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Decision 99-07-031 July 22, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY to Report Assessments of Inventory Balances and to Address Appraisal of Retained Generation Assets. (U 39 E)

Application 98-05-022
(Filed May 1, 1998)

OPINION

For purposes of transition cost recovery, the Commission adopts various proposals for market valuation of Pacific Gas and Electric Company's (PG&E) materials and supplies (M&S) inventories, fuel-oil inventories, common and general plant and land associated with its power plants, as follows:

1. PG&E's recorded December 31, 1997 balance will be used for purposes of establishing the market value of its generation M&S inventories.
2. PG&E's recorded December 31, 1997 balance will be used for purposes of establishing the market value of its fuel-oil inventories which are not separately valued as part of the sale contract for the related fossil facilities.
3. The appraisal of PG&E's off-site common and general plant that cannot be reclassified or sold will be addressed later in the transition period after market valuation of the power plants, or no later than the next Annual Transition Cost Proceeding (ATCP) following market valuation of the associated plants.

4. The disposition of generation-related lands that will not remain with the power plants will be addressed in separate Pub. Util. Code § 851¹ applications to be filed by PG&E following market valuation of the associated power plants.

Procedural Summary

As directed by Decision (D.) 97-11-074 (the Transition Cost Phase II decision), PG&E filed its application and testimony on May 1, 1998.² In Resolution ALJ 176-2993 dated May 21, 1998, the Commission preliminarily categorized this application as ratesetting, and determined that hearings were necessary. A prehearing conference was held on October 1, 1998.

A Scoping Memo and Ruling of Assigned Commissioner was issued on February 1, 1999. Assigned Commissioner Duque ruled that: (1) issues related to land, M&S inventories and fuel oil inventories should be treated as a separate phase in this proceeding; (2) since these issues do not involve any disputed issues of material fact, an evidentiary hearing was not necessary and the issues should be submitted for decision based on the written pleadings of the parties; and (3) these issues would be categorized as ratesetting. In addition, the Scoping Memo designated the assigned Administrative Law Judge (ALJ) as the presiding officer. We affirm in this decision that no hearings are necessary for this phase.

On March 2, 1999, opening briefs were filed by PG&E and Enron Corp. (Enron). Reply briefs were filed by PG&E, Enron and The Utility Reform Network (TURN) on March 16, 1999. Thereupon, this phase of the proceeding was submitted for decision.

¹ All statutory references are to the Public Utilities Code unless otherwise stated.

² See Ordering Paragraphs 3, 4 and 17 of D.97-11-074, and D.98-04-065.

Assessment of Generation Materials and Supplies Inventories

Ordering Paragraph 17 of D.97-11-074, requires the utilities to "report assessments of the materials and supplies inventories." More specifically, the Commission found that non-nuclear generation M&S inventories should be inventoried as of December 31, 1997, and that the utilities should determine the fair market value of these inventories. To the extent a portion of these inventories are uneconomic, i.e., the book value is greater than market value, the Phase 2 decision finds that such uneconomic costs are eligible for recovery in the Transition Cost Balancing Account (TCBA). (D.97-11-074, mimeo., at p. 67.) The utilities were required to report the market value of the M&S inventories in this application for the Commission's review.

Alternatively, the Commission ruled that utilities "may deem the book value of the December 31, 1997, M&S balances equal to their market value." (Id.) Under this option, utilities are required to track the difference between the inventories at year-end 1997 and those existing at the date of market valuation of the plant to ensure that the "going forward" costs of M&S are not recovered in the TCBA.

In compliance with the Phase 2 decision, PG&E assessed its inventory of non-nuclear generation M&S associated with its power plants. A report identifying the book values of the generation M&S as of December 31, 1997, on a plant-by-plant basis, is included as Attachment A to its application.

PG&E elects to adopt the option to deem the market value of its M&S inventories equal to the book value. Accordingly, PG&E will use the December 31, 1997, inventory levels for purposes of market valuation of the generation facilities and will track changes in inventory levels to ensure that additional costs are not recovered as Competition Transition Charge (CTC). *55, 3, 4*

Also, PG&E has made adjustments to its December 31, 1997 M&S balances for its hydroelectric generation facilities. Specifically, PG&E has adjusted the recorded balances to reflect the transfer of spare runners that were purchased prior to December 31, 1997, but were not installed and are instead being kept in inventory for future use. There are three runners that have been included in the balance, one at the Spaulding Powerhouse, and two at Poe Powerhouse.³ According to PG&E, these items are properly included in inventory and will be sold or transferred with the plants. Thus, PG&E expects that the costs of these spare parts must be included in the inventory balances adopted for purposes of market valuation.

No party objects to this proposal. We agree with this approach, which is reasonable. PG&E's entries to the TCBA will be reviewed in the ATCP established by the Commission in D.97-06-060.

