

Decision 00-06-040 June 8, 2000

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Pacific Gas and Electric Company for Authority to (i) Establish Its Authorized Rates of Return on Common Equity and for Electric Distribution and Gas Distribution, and (ii) Establish Its Unbundled Rates of Return for Year 2000 for Electric Distribution and Gas Distribution. (U 39 M)

Application 99-11-003  
(Filed November 1, 1999)

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Department of Navy, by Norman J. Furuta, Attorney at Law, for Federal Executive Agencies; James Weil, for Aglet Consumer Alliance; and Ron Knecht and Ray Czahar, for themselves; interested parties.

Robert C. Cagen, Attorney at Law, for the Office of Ratepayer Advocates.

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## O P I N I O N

### I. Summary

After considering the evidence of the market conditions, trends, interest rate forecasts, quantitative financial models, risk factors, and an all-party settlement agreement, we conclude that Pacific Gas and Electric Company (PG&E) should be authorized a 11.22% return on common equity (ROE). This ROE is within the 10.90% to 11.30% ROE range found reasonable in this proceeding. This authorized ROE results in a corresponding 9.12% return on rate base requiring a \$42.1 million electric and \$13.5 million gas revenue requirement increase for 2000. The increase in electric revenue requirement shall be included in PG&E's Transition Revenue Account (TRA) and not result in increased electric rates at this time because PG&E's electric rate freeze remains in effect. The average residential gas customer, with average usage of 50 therms per month, will see an average monthly bill increase of 0.805% or \$0.23 from \$27.98 to \$28.21. PG&E's adopted capital structure for 2000 is summarized as follows:

	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	46.20%	7.26%	3.35%
Preferred Stock	5.80	6.60	0.38
Common Equity	<u>48.00</u>	<u>11.22</u>	<u>5.39</u>
<b>Total</b>	100.00%		9.12%

This compares with the following adopted capital structure and weighted cost of capital currently in effect for PG&E:

	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	46.20%	7.09%	3.28%
Preferred Stock	5.80	6.55	0.38
Common Equity	<u>48.00</u>	<u>10.60</u>	<u>5.09</u>
<b>Total</b>	100.00%		8.75%

As addressed in our subsequent discussion of Return on Equity Analysis Methods, the main driver of the increased cost of capital is the substantial rise in interest rates throughout the national economy.

## II. Jurisdiction

PG&E is a public utility electric and gas corporation subject to the jurisdiction of this Commission, as defined in Pub. Util. Code § 218 and 222, respectively. This application was filed pursuant to Rules 23 and 24 of the Commission's Rules of Practice and Procedure (Rules), Ordering Paragraph 2 of Decision (D.) 99-09-001, dated September 2, 1999, and in accordance with Appendix C of the Commission's rate case plan set forth in D.89-01-040.<sup>1</sup>

## III. Request

PG&E seeks authority to increase its authorized ROE by 1.90% from 10.60% to 12.50% for its electric and gas utility distribution operations based on its ratebase set forth in its 2000 rate of return request filed on October 1, 1999.<sup>2</sup>

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<sup>1</sup> 30 CPUC2d 576 at 610 (1989).

<sup>2</sup> Advice Letters No. 1921-E and 2188-G.

Approval of PG&E's requested ROE for 2000 would result in an increased authorized overall rate of return by 1.01% from 8.75% to 9.76% and require a \$127.8 million increased revenue requirement for its electric distribution and \$36.6 million for its gas distribution operations.

#### **IV. Proceeding Type**

PG&E requested that this application be classified as a ratesetting proceeding within the meaning of Rule 5(c). The Commission preliminarily found in Administrative Law Judge (ALJ) Resolution 176-3027, dated November 18, 1999, that this proceeding is a ratesetting proceeding and that hearings may be held. This ratesetting classification was subsequently affirmed in the Assigned Commissioner's January 21, 2000 Scoping Memo and Ruling.

