reporting, and a proposal for periodic audits. In this application, Pacific Gas and Electric Company (PG&E) seeks approval of its proposed approach for dealing with these issues. Here, we approve PG&E's proposal on an interim basis pending the examination of a permanent revenue sharing mechanism in PG&E's performance based ratemaking (PBR) application (A.98-11-023).

Procedural History

PG&E filed this application on May 4, 1998. The Office of Ratepayer Advocates (ORA) filed a protest and The Utility Reform Network (TURN) filed a

limited protest on June 8, 1998. PG&E replied to the protests on June 18, 1998. Assigned Commissioner Richard A. Bilas and Administrative Law Judge (ALJ) Steven Weissman presided over a prehearing conference on August 26, 1998 at which they directed ORA to prepare and submit written testimony no later than September 30, 1998. ORA complied with this direction. The parties filed concurrent opening and closing briefs on October 21, 1998. In its brief, ORA asks to have its prepared testimony admitted into evidence in this proceeding. Its motion is unopposed and is hereby granted. ORA's testimony will be included in the formal record for this proceeding as Exhibit 1.

Background

Under the Affiliate Transaction Rules, utilities are limited to providing those untariffed services that meet the following criteria (as set forth in Rule VII.C.4., found in Appendix B of D.98-08-035):

- a. The non-tariffed product or service utilizes a portion of a utility asset or capacity;
- b. Such asset or capacity has been acquired for the purpose of and is necessary and useful in providing tariffed utility services;
- c. The involved portion of such asset or capacity may be used to offer the product or service on a non-tariffed basis without adversely affecting the cost, quality or reliability of tariffed utility products and services;
- d. The products and services can be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk being incurred by utility ratepayers, and no undue diversion of utility management attention; and
- e. The utility's offering of such non-tariffed product or service does not violate any law, regulation, or Commission policy regarding anticompetitive practices.

Pursuant to Rule VII.D, a utility can offer new non-tariffed products or services only if the Commission has adopted and the utility has established:

1. A mechanism or accounting standard for allocating costs to each new product or service to prevent cross-subsidization between services a utility would continue to provide on a tariffed basis and those it would provide on a non-tariffed basis;
2. A reasonable mechanism for treatment of benefits and revenues derived from offering such products and services, except that in the event the Commission has already approved a performance-based ratemaking mechanism for the utility and the utility seeks a different sharing mechanism, the utility should petition to modify the performance-based ratemaking decision if it wishes to alter the sharing mechanism, or clearly justify why this procedure is inappropriate, rather than doing so by application or other vehicle.
3. Periodic reporting requirements regarding pertinent information related to non-tariffed products and services; and
4. Periodic auditing of the costs allocated to and the revenues derived from non-tariffed products and services.

PG&E's Proposal

For all existing non-tariffed products and services, PG&E is required to present, in its general rate case application, a forecast for expected revenues. The otherwise applicable over-all revenue requirement is reduced by the full amount of the predicted revenues from the non-tariffed offerings. PG&E's shareholders are at risk if these revenues do not meet expectations and stand to gain if they exceed the forecasted amount. Here, PG&E proposes a more direct approach for a sharing of the revenues for new non-tariffed products and services that are not covered by the existing mechanism. Ratepayers and shareholders would each receive half of any revenues remaining after deducting all reasonable expenses

related to the provision of new non-tariffed offerings, including corporate taxes. Shareholders would bear any losses resulting if these net revenues are negative.

PG&E argues that the Commission should adopt its proposal to encourage the utilities to offer new non-tariffed products and services. PG&E suggests adopting this single, "one category fits all" mechanism to avoid the increased regulatory burden and contentiousness that would accompany a more complex approach.

PG&E proposes that all incremental costs related to the new offerings be allocated to those offerings, but that embedded asset costs and Corporate Administrative and General costs not be allocated to the new non-tariffed offerings. The utility argues that such embedded costs would not be affected by the new offerings, and ratepayers would face the same level of embedded costs either way.

This new revenue-sharing arrangement would apply only to new non-tariffed offerings and would remain in effect at least until PG&E gains approval of a yet-to-be-proposed performance-based ratemaking mechanism. The company proposes tracking the accumulated revenues and costs of new non-tariffed offerings in a memorandum account for retrospective reporting, ratemaking adjustments and auditing. For two years, PG&E would file reports every six months identifying the accrued gross revenues, incremental costs, taxes and net revenues for new offerings. Thereafter, it would file annual reports. After an annual Commission audit and review, the ratepayer share of after-tax net revenue would be applied by PG&E as an adjustment to authorized Distribution Revenue Requirement in its Transition Revenue Account. This account would be reviewed annually in the Revenue Adjustment Proceeding.

