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MAIL DATE
August 10, 1999

Decision D.99-08-030 August 5, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY For Rehearing Of Resolution E-3580, Denying PG&E's Request To Establish A Reallocated Residual Administrative And General Memorandum Account (RRAGMA) For The Period Between July 1, 1998 and December 31, 1998 (U 39 E)	Application 99-03-028

ORDER CLARIFYING AND DENYING REHEARING OF RESOLUTION E-3580

I. SUMMARY

In this order, we deny the application for rehearing of Resolution (Res.) E-3580 filed by Pacific Gas and Electric Company (PG&E). We conclude that Res. E-3580 correctly applied standards set out in previous decisions. We also clarify a summary of cost recovery techniques contained in Res. E-3580.

II. BACKGROUND

This case is about Pacific Gas and Electric Company's (PG&E's) generation-related administrative and general (A&G) expenses. The main issue is when these expenses can be "reallocated," that is recovered from PG&E's distribution customers instead of from generation customers.

The need to allocate PG&E's costs to different functions (generation, transmission or distribution) results from electric restructuring's "unbundling" of utility services. The decision to foster generation competition included a policy

encouraging integrated electric utilities to sell off generation facilities. In addition, under the new market structure for electricity, transmission was subject to federal regulation, while distribution remained under state jurisdiction. California's electric restructuring policy also favored unbundled rates, where customers were separately billed for each of the different services that integrated utilities formerly charged a single rate to provide.

In Decision (D.) 97-08-056, referred to as the "Unbundling Decision," we separated the three major electric utilities' revenue requirements so they corresponded with those companies' major functions. (Re: Pacific Gas and Electric Co. (Unbundling Rate Components) [D.97-08-056] (1997) __ Cal.P.U.C.2d. __.) In the unbundling proceedings, some electric utilities argued that generation-related A&G costs should be allocated to distribution. These utilities alleged that A&G costs were fixed, that is, they would not be eliminated when they divested their generation assets. In addition, the utilities asserted that these costs would prevent them from setting competitive generation prices or from recovering these costs through the competitive generation market.

In the Unbundling Decision, we rejected these contentions, and determined that generation-related A&G costs should not be reallocated to distribution. The Unbundling Decision found there was no real reason to fear these costs would not be recovered in the generation market. The Unbundling Decision noted that competitors would also have A&G expenses,[1] and that "uneconomic" generation costs were to be recovered through "CTC," the competitive transition charge. (Re: Pacific Gas and Electric Co. (Unbundling Rate Components)

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1 In fact, the Unbundling Decision pointed out that it would be anticompetitive to allocate generation-related A&G expenses to distribution. If that occurred the utilities' distribution customers would then end up subsidizing the cost of generation. Stand-alone generation companies would not be able to similarly subsidize their costs and would be placed at a disadvantage. The unbundling Decision noted that Public Utilities Code section367, subdivision (c) also prevented such a subsidy from occurring. (Re: Pacific Gas and Electric Co. (Unbundling Rate Components) [D.97-08-056], supra, at p. 23 (mimeo.).)

[D.97-08-056], supra, at p. 22 (mimeo.).) With respect to plants that would be sold, the Unbundling Decision pointed out that "the utilities will have opportunities to reduce their overheads. In addition, the utilities may be able to recover fixed A&G as part of the two year service contract between utilities and purchasers of generation plant required under Section 363." (Id., at p. 23.)

However, we created one possible exception to the Unbundling Decision's holding. We allowed that some fixed A&G costs "may remain following divestiture and the end of the period during which the utility operates the plant on behalf of a purchaser." (Re: Pacific Gas and Electric Co. (Unbundling Rate Components) [D.97-08-056], supra, at p. 24 (mimeo.), emphasis added.) As a result, the Unbundling Decision stated we would consider reallocating generation-related fixed A&G costs to the extent those costs were "truly fixed and continue[d] to exist following this period." (Ibid., emphasis added.) The assigned Commissioners for the unbundling proceeding were directed to develop a streamlined procedure to allow such allocation by December 16, 1997.