#### **V. Prehearing Conference**

A Prehearing Conference (PHC) was held on PG&E's application before assigned Commissioner Carl W. Wood and ALJ Galvin in San Francisco on January 11, 2000. The PHC was held to identify and clarify the issues in this proceeding, to deal with procedural matters, and to set dates for an evidentiary hearing.

Appearances were received from PG&E, Knecht and Czahar, Federal Executive Agencies (FEA), Department of the Navy, New West Energy Corporation (New West), Aglet Consumer Alliance (Aglet), and the Office of Ratepayer Advocates (ORA). New West's appearance was accepted on the basis that it would participate in this proceeding through either the presentation of testimony or cross-examination and filing of briefs. Because it neither presented testimony nor participated in the cross-examination of witnesses, New West was reclassified from an appearance of record to information only at the April 13, 2000 evidentiary hearing.

## **VI. Presiding Officer and Scope of Proceeding**

A Scoping Memo and Ruling was issued by the assigned Commissioner that, among other matters, designated ALJ Galvin as the principal hearing officer, established an evidentiary hearing schedule, established a service list, and determined the scope of this proceeding. It also authorized parties to update long-term debt and preferred stock costs to reflect the result of the April 2000 "DRI" interest rate forecast for 30-year Treasury Bonds.

The issues in this proceeding are interest rate increases and forecasts, ROE and rate base, analytical methods as discussed at the PHC, and risk factors. Issues addressed and resolved in PG&E's most recent cost of capital decision, D.99-06-057, dated June 10, 1999 are not re-litigated in this proceeding.

## **VII. Interim Order**

In D.00-02-049, we granted PG&E the authority to make the 2000 cost of capital adopted in this order effective as of to February 17, 2000. That interim order was issued for the purpose of returning PG&E to the established rate case plan cycle, which requires PG&E to file an annual cost of capital application in early May. Hence, the effective date of this order should be February 17, 2000.

## **VIII. Customer Notice**

PG&E provided notice of its cost of capital application to its customers, and to the cities, counties, and the state affected by its application, as required by Pub. Util. Code § 454 and Rule 24. PG&E effectuated its notice requirement through mail notices to the affected cities, counties, and the state, and bill insert notices to its customers. Notice of the application was also included in various newspaper publications throughout California.

## **IX. Evidentiary Hearings**

Evidentiary hearings were held on April 12 and 13, 2000. This proceeding was submitted upon receipt of an April 28, 2000 late-filed comparison exhibit. The assigned Commissioner and ALJ attended the PHC. The assigned ALJ presided over the evidentiary hearing. A final decision in this matter is being issued well within the 18-month statutory time period set forth in SB 960 (Stats. 1996, Ch.856, §1).

## **X. Proposed Stipulation and Settlement**

On the second day of the evidentiary hearing, PG&E, Aglet, FEA, Knecht and Czahar, and ORA submitted an all-party stipulation and settlement agreement on the record. Article 13.5 of the Commission's Rules sets forth the procedure for parties to stipulate to the resolution of any issue of law or fact material to the proceeding and to settle on a mutually acceptable outcome to the proceeding.

Prior to the signing of any stipulation or settlement, Rule 51.1(b) requires that the settling parties convene at least one conference and provide to all parties written notice and opportunity to participate in settlements discussions. However, this rule is not applicable in this proceeding because the proposed stipulation and settlement agreement was offered via oral testimony and all parties testified to the reasonableness of the proposed stipulation and settlement agreement.

Irrespective of the inapplicability of Rule 51.1(b), a motion was made by PG&E at the evidentiary hearing to waive the settlement conference requirement set forth in Rule 51.1(b). Rule 51.6(c) provides the assigned ALJ with authority to accept stipulations on the record in any proceeding and to waive application of the stipulation and settlement rules upon motion and for good cause shown.

Rule 51.10 provides that a motion for waiver of the stipulation and settlement rules may be granted upon a demonstration that the public interest will not be impaired by the waiver of these rules in proceedings where all parties join in the proposed stipulation or settlement. There was no opposition to PG&E's motion and consistent with Commission Rules, the ALJ waived the settlement conference requirement and accepted the all-party oral settlement agreement for the Commission's consideration.