The Protests

ORA filed a protest to this application in which it expressed a preference for a gross revenue-sharing mechanism, as opposed to the net revenue-sharing approach proposed by PG&E. In addition, ORA asserted that PG&E's proposal for reporting and auditing lacked specific detail. ORA posed a number of questions related to that proposal which it asks PG&E to address. TURN filed what it referred to as a limited protest in which it stated that it does not object to PG&E's proposal but wishes to emphasize that it does not want the Commission to "encourage" utilities to pursue new non-tariffed products and services. TURN cites D.97-12-088 (pp. 81-82) where the Commission discussed its desire to avoid adopting "a mechanism by which the utility can circumvent [the affiliate transaction] rules by offering the products and services itself instead of through an affiliate, especially when the utility's offering is for a competitive or potentially competitive service and might interfere with the development of a competitive market. We recognize that in some limited instances it might be appropriate for a utility to offer new non-tariffed products and services in lieu of requiring all such services to be offered by the affiliate."

ORA's Proposal

The Southern California Edison Company (Edison) sought authority to adopt a revenue-sharing mechanism for certain of its operating revenues in Application 97-06-021. Recently, ORA and Edison entered into an agreement under which Edison would share a certain percentage of its gross revenues with its ratepayers. For what are referred to as "passive" activities, shareholders would receive 70% of the gross revenues, while ratepayers would receive 30%. For "active" activities, defined as those involving incremental shareholder investment of at least \$225,000, shareholders would retain 90% of the revenues

and ratepayers would receive the remaining 10%. In its prepared testimony dated September 30, 1998, which we will receive in evidence as Exhibit 1 in this proceeding, ORA recommends that the Commission adopt a gross revenue-sharing mechanism for PG&E as well, and offers its agreement with Edison as a model.

ORA argues that the use of a gross sharing method, as opposed to a net sharing method, insulates ratepayers from risk associated with PG&E's unregulated business activities. ORA asserts that PG&E is seeking to optimize the use of utility assets with its proposal, while the more appropriate goal would be to simply make better use of those assets, and that its gross sharing approach would ensure that PG&E would only pursue particularly favorable sources of added revenue. ORA also sees gross sharing as a form of rent on ratebase assets, with that rent going toward recovery of non-incremental costs associated with those assets.

ORA objects to PG&E's suggestion that it allocate none of its embedded corporate costs to these untariffed offerings for the purpose of calculating net revenues. ORA has also expressed concerns about the lack of detail in PG&E's proposed accounting and reporting mechanisms, but states that those concerns are lessened if the Commission adopts a gross sharing mechanism, since the need for accounting detail would be reduced.

Discussion

Accounting, Reporting and Auditing

PG&E proposes to track revenues and costs from new services in a memorandum account subject to annual Commission audit and review. The company would reduce its authorized Distribution Revenue Requirement in its Transition Revenue Account that would be verified annually in the Revenue

Adjustment Proceeding. In its protest, ORA asserts that this proposal lacks sufficient detail and asks the following questions: Does PG&E intend for the Commission's Energy Division to audit the report annually, or does PG&E propose that the reports can be audited if the Commission or interested parties choose to do so? Has PG&E developed a format for the periodic reporting? Would reporting be done by category or by individual project? Does PG&E intend to submit a sample report in a compliance filing in this proceeding? ORA states that it is unable to review and comment on PG&E's proposal in the absence of further detail.

In its response to the protests, PG&E proposes that non-tariffed product and service costs and revenues be reported in accordance with the Commission's Affiliate Transaction Rules, adopted in D.97-12-088. The first report under these rules was filed in September 1998. In comments on the draft order, PG&E claims that ORA is now in agreement on reporting, accounting and auditing requirements. ORA clarifies in comments that it only supports these requirements for a gross revenue sharing mechanism, but not for a net revenue sharing mechanism. In an appendix to its comments, PG&E clarifies that it will account for and report incremental costs and revenues in the same manner that it accounts for and reports existing non-tariffed product and service categories. In addition, PG&E provides additional detail for workpapers, accounting entries, and audits. We are satisfied that the accounting, reporting, and auditing requirements set forth by PG&E in its comments on the draft decision satisfy the requirements of Rule VII.D for the interim period that this revenue sharing mechanism will be in effect. Therefore, we shall require PG&E to comply with the requirements set forth in Appendix A.

Sharing Mechanism

In order to offer new non-tariffed products and services, PG&E must persuade this Commission that it has, in place, accounting and cost allocation mechanisms that will protect against cross-subsidization and a reasonable method for sharing benefits and costs related to these offerings.

Under PG&E's proposal, net revenues from new non-tariffed offerings would be split 50-50 with ratepayers. Ratepayers would receive half of the gains in exchange for the use of regulated assets and shareholders would receive half of the gains in exchange for bearing the risk associated with incremental investments necessary to provide the product or service.