On December 16, 1997, the assigned Commissioners issued an Assigned Commissioners' Ruling (ACR) indicating that utilities were "authorized to propose" reallocating generation-related A&G costs to distribution in conjunction with their divestiture applications. Subsequently, at the urging of PG&E in a letter to the assigned Commissioners, another ACR issued, this time directing PG&E to raise the issue of reallocating generation-related A&G costs to distribution in its ongoing general rate case, A.97-12-020. Parties raised the issue there, but no decision has issued in that proceeding.

At the time, PG&E was also seeking authorization to sell three generating plants as part of its "first wave" of divestiture. After the Unbundling Decision was issued, we decided Re: Pacific Gas and Electric Company [D.97-11_030] (1997) __ Cal.P.U.C.2d __. That decision reviewed the form, but

not the reasonableness of an operation and maintenance (O&M) agreement proposed by PG&E. The O&M agreement was designed to satisfy section 363's requirement that sellers of generation plants operate them on behalf of their purchasers for two years following the sale, this two years being referred to as the "O&M period."

In June, 1998, PG&E filed Advice Letter 1784-E, requesting authority to establish a "RRAGMA" account.[2] This advice letter anticipated PG&E's subsequent sale of the "first wave" of generation plants. PG&E proposed that the RRAGMA would record the fixed and continuing A&G expense and revenue requirement for plants divested in the first wave until the Commission decided PG&E's general rate case.

In Resolution (Res.) E-3580, referred to as the "Resolution," we denied PG&E's request to establish the RRAGMA. The Resolution held that the RRAGMA, as proposed by PG&E, was inconsistent with the Unbundling Decision because that decision only created an exception to the ban on reallocation of generation-related A&G costs for costs that were truly fixed and continued to exist after the O&M period was over. PG&E has applied for rehearing of the Resolution, and Enron Corp. (Enron) has opposed this application.

III. DISCUSSION

The application's claims of error all stem from its assertion that we misinterpreted the Unbundling Decision in the Resolution. The portion of Re: Pacific Gas and Electric Co. (Unbundling Rate Components) [D.97-08-056],

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2 "RRAGMA," originally an acronym, is now used as a proper name because it no longer refers to the words that make up the account description. Initially RRAGMA referred to PG&E's proposed name for the account, "reallocated residual administrative and general memorandum account." However, PG&E filed a supplement to its advice letter indicating that the account should instead be described as a potentially reallocable "fixed and continuing administrative and general memorandum account."

supra, at issue set out the exception to the holding that generation-related A&G costs should not be reallocated. We announced this exception on page 24, stating:

> However, we are persuaded that some of these fixed A&G costs may remain following divestiture and the end of the period during which the utility operates the plant on behalf of a purchaser. On the other hand, we want the utilities to take actions to reduce their costs, especially as a result of divestiture.
>
> It is not our intent to deny utilities an opportunity to recover reasonable costs which they actually must incur, but we must balance this with our need to ensure that ratepayers are not paying for costs that no longer exist. To the extent that the fixed A&G costs we have allocated to generation are truly fixed and continue to exist following this period, we will review and reallocate continuing fixed A&G costs to distribution using a streamlined procedure. No such procedure was proposed in this proceeding. The Assigned Commissioners in this proceeding shall develop a streamlined process for this reallocation by December 16, 1997.

The application's various claims regarding the meaning of this language, and how it affects the legality of the Resolution, are discussed below.

A. The Resolution Properly Applies the Unbundling Decision.

The Resolution noted that the Commission created the exception allowing potential reallocation of generation-related A&G expenses with the specific language stating: "To the extent that the fixed A&G costs we have allocated to generation are truly fixed and continue to exist following this period, we will review and reallocate continuing fixed A&G costs to distribution using a streamlined procedure." In the Resolution, we denied PG&E's request to track A&G costs during the term of the O&M agreements because this portion of the Unbundling Decision indicated that we would consider reallocation only if both of

two conditions were met: (i) the expenses were truly fixed, and (ii) they continued to exist following the end of the O&M period. (Res. E-3580, approved February 4, 1999, p. 4. (mimeo.).) The Resolution indicated PG&E should instead recover or reduce its A&G costs in the other ways specified in the Unbundling Decision during the term of the O&M agreements.