The all-party settlement agreement proposes that:

- PG&E's 2000 capital structure shall be the same capital structure proposed in PG&E's application.
- PG&E's 2000 long-term debt and preferred stock costs proposed in its application shall be updated to reflect the results of the April 2000 DRI update.
- PG&E's 2000 ROE shall be 11.22%.
- The resulting electric and gas revenue requirement increase from this cost of capital application shall be effective February 17, 2000.
- A workshop shall be held to address market risk premium and "betas" prior to PG&E's 2002 scheduled cost of capital proceeding.
- A workshop report shall be issued if a consensus is reached on market premium and betas.
- The agreement shall not be a precedent, as set forth in Rule 51.8.
- An updated exhibit reflecting the impact of this settlement agreement shall be submitted on April 28, 2000.

In regards to the workshop agreement, all parties agreed to organize their own workshop market risk premium and beta issues over a four-day period in the October/November 2000 time period. The parties to the agreement will provide notice of the workshop to all parties to PG&E's 1999 cost of capital

proceeding. A workshop report, if issued by all parties to the settlement agreement will not be filed, but must be served on all parties notified of the workshop.

All parties concurred that the settlement agreement is in the public interest and reasonable in light of the entire record on the basis that:

- The settlement agreement represents a reasonable compromise of strongly held views actively and vigorously contested.
- The 11.22% ROE settlement outcome is well within the 10.5% to 12.5% range of disputed returns on equity.
- The settlement avoids further costly and lengthy litigation.
- There is sufficient information for the parties and the Commission to assess strengths and weaknesses of the individual parties' cases and to make an informed decision.
- The interested parties are knowledgeable and experienced in the subject matter.
- The interested parties represent a broad range of affected interests, including shareholders and large and small customers.
- The settlement amount is reasonable in relation to risk.

All parties concluded that the settlement agreement is consistent with the law and know of no law or Commission decision contravened by this agreement including the Bluefield and Hope decisions.<sup>3</sup> All parties also concluded that the agreement is in the public interest because it provides PG&E with necessary and sufficient revenue to provide safe and reliable service and because the public has

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<sup>3</sup> Bluefield Water Works & Improvement Company v. Public Service Commission of the State of Virginia, 262 U.S. 679 (1923) and the Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944).

a strong interest in the resolution of disputes by settlement, which promotes administrative efficiency and avoids costly litigation.

The Commission may reject a proposed stipulation or settlement without hearing whenever it determines that the stipulation or settlement is not in the public interest. Hence, we assess the all-party settlement agreement in light of the whole record to determine whether it is consistent with law and in the public interest.

## **XI. A Fair Return**

Although the Commission is only considering rate of return for PG&E's electric and gas distribution operations in this proceeding, the legal standard for setting the fair rate of return has been established by the United States Supreme Court in the Bluefield and Hope cases.<sup>4</sup> The Bluefield decision states that a public utility is entitled to earn a return upon the value of its property employed for the convenience of the public and sets forth parameters to assess a reasonable return. Such 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 attended by corresponding risks and uncertainties. That return should also be reasonably sufficient to assure confidence in the financial soundness of the utility, and adequate, under efficient management, to maintain and support its credit, and to enable it to raise the money necessary for the proper discharge of its public duties.

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<sup>4</sup> *Id.*

The Hope decision reinforces the Bluefield decision and emphasizes that such returns should be sufficient to cover operating expenses and capital costs of the business. The capital cost of business includes debt service and stock dividends. The return should also be commensurate with returns available on alternative investments of comparable risks. However, in applying these parameters, we must not lose sight of our duty to utility ratepayers to protect them from unreasonable risks including risks of imprudent management.

PG&E seeks a fair ROE for its electric and gas distribution systems. Consistent with its prior cost of capital order finding that PG&E's electric and gas distribution systems have the same risk, PG&E seeks to increase its authorized ROE for both its electric and gas distribution operations from 10.60% to 12.50%. The first step in determining a fair ROE is to establish a reasonable capital structure.