ORA proposes the idea of a gross sharing mechanism, but does not provide any specific gross sharing proposal. Instead, ORA offers its recent agreements with Edison as a model.¹ If PG&E shared its gross revenues with ratepayers as ORA suggests, it would allocate to ratepayers a pre-determined percentage of the revenues it received for offering the product or service.

PG&E objects to the use of a gross revenue sharing approach on several grounds. First, PG&E argues that gross sharing would result in lower revenues for ratepayers because it would discourage the company from pursuing some potentially profitable offerings. Since PG&E would be forced to share some revenues with ratepayers even in the early years, when start-up costs may be high, the time during which PG&E would fail to earn a profit would increase. PG&E argues that this would tend to discourage the company from offering some products or services that may ultimately turn a profit because shareholders

¹ The ORA/Edison revenue sharing agreement is under consideration by the Commission in A.97-06-021 and has not yet received approval.

would bear too great a risk that costs will exceed PG&E's share of gross revenues. PG&E notes that this disincentive would prevent efficient utilization of the company's assets as capacity could sit idle and benefit neither ratepayers nor shareholders. PG&E also argues that ORA's proposal would be unfair to shareholders because they would be required to share a substantial amount of revenue from new products and services even if the new offerings failed to generate profits in a given period.

PG&E further argues that, contrary to ORA's stated goal to reduce controversy over the reasonableness of recorded costs, a gross sharing mechanism would not reduce the regulatory burden. As PG&E points out, Rule VII.D.1 regarding cost allocation must be met no matter what revenue sharing mechanism is used.

Finally, PG&E asserts that ORA has failed to demonstrate that the gross sharing levels reflected in ORA's agreement with Edison are appropriate for PG&E and has failed to provide sufficient specificity.

While the ORA/Edison agreement provides an example of a gross revenue sharing agreement, we agree with PG&E that ORA has not yet demonstrated that it would be appropriate to apply the same sharing ratios or other implementing provisions to PG&E. While there may be merit to pursuing a gross revenue sharing arrangement, this idea is better explored within the context of PG&E's PBR application. Until that examination can occur, we will adopt PG&E's proposal on an interim basis with the understanding that the debate over gross versus net sharing may arise again. Furthermore, this interim adoption of PG&E's net-sharing mechanism should not be considered precedential.

Given that this revenue sharing mechanism need only be interim in nature and only apply to new non-tariffed products and services, we find that PG&E's proposal adequately addresses the requirements of Rule VII.D. First, this

proposal is reasonable and complies with Rule VII.D.2 because it provides PG&E an incentive to maximize revenues for ultimate sharing with ratepayers and because ratepayers incur no costs or harm if the offering is not profitable. Although revenues will be shared net of taxes, this is not unlike sharing arrangements under current PBR mechanisms which also base sharing on after-tax earnings (see Southern California Gas Company PBR, D.97-07-054 and Southern California Edison PBR, D.96-09-092). While we do not wish to prejudge the merits of any gross sharing proposal that may be considered in PG&E's PBR application, we find that PG&E's net sharing mechanism will suffice for the interim. We will direct PG&E to file supplemental testimony in A.98-11-023 to describe a permanent revenue sharing mechanism for new non-tariffed products and services. Such testimony should be filed no later than 30 days from the effective date of this order.

Second, we find that PG&E's proposal to allocate only incremental costs to new non-tariffed products and services is reasonable for the interim and complies with Rule VII.D.1. Ratepayers will receive the benefit of a 50 percent share of net revenues from these offerings. These revenues would only be reduced if PG&E were required to allocate embedded costs to these products and services. By allocating only incremental costs, PG&E can price these products and services to compete in the applicable market.

Finally, we note that revenues from existing products and services will continue to be included in Other Operating Revenue (OOR) in PG&E's general rate case. This interim mechanism shall also not apply to revenues from existing Direct Access service fees and unbundled public purpose programs, per PG&E's proposal.

Pricing Flexibility

PG&E seeks to retain full discretion to set prices for these new offerings. Such discretion is consistent with the non-tariffed nature of these products and services, and we will grant it. However, PG&E remains responsible to set its prices and terms of service in a manner that is consistent with an open and fair competitive market. We may find it necessary to limit PG&E's pricing discretion in specific instances. The company remains answerable before this Commission and appropriate courts of law for any anticompetitive aspects of its non-tariffed products and services.

Conclusion

PG&E's proposal for a net revenue sharing mechanism for new non-tariffed products and services, is adopted on an interim basis until the Commission adopts a permanent revenue sharing mechanism in PG&E's PBR application (A.98-11-023). PG&E's proposed accounting, reporting, and auditing requirements, set forth in Appendix A, are also adopted on the same interim conditions.