Establishing the Market Value of Fuel-Oil Inventories Which Are Not Separately Valued

The Phase 2 decision deferred the consideration of transition cost recovery of fuel-oil inventories pending the determination of the Independent System Operator (ISO) as to whether the inventories are needed for system reliability and instructed the utilities to provide that information in their

³ The Spaulding runner had initially been included in plant and has since been transferred to inventory. Parties in PG&E's Capital Additions Proceeding (A.97-10-014) agreed in a Joint Recommendation settling all issues in the proceeding to support the inclusion of the Spaulding runner in inventory. This settlement was approved in D.98-05-059.

appraisal applications. (Id., at p. 72.) PG&E states that the ISO has not yet determined whether these inventories are needed for system reliability.⁴

Even though the ISO has not ruled specifically on whether fuel-oil inventories are needed for reliability purposes, PG&E believes it is necessary for the Commission to rule on the market value of these inventories for purposes of transition cost recovery. PG&E requests that the Commission adopt the same principle that it adopted for M&S inventories: the recorded December 31, 1997 balance should be used for purposes of setting the market value of fuel-oil inventories, unless they are separately valued as part of the divestiture transaction.

PG&E has sold all fuel-oil inventories associated with its Moss Landing, Morro Bay, and Oakland power plants to Duke Energy and is in the process of selling the fuel-oil inventories for its Potrero, Contra Costa and Pittsburg plants to Southern Company.⁵ The fuel-oil inventories and tank farms at Moss Landing and Morro Bay and the distillate fuel-oil inventory and storage tanks at Oakland were transferred to Duke upon close of the sale. The fuel oil inventory at Moss Landing was included in the purchase price of the three plants. The distillate oil inventory at the Oakland Power Plant was handled

⁴ PG&E states that the ISO has indicated it intends to make a decision in 1999 concerning which, if any, fossil-thermal units will require heavy fuel oil as a back-up fuel source. The ISO has deemed all of PG&E's fossil plants except for Morro Bay as must-run plants.

⁵ Pursuant to a settlement with the City and County of San Francisco that has been approved by the Commission, the market value of the Hunters Point power plant, has been set and the plant will be shut down as soon as the ISO deems that it is no longer needed for reliability purposes. The cost of the fuel oil was included in the net book value of the plant which will be amortized over the transition period.

separately. The purchase price of the three plants was increased by the fair market value of the distillate oil at Oakland Power Plant based on a contractual formula. PG&E included similar adjustments to the purchase price for all fuel-oil inventories in the Purchase and Sale Agreement for the Potrero, Contra Costa and Pittsburg plants. Thus, for those plants where PG&E separately valued its fuel oil inventories as part of the sale of its fossil facilities, PG&E requests that the market value determined by the contractual formula in the Purchase and Sale Agreement be used for purposes of market valuation. In all other cases, PG&E requests that the December 31, 1997 book value be used.

No party objects to this proposal. We adopt PG&E's approach, which is reasonable. PG&E's entries to the TCBA will be reviewed in the ATCP.

Appraisal of Off-Site Common and General Plant That Cannot Be Reclassified or Sold

PG&E proposes that the appraisal of off-site Common and General (C&G) plant that cannot be reclassified or sold should be addressed late in the transition period after the market value of the power plants has been established.

D.97-11-074 decided that off-site C&G plant will not be recovered initially in the TCBA, pending efforts to mitigate these costs, for example, by reclassifying assets that may be used by other utility functions or selling the assets. (*Id.*, at p. 93.) The Commission ruled that, to the extent these costs cannot be fully mitigated, they may be recoverable through the TCBA. (*Id.*) However, the Commission also ruled that the utilities' mitigation efforts will be thoroughly reviewed in the ATCP.

PG&E states that it will not be in a position to assess how much of its off-site generation-related C&G plant will be stranded or rendered uneconomic until it has completed or nears completion of the market-valuation process. At that time, PG&E will be in a position to identify the amount of C&G plant that is

not needed by other utility functions and cannot be sold or mitigated and to assess the uneconomic costs associated with such assets. Since this review will be conducted in the ATCP late in the transition period, PG&E proposes that the appropriate procedures for establishing market value of these C&G plant assets (including appraisal) be addressed in the ATCP at the time that PG&E seeks recovery of such costs.

Enron argues that the amount of C&G plant costs for which PG&E may seek CTC recovery should be known as soon as possible, consistent with the Commission's intentions to set the market value of generation-related assets as early in the transition period as possible. Accordingly, Enron recommends that the Commission develop in this proceeding, rather than in an ATCP, the market value procedures to be used for the C&G plant assets. Enron asserts that once developed, these procedures can be applied to any remaining off-site generation-related C&G plant costs, once the costs are known. Enron contends that applying established procedures, instead of deferring their consideration and development to an undesignated future ATCP, will serve to expedite the determination of the overall level of uneconomic costs, consistent with the Commission's articulated policies.

We share Enron's concern, however, it would not be practical to develop procedures for market valuing C&G plant in the absence of some idea of the nature and extent of the plant involved. PG&E's proposal is reasonable and we adopt this approach.