## **XII. Capital Structure**

Capital structure is comprised of long-term debt, preferred stock, and common equity.<sup>5</sup> Because the level of financial risk that PG&E faces is determined by the proportion of its debt to permanent capital, or its leverage, the concern is to ensure that the adopted equity ratio is sufficient to maintain reasonable credit ratings and to attract capital.

PG&E's capital structure policy is driven primarily by two objectives. The first objective is to maintain financial flexibility so that a sufficient amount of liquidity exists to withstand adverse business events and to fund on-going capital requirements. The second objective is to minimize financing costs by

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<sup>5</sup> Excludes short-term debt.

taking advantage of the tax benefits of debt, which avoid the higher costs of capital associated with excessive levels of leverage. To achieve these objectives, PG&E considers factors such as bond rating, event risk, dividend policy, and business strategy to arrive at a targeted single-A bond rating.

PG&E derives its core capital structure by removing the capital attributable to Diablo Canyon, which for ratemaking purposes has been previously segregated by the Commission from PG&E's utility business. PG&E then estimates its pre-tax interest coverage. The result was a projected pre-tax interest coverage ratio of 3.52 and 4.34 times earnings for 1999 and 2000, respectively. These pre-tax interest coverage ratios exceed its targeted 3.50 times interest rate coverage ratio for a single-A bond rating.

With no plan to change its current authorized capital structure, PG&E proposes to use the identical capital structure that the Commission approved in its prior year's cost of capital proceeding. That capital structure consists of 46.20% long-term debt, 5.80% preferred stock, and 48.00% equity, which is also the same capital structure recommended by the interested parties in their individual prepared testimony. This undisputed capital structure is also the same capital structure being proposed in the all-party settlement agreement.

PG&E's proposed capital structure is also recommended in the all-party settlement agreement. This capital structure reasonably maintains PG&E's single-A bond rating,<sup>6</sup> and financial soundness, maintains and supports its credit, and enables PG&E to raise the money necessary for the proper discharge of its public duties as required by the Bluefield decision. We concur that, PG&E's 2000

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<sup>6</sup> The settlement agreement enables PG&E to maintain a 4.11 times interest rate coverage ratio for all debt, including short-term debt and 4.58 times interest rate coverage ratio excluding short-term debt.

capital structure consisting of 46.20% long-term debt, 5.80% preferred stock, and 48.00% equity is consistent with the law, in the public interest and should be adopted. The next step in determining a fair ROE is to establish reasonable long-term debt and preferred stock costs.

### **XIII. Interest Rate Increases and Forecast**

The forecasted long-term debt and preferred stock costs are based on PG&E's actual, or embedded, costs. However, because we establish the cost of capital on a forecast basis each year, future interest rates must be anticipated to reflect projected changes in PG&E's long-term debt and preferred stock caused by the issuance and retirement of long-term debt and preferred stock during the year.

PG&E estimated its long-term debt cost by starting with its August 31, 1999 recorded debt cost. Added to this base was the projected issuance of new debt assumed to cost 7.98% for the remainder of 1999 and 7.47% for 2000. The projected debt cost was derived from the October 1999 DRI forecast of incremental debt rates for AA rated utility bonds. Its long-term debt cost was then adjusted to reflect scheduled maturity of bond issues, sinking fund purchases, and high coupon debt refunding for 1999 and 2000. PG&E forecasted that its 7.09% authorized long-term debt cost would increase to 7.32% for 2000.

PG&E estimated its embedded preferred stock cost in a similar fashion. PG&E started with its August 31, 1999 recorded preferred stock cost. Unlike its long-term debt cost PG&E kept its embedded preferred stock cost constant through the remainder of 1999 and 2000 because it has no plan to repurchase or issue any preferred stock in 1999 or 2000. PG&E forecasted that its 6.55% authorized embedded preferred stock cost for 1999 will increase to a 6.60% average cost for 2000.

ORA calculated a different long-term debt cost in its prepared testimony. This difference in long-term debt cost between ORA's prepared testimony and PG&E's application simply reflects ORA using a more recent interest forecast than PG&E. No party calculated a different preferred stock cost.