The application asserts this holding was in error because it relied on a misreading of the Unbundling Decision. The application asserts our statement that generation-related A&G costs may be reallocated if they are "truly fixed and continue to exist following this period" is unclear, and requires textual interpretation in light of other sources, such as the Unbundling Decision's overall policies. These contentions advance a strained reading of the Unbundling Decision and do not demonstrate error. The costs we stated might be eligible for reallocation are costs that will "continue to exists following this period." The application asserts the words "this period" must be read to refer to two different periods. But the phrase is singular, not plural. The application next claims that one of the periods the phrase "following this period" refers to is the period of time preceding the end of an O&M agreement, relying on the Unbundling Decision's reference to the time "following divestiture and the end of the period during which" an O&M agreement is in effect. However, the Unbundling Decision uses the word and—not or—to indicate the span of time in question. Thus, "this period" must follow both divestiture and the end of the O&M period. The application similarly ignores the fact that the time when A&G Costs are reallocable <u>follows</u> the events stated in the Unbundling Decision. The application, instead, refers to the time <u>between</u> divestiture and the end of an O&M agreement. Finally, the application mischaracterizes Divestiture as a "period." Divestiture is an event, while the length of the O&M agreements is a two-year period of time.

The Resolution's holdings, on the other hand, make sense in light of the Unbundling Decision's language. The Resolution simply reads the Unbundling Decision to create an exception that applies following the period of time described in that decision, and that does not apply before the last event in the definition of the time period has occurred. In addition, the Resolution comports with the Unbundling Decision's policy determinations. That decision indicates that an exception is being created to the general policy that the generation-related revenue requirement for A&G costs should not be reallocated to distribution customers. The exception was created to account for the possibility that there might be no method for a utility to recover generation-related A&G expenses. However, the Unbundling Decision makes clear that during the effectiveness of an O&M agreement utilities have several methods of recovering or reducing generation-related A&G expenses and should not need to resort to reallocation.

The application's claims, however, appear contrary to the Unbundling Decision's general policy. Although we held that generation-related A&G costs should not be reallocated to distribution simply because they were fixed, the application appears to argue that so long as PG&E can demonstrate that its costs are "truly fixed" the revenue requirement for those costs should be reallocated. This interprets the exemption in a way that swallows the rule and essentially re-argues much of the position we rejected when we issued the Unbundling Decision.

The application's claims do not demonstrate error for two additional reasons. First, the application does not show a clear mistake in the Resolution's holding. In order to demonstrate that we incorrectly applied the Unbundling Decision, the application must show that it is impossible to read the Unbundling Decision in any way other than the way advanced by PG&E. However, the application's best argument is that the Unbundling Decision's language is merely

unclear, and, when subjected to textual interpretation, indicates the interpretation PG&E favors. The claim that language in a previous decision could be interpreted to support a particular point of view does not mean that the language must be interpreted that way. If the language really is unclear, it is not error for us to determine how that language should be applied—as we did in the Resolution.

Second, the application is incorrect to claim that the Unbundling Decision's language must be given a different meaning so that it conforms to the subsequently issued ACRs. The ACRs do not, in fact, conclusively indicate that the assigned Commissioners adopted PG&E's reading of the Unbundling Decision. The most persuasive language cited in the application indicates a willingness to consider these issues "concurrent" with divestiture issues. Moreover, the ACRs reflected the views of individual Commissioners and are not Commission decisions or orders.

The Commission itself has only held that A&G costs incurred following the O&M period would be subject to reallocation, as it did in the Resolution and in the decision approving San Diego Gas and Electric Company's PBR settlement. There, we stated the Unbundling Decision "prohibits reallocation of fixed administrative and general (A&G) expenses during the two-year term of" the O&M agreements. (Re: San Diego Gas and Electric Company (Distribution PBR) [D.98-12-038] (1998) __ Cal.P.U.C.2d __, at pp. 23-24 (mimeo.).)