Disposition of Generation Lands That Will Not Remain with the Power Plants

PG&E does not intend to retain any of its generation-related lands in the distribution utility. These lands typically (1) surround PG&E's hydroelectric facilities and may be included within or outside the FERC license boundaries of

hydroelectric facilities; (2) are the sites of retired power plants; or (3) are portions of generating parcels but have non-generation utility assets (such as transmission or distribution facilities) on them. Some of these lands will be transferred (at book value) to other utility functions, such as transmission or distribution. Some of the lands (such as the hydroelectric-related lands that are within the FERC boundaries) will remain with the generation facilities for disposition with the plants. Some of the generation-related lands will be transferred, sold or donated. In these instances in accordance with the requirements of Code § 851, PG&E agrees that it will file separate applications addressing the disposition of and ratemaking and environmental review for any such lands.

As an electric service provider in the restructured electricity market, Enron argues that it is critical to know as early as possible the total overall level of uneconomic generation-related costs, in order to determine when the CTC and the rate freeze can end. Enron urges the Commission to remove from PG&E's rate base the generation-related land not retained within the utility, as of January 1, 1998, as Southern California Edison Company (Edison) has proposed to do with respect to its generation-related lands that have not been divested with power plants.

TURN agrees with Enron that PG&E should be required to remove these generation-related lands from rate base as of the earliest possible date. Also, TURN argues that PG&E should be directed to identify as soon as possible the land that will not be divested with the associated generation plant, or retained for distribution or transmission purposes. TURN contends that all such lands should then be expeditiously market valued so that ratepayers may receive the expected credit against uneconomic asset costs at the earliest opportunity.

PG&E responds that the only generation-related lands that are in ratebase today are those associated with PG&E's currently owned power plants

which continue to be "used and useful" and are subject to the reduced rate of return established in the transition cost decision. PG&E points out that Edison was directed to remove certain retained generation lands from ratebase following divestiture of its power plants (when they no longer had a generation use). Accordingly, PG&E contends there is no basis for denying it a return (albeit reduced) on generation lands that are currently used and useful for purposes of power generation.

We share Enron's concern regarding the need for a quick end to the rate freeze. However, unlike the situation with Edison, the lands related to PG&E's power plants are currently used and useful. Therefore, there is no reason to deny PG&E a reduced rate of return on these lands prior to divestiture of the related power plants. However, we will require PG&E to address this matter in separate § 851 filings following market valuation of the related power plant. Pursuant to the requirements of § 367(b), all generation-related assets must be market valued for transition cost purposes by year-end 2001.

153,11

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed by PG&E on June 30, 1999. No reply comments were filed. We have reviewed the comments and made changes to the draft decision where appropriate.

Findings of Fact

1. The December 31, 1997 M&S inventory levels and associated book values of its generation facilities that are identified in Attachments A and B of PG&E's application should be adopted for purposes of market valuation.
2. PG&E's adjustments to the hydro M&S inventory balances are reasonable.

3. The fuel oil inventory levels and market value for PG&E's fuel oil inventories should be determined based on the contractual formula included in the sales transaction's Purchase and Sale Agreement for the power plants that have been divested in all other cases, the December 31, 1997 book value should be used.

4. PG&E should address the market valuation of any generation-related off-site C&G plant that cannot be reassigned to other utility functions or sold in the relevant ATCP.

5. PG&E should submit separate § 851 applications for market valuation of lands that will not remain with its power plants.

Conclusions of Law

1. PG&E's proposal to deem the market value of PG&E's generation M&S inventories equal to book value for transition cost ratemaking purposes is reasonable and complies with D.97-11-074.

2. PG&E's proposal that it address in the relevant ATCP the market valuation of generation-related off-site C&G plant that cannot be reassigned to other utility functions or sold, is reasonable.

3. PG&E's proposal to file separate applications addressing the disposition of and ratemaking and environmental review of lands that will not remain with its power plants at market valuation is reasonable.

4. Pursuant to § 367(b), the market valuation of all generation-related assets must be determined not later than December 31, 2001.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) shall use December 31, 1997 generation materials and supplies inventory levels and associated book values for purposes of market valuation of the generation facilities and shall track changes in inventory levels.
2. PG&E's proposal that the fuel oil inventory levels and market value of fuel-oil inventories should be based on the contractual formula included in the sale transaction's Purchase and Sale Agreement, and in all other cases, the December 31, 1997 book value be used, is adopted.
3. For purposes of transition cost recovery, PG&E shall in the Annual Transition Cost Proceeding (ATCP) address the market valuation of any generation-related off-site common and general plant that cannot be reassigned to other utility functions or sold following market valuation of the associated power plants.
4. PG&E shall file separate Public Utilities Code Section 851 applications addressing market valuation of lands that will not remain with its power plants following market valuation.

5. Hearings are not necessary in this phase of the proceeding.
6. This proceeding shall remain open to address other issues.

This order is effective today.

Dated July 22, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
CARL W. WOOD
Commissioners