Prior cost of capital proceedings generated a considerable debate on the validity of various interest rate forecasts and on the appropriate methodology for equating forecast utility bond rates to other bond ratings. However, in D.90-11-057,<sup>7</sup> we recognized that actual interest rates do vary and that our task is to determine the "reasonable" cost of debt rather than an actual cost based on an arbitrary selection of a past figure. We concluded that the latest available "DRI" forecast should be used to determine the embedded debt cost in cost of capital proceedings. Consistent with this conclusion, the assigned Commissioner's Scoping Memo and Ruling instructed all parties that long-term debt and preferred stock costs should be updated to reflect the April 2000, DRI Interest Rate Forecast for 30-year Treasury Bonds, as published by McGraw-Hill or its successor.

PG&E updated its long-term debt and preferred stock costs to reflect the April 2000 DRI interest forecast at the April 12, 2000 evidentiary hearing. The result of this update changed PG&E's forecasted long-term debt cost from 7.32% to 7.26%. The results of this update did not change PG&E's forecasted 6.60% preferred stock cost. No party objected to the updated long-term debt and preferred costs. These same updated costs comply with D.90-11-057, are consistent with embedded costs, and are reflected in the all-party settlement agreement. The recommended 7.26% long-term debt and 6.60% preferred stock

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<sup>7</sup> 38 CPUC2d 233 at 242 and 243 (1990).

costs should be adopted. Having determined the appropriate long-term debt and preferred stock costs we now address the appropriate ROE for PG&E.

#### **XIV. Return on Common Equity**

At issue is the appropriate ROE for PG&E's electric and gas distribution operations for 2000. Although the parties agreed to an 11.22% ROE in the all-party settlement agreement, each party proposed a different ROE in their prepared testimony. This agreed-upon ROE falls within the lower to middle range of the individual parties' initial 10.50% to 12.50% ROE recommendation. The following table summarizes the revised ROE position of each party.

<u>Party</u>	<u>Recommended Return</u>	
	<u>Electric</u>	<u>Gas</u>
PG&E	12.50%	12.50%
Knecht & Czahar	10.50	10.50
FEA	10.70	10.70
Aglet	10.70	10.80
ORA	10.80	10.80

We attempt to set the ROE at a level of return commensurate with market returns on investments having corresponding risks, and adequate to enable a utility to attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility service obligation. To accomplish this objective we have consistently evaluated analytical financial methods and risk factors prior to arriving at a fair ROE.

##### **A. Analytical Methods**

Historically, quantitative financial models are used as a starting point to estimate a fair ROE. The models commonly used in the cost of capital proceedings are the Capital Asset Pricing Model (CAPM), Discounted Cash Flow

Analysis (DCF), and other Risk Premium (RP). Detailed descriptions of each financial model are contained in the record and are not repeated here.

The financial models are used only to establish a range from which the parties apply their individual judgment to determine a fair ROE. Although the parties agree that the models are objective, the results are dependent on the subjective inputs. From these subjective inputs the parties advance arguments in support of their respective analyses and in criticism of the input assumption used by other parties. These arguments will not be addressed extensively in this opinion, since they do not alter the model results. In the final analysis, it is the application of judgment, not the precision of these models, which is the key to selecting a specific ROE estimate within the range predicted by analysis. We affirmed this view in D.89-10-031,<sup>8</sup> which established rates of return for GTE California, Inc. and Pacific Bell, noting that we continue to view these models with considerable skepticism.

The CAPM, DCF, and RPM models were used by a majority of the parties to the proceeding. Aglet opted not to use the traditional financial models. Instead, Aglet used PG&E's 1999 ROE as a base and adjusted that base to reflect an increase in interest rates of approximately 160 to 200 basis points<sup>9</sup> from October 1998 to February 2000, and a decrease in risk.

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<sup>8</sup> 33 CPUC2d 43 (1989).

<sup>9</sup> One basis point is equal to 0.01%.