Comments on the Draft Decision

The draft decision of ALJ Weissman in this matter was mailed to the parties in accordance with Public Utilities Code § 311(g)(1) and Rule 77.1 of the Rules of Practice and Procedure. PG&E and ORA filed comments on the draft decision on February 9, 1999. In addition, PG&E, ORA, and TURN filed reply comments on February 16, 1999. Minor changes in response to these comments have been incorporated into the text.

The alternate order of Commissioner Bilas was mailed to the parties in accordance with Rule 77.6. Comments were filed by PG&E and ORA. In response to comments by ORA, we have modified the decision to direct PG&E to

file supplemental testimony in A.98-11-023 on a permanent revenue sharing mechanism. Other minor clarifications are also incorporated in the text.

Findings of Fact

1. PG&E's proposed accounting, reporting and auditing requirements for costs and revenues from new non-tariffed products and services as set forth in Appendix A to this order are reasonable for use on an interim basis.

2. PG&E's proposal for net revenue sharing adequately addresses the requirements of Affiliate Transaction Rule VII.D for an interim period until a permanent proposal is adopted in A.98-11-023.

3. PG&E's proposal is limited to new categories of non-tariffed products and services and does not apply to existing non-tariffed products and services.

4. PG&E should file supplemental testimony in A.98-11-023 describing a permanent revenue sharing mechanism for new non-tariffed products and services.

5. PG&E's proposal does not apply to existing direct access services and unbundled public purpose programs.

Conclusions of Law

1. PG&E's proposal for accounting, reporting, and auditing of costs and revenues related to non-tariffed products and services, attached to this decision as Appendix A, satisfies the requirements of Affiliate Transaction Rule VII.D and should be adopted on an interim basis.

2. PG&E's proposed revenue sharing mechanism should be adopted on an interim basis until a permanent revenue sharing mechanism is addressed in PG&E's PBR application (A.98-11-023).

3. The interim adoption of PG&E's net-revenue sharing mechanism should not be considered precedential.

4. PG&E should be given pricing flexibility for new categories of non-tariffed products and services, within the constraints discussed in this decision.

INTERIM ORDER

IT IS ORDERED that:

1. The proposal of Pacific Gas and Electric Company for a net revenue sharing mechanism for new non-tariffed products and services is adopted on an interim basis until further order of this Commission.

2. The proposal of PG&E for accounting, reporting, and auditing requirements for new non-tariffed products and services is adopted on an interim basis as set forth in this decision.

3. No later than 30 days from the effective date of this order, PG&E shall file supplemental testimony in A.98-11-023 describing a permanent revenue sharing mechanism for new non-tariffed products and services.

4. Application 98-05-007 is closed.

This order is effective today.

Dated April 1, 1999, at San Francisco, California.

RICHARD A. BILAS
President
JOSIAH L. NEEPER
Commissioner

I dissent.

/s/ HENRY M. DUQUE
Commissioner

Appendix A

ACCOUNTING, REPORTING AND AUDITING PROPOSAL FOR NEW NON-TARIFFED PRODUCTS AND SERVICES

- PG&E will account for incremental costs of, and revenues from, new categories of non-tariffed products and services in the same manner in which it accounts for costs of and revenues from existing categories of non-tariffed products and services.
- PG&E will report the incremental costs of, and revenues from, new categories of non-tariffed products and services as part of its Periodic Reports of Non-Tariffed Products and Services filed in compliance with Rule VII.H. of the Affiliate Transaction Rules. (These Periodic Reports will be filed semi-annually for 1998 and 1999 and annually thereafter. They will be served on all parties to the Affiliate Transaction Rules proceeding, R.97-04-011).
- The Periodic Reports will contain cost and revenue information at the category level. PG&E will maintain auditable work papers at the Product and Service level for three years after each Periodic Report is filed.
- The Periodic Reports will include the amounts of shareholder and ratepayer revenue allocations for the relevant period as ordered by the Commission in its Decision approving a revenue-sharing mechanism for new categories of non-tariffed products and services.
- Costs of and revenues from new categories of non-tariffed products and services will be tracked using accounting entries that separate them from other utility operations.

Appendix A

- Costs of and revenues from existing categories of non-tariffed products and services will be treated as Other Operating Revenues (OOR) in accordance with the applicable General Rate Case.
- The ratepayer share of revenues will be applied by PG&E as an adjustment to authorized revenue requirement in PG&E's Transition Revenue Account (TRA). The TRA will be verified annually, in the Revenue Adjustment Proceeding (RAP).
- If the Commission determines, as the result of an audit undertaken within three years of the filing of a Periodic Report, that revenues reported in that Periodic Report should be adjusted, appropriate adjustments to the Periodic Report and TRA can be made.
- The Periodic Reports will be audited annually. These audits will be separate from the Affiliate Transaction audits required by Rule VI. C. of the Affiliate Transaction Rules.