The following table summarizes the substantial change in the DRI interest rate forecast from October 1998 (a factor used to establish PG&E's 1999 authorized ROE) to April 2000 ( a factor used to establish the authorized ROE in this proceeding):

<u>Date</u>	<u>30 Year Treasury Bond</u>	<u>AA Utility Bonds</u>
April 2000	6.08%	7.72%
February 2000	6.31	7.93
October 1999	6.13	7.47
October 1998	4.71	5.87

The following tabulation summarizes the 7.88% - 13.40% broad range of results derived from the various quantitative financial models used by PG&E, Knecht & Czahar, FEA, and ORA:

<u>Party</u>	<u>CAPM</u>	<u>DCF</u>	<u>Other RP</u>
PG&E	11.80%	12.30%	13.40%
Knecht/Czahar	9.21 – 10.35	10.16 – 11.61	10.81
FEA	7.88 – 11.32	8.50 – 12.12	9.77 – 12.23
ORA <sup>10</sup>	10.31 – 11.11	10.59 – 11.14	9.40 – 10.54

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<sup>10</sup> The lower result of ORA's financial model is applicable to PG&E's electric distribution system and the upper number is applicable to PG&E's gas distribution system.

## **B. Risk Factors**

The parties fine-tuned the results of their respective financial models to reflect informed judgment with respect to financial, business, and regulatory risk expected to occur in 2000 to arrive at their recommended ROE.

Financial risk is tied to the utility's capital structure. The proportion of its debt to permanent capital determines the level of financial risk that a utility faces. In general, the lower the proportion of a utility's total capitalization consisting of common equity, the higher the financial risk. Therefore, as a utility's debt ratio increases, a higher ROE may be needed to compensate for that increased risk. Because no change is proposed in PG&E's capital structure, there is no change in financial risk and no adjustment should be made to PG&E's cost of equity.

Business risk is defined to be the degree of variability in operating results. That is, a company that has the most variability in operating results has the most business risk. An increase in business risk can be caused by a variety of events which include, but are not limited to, deregulation, poor management; a failed marketing campaign; fire in a factory; and, greater fixed costs in relationship to sales volume. Because PG&E doesn't expect any measurable change in risk throughout 2000, there is no basis to reflect an upward or downward adjustment to PG&E's cost of equity to reflect a change in business risk.

Regulatory risk pertains to new risks that may result from future regulatory action that this and other regulatory agencies might take. It also includes the potential disallowance of operating expenses and rate base additions. PG&E contends that mechanisms increase the volatility of earnings relative to current ratemaking and investors' view such mechanisms to

lead to new risk. PG&E concluded that the process of unbundling electric and gas operations and implementation of Performance-Based Ratemaking (PBR) increases its regulatory risk.

Aglet contends that PG&E's regulatory risk within California is declining due to the winding down of the associated electric industry restructuring proceedings and that the alleviation of fears that PG&E might not recover all of its transition costs before the end of the legislated transition period has abated.

We do not necessarily agree with PG&E's argument that PBR mechanisms lead to new risk. Irrespective, this issue is moot because PG&E withdrew its PBR application in March of 2000 and is directed only to propose specific performance indicators. PG&E has not demonstrated that there is increased regulatory risk from last year.

PG&E has not substantiated that it will experience any increased financial, business or regulatory risk in 2000. On balance, there is no net increase or decrease in investor risk.<sup>11</sup> Hence, the cost of capital being adopted in this proceeding should not reflect an upward or downward adjustment for any changes in risks.

### **C. Conclusion**

After considering the evidence on the market conditions, trends, interest rate forecasts, quantitative financial models, risk factors, and interest coverage presented by the parties and applying our informed judgment, we conclude that a ROE range from 10.90% to 11.30% is just and reasonable for

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<sup>11</sup> Reporting Transcript 85.

PG&E. This ROE range reflects the substantial change in forecasted interest rates and no change in risks.

Although the 11.22% ROE being proposed in the all-party settlement agreement is in the upper range of our ROE reasonableness range, it is within the range of reasonableness. We recognize that a settlement reflects a compromise of strongly-held positions and are satisfied that this settlement complies with the criteria set forth in our rules and in D.91-12-019. (46 CPUC2d at 538, 550.) As we have discussed, the proposed settlement is approved by all active parties and these parties represent the affected interests. PG&E obviously represents the interests of its shareholders. ORA represents the interests of all ratepayers. FEA represents the interests of large users and Aglet represents that it represents residential customers concerned about broad matters of public interest raised by this proceeding. Czahar and Knecht represent themselves, as individual ratepayers.

As we have discussed, the settlement does not conflict with applicable law or prior decisions. Because we have the testimony of each party, we have a sufficient record to conclude that this is a reasonable compromise. We find that the all-party settlement agreement is reasonable in light of the whole record, consistent with law, and in the public interest. The all-party settlement agreement should be adopted.

#### **XV. Rate Increase Implementation**

PG&E proposes to consolidate the revenue requirement changes being authorized by this decision for its electric and gas distribution systems with other Commission proceedings. Because PG&E's electric rate freeze remains in effect, there will be no resulting increase in electric rates at this time. The increased electric revenue requirement authorized by this decision should be included in

PG&E's TRA, as established by the Electric Tariff streamlining Decision 97-10-057 in October 1997.

The increased gas revenue requirement authorized by this decision should be implemented through an advice letter filing. The increased gas revenue requirement should be spread among the gas customer class of service pursuant to the gas rate design currently in effect for PG&E.

#### **XVI. Comments on Proposed Decision**

The principal hearing officer's proposed decision on this matter was filed and served pursuant to Public Utilities Code Section 311(d) and Rule 77.2 of the Commission's Rules.

PG&E filed comments on the proposed decision and ORA filed a reply to PG&E's comments, pursuant to Rule 77.2 and Rule 77.5, respectively. All comments have been carefully reviewed and considered. The comments did not result in any changes to the draft decision.

#### **Findings of Fact**

1. PG&E is a public utility electric and gas corporation subject to the jurisdiction of this Commission.
2. PG&E seeks authority to increase its authorized ROE for its electric and gas distribution systems in 2000.
3. D.00-02-049 was issued for the purpose of returning PG&E to the established ROE rate case plan cycle, and granted PG&E authority to make its 2000 cost of capital being adopted in this order effective as of February 17, 2000.
4. PG&E provided notice of its cost of capital application to its customers, and to the cities, counties, and the state affected by its application.
5. The active parties entered into an oral all-party stipulation and settlement agreement on the second day of the evidentiary hearing.

6. Article 13.5 of the Commission's Rules set forth the procedure for parties to stipulate to the resolution of any issue of law or fact material to the proceeding and to settle on a mutually acceptable outcome to the proceeding.

7. Rule 51.10 provides that a motion for waiver of the stipulation and settlement rules may be granted upon a demonstration that the public interest will not be impaired by the waiver of these rules in proceedings where all parties join in the proposed stipulation or settlement. There was no objection to PG&E's motion to waive the settlement conference requirement.

8. The legal standard for setting the fair rate of return has been established by the United States Supreme Court in the Bluefield and Hope cases. The adopted rate of return is consistent with this standard.

9. PG&E proposed to use the identical capital structure approved by the Commission in its prior year's cost of capital proceeding.

10. PG&E's proposed capital structure is that adopted in D.99-06-057 and is the same capital structure proposed by the interested parties in individual prepared testimony and in the all-party settlement agreement.

11. PG&E's proposed long-term debt and preferred stock costs are the same costs initially proposed by the interested parties proposed in the all-party settlement agreement.

12. The ROE recommended by individual parties, as part of their prepared testimony, ranged from 10.50% to 12.50%.

13. The 11.22% ROE set forth in the all-party settlement agreement is within the ROE range initially recommended by the individual parties.

14. CAPM, DCF, and RP are the quantitative financial models commonly used as a starting point to estimate a fair ROE.

15. Although the quantitative financial models are objective, the results are dependent on subjective inputs.

16. The individual parties' use of quantitative financial models resulted in a broad ROE range from 7.88% to 13.40%.

17. There is a 137 to 185 basis points difference between the October 1998 DRI interest rate forecast used as a factor to establish PG&E's 1999 authorized ROE and the April 2000 DRI interest rate forecast being used to establish PG&E's ROE for 2000.

18. It is the application of informed judgment, not the precision of quantitative financial models, which is the key to selecting a specific ROE.

19. There is no investor exposure to new risk or an increase of an old risk from 1999 to 2000.

### **Conclusions of Law**

1. PG&E's proposed capital structure is identical to that adopted for 1999 should be adopted for 2000.

2. PG&E's proposed long-term debt and preferred stock costs are reasonable and should be adopted.

3. An ROE range from 10.90% to 11.30% is just and reasonable for PG&E.

4. All parties concurred that the all-party stipulation and settlement agreement is in the public interest and reasonable in light of the entire record.

5. The 11.22% ROE being proposed in the all-party settlement agreement is within the range of reasonableness and should be adopted.

6. The all-party settlement agreement is reasonable in light of the whole record, consistent with the law, and in the public interest and should be adopted.

7. The all-party settlement complies with the criteria established in D.91-12-019. The settlement 1) is approved by all active parties, which represent affected interests; 2) no component of the settlement conflict with applicable law

or prior decisions; and 3) we have sufficient information to conclude that this is a reasonable compromise.

8. The increased electric revenue requirement authorized by this order should be included in PG&E's TRA.

9. The increased gas revenue requirement authorized by this order should be implemented through an advice letter filing.

10. The application should be granted to the extent provided for in the following order.

## O R D E R

**IT IS ORDERED** that:

1. Pacific Gas and Electric Company's (PG&E) adopted cost of capital for 2000 is as follows:

<u>Component</u>	<u>Capital Ratio</u>	<u>Cost Factor</u>	<u>Weighted Cost</u>
Long Term Debt	46.20%	7.26%	3.35%
Preferred Stock	5.80	6.60	0.38
Common Equity	<u>48.00</u>	<u>11.22</u>	<u>5.39</u>
<b>Total:</b>	100.00%		9.12%

2. PG&E's adopted 2000 cost of capital is effective February 17, 2000, as authorized by Decision 00-02-049.

3. This authorized ROE results in a corresponding 9.12% return on rate base requiring a \$42.1 million electric and \$13.5 million gas revenue requirement increase for 2000. The increased electric revenue requirement authorized by this decision shall be included in PG&E's Transition Revenue Account.

4. The increased gas revenue requirement authorized by this decision shall be spread among PG&E's gas customer class of service pursuant to the gas rate

design currently in effect for PG&E and shall be implemented through an advice letter filing. PG&E shall file this Advice Letter within 15 days of the effective date of this decision.

5. All interested parties to this proceeding shall organize a workshop to be held over a four-day period in October or November 2000 to address market risk premiums and betas. Notice shall be provided to all parties listed in PG&E's 1999 cost of capital proceeding. A workshop report, if issued, should not be filed, but shall be served on all parties notified of the workshop.

6. Application 99-11-003 is closed.

This order is effective today.

Dated June 8, 2000, at San Francisco, California.

LORETTA M. LYNCH  
President  
JOSIAH L. NEEPER  
CARL W. WOOD  
Commissioners

I dissent.

/s/ HENRY M. DUQUE  
Commissioner

I dissent.

/s/ RICHARD A. BILAS  
Commissioner

**APPENDIX A**

**TABLE OF ACRONYMS AND ABBREVIATIONS**

Aglet	Aglet Consumer Alliance
ALJ	Administrative Law Judge
CAPM	Capital Asset Pricing Model
D.	Decision
DCF	Discounted Cash Flow
FEA	Federal Executive Agencies
New West	New West Energy Corporation
ORA	Office of Ratepayer Advocates
PBR	Performance-Base Ratemaking
PG&E	Pacific Gas and Electric Company
PHC	Prehearing Conference
ROE	Return on Equity
RP	Risk Premium Analysis
Rules	Commission's Rules of Practice and Procedure
TRA	Transition Revenue Account

**(END OF APPENDIX A)**