B. Concerns About SDG&E's PBR do not Affect the Resolution.

The application for rehearing also suggests that the Resolution is in error because of an alleged internal inconsistency within Re: San Diego Gas and Electric Company (Distribution PBR) [D.98-12-038], supra. That decision approved the settlement agreement regarding cost-of-service issues reached in San Diego Gas and Electric

Company's (SDG&E's) Performance Based Ratemaking (PBR) proceeding, and is referred to as the SDG&E PBR Decision.

In the SDG&E PBR Decision, we noted that the all-party settlement had the potential to conflict with the Unbundling Decision's prohibition of reallocation of fixed A&G expenses during the term of an O&M agreement. However, we explained why this potential conflict did not warrant rejecting the settlement. The SDG&E PBR Decision indicated that the settlement anticipated recovery of generation-related A&G expenses through an O&M agreement. If that occurred the settlement would be compliant with the Unbundling Decision and no conflict would result. In its application for rehearing of the Resolution, PG&E asserts that it is not persuaded by the our explanation of why the conflict with the Unbundling Decision would not occur. However, PG&E does not directly state its view that the SDG&E PBR Decision was wrongly decided. Instead, the application insinuates that we should avoid any potential problems that could be caused by this alleged inconsistency by re-interpreting the Unbundling Decision so the conflict would not occur in SDG&E's PBR proceeding. This suggestion has no merit. The SDG&E PBR Decision explains why the potential conflict with the Unbundling Decision was avoided in the settlement agreement. If PG&E disagreed with that contention, it should have challenged the SDG&E PBR Decision itself. The fact that the conflict was not resolved to PG&E's satisfaction does not detract from the point of the SDG&E PBR Decision that is relevant here: provisions for the reallocation of generation-related A&G costs during the term of an O&M agreement conflict with the Unbundling Decision. The Resolution properly relied on the SDG&E PBR Decision.

C. The Application's Policy Arguments do not Show Legal Error.

The application asserts that applying PG&E's interpretation of the Unbundling decision is "better policy" because it prevents PG&E from being treated "unfairly." Specifically, the application contends that even though PG&E reduced its generation-related A&G expenses, certain expenses remained. The application claims that a policy allowing reallocation during the O&M period should now be adopted to prevent those expenses from being entirely unrecoverable. These claims do not involve legal issues and do not demonstrate legal error.

In essence, the application claims that a policy consideration favoring full utility recovery of actual expenses should be the Commission's dominant concern here. Although that is a legitimate concern, the Unbundling Decision determined that it needed to be balanced against other concerns. For example, the Unbundling Decision noted that when generation costs were reallocated to distribution, market power and other competitive policy issues would arise because most generators cannot pass portions of their costs on to other customers. The Unbundling Decision also noted that it "does not necessarily follow, however, that distribution customers should assume liability for [fixed] costs even if the utilities will continue to incur them."

The Unbundling Decision has balanced the relevant policy considerations and determined that generation-related A&G costs should not be reallocated until the O&G agreements expired. The Resolution correctly followed this holding. The claim that we should re-balance the various policy concerns and produce a different holding now does not show that the Resolution is in error.

D. The Resolution's Summary of the Unbundling Decision Should be Clarified.

The application contends that the Resolution overstates the Unbundling Decision's requirements with respect to how utilities should reduce or recover generation-related A&G expenses. The Unbundling Decision contains a detailed discussion of methods utilities could use to ensure that they did not end up with unrecoverable revenue associated with generation-related A&G expenses. This discussion was meant to show that during the O&M period utilities had many options available to them for recovering or reducing these costs. The Resolution states that PG&E is required to use certain of these methods rather than seek reallocation of generation-related A&G costs. However the application asserts this language requires PG&E to limit its efforts to only those stated in the Resolution. The Resolution's intent was to indicate the PG&E was required to take available steps other than seeking reallocation. To the extent that it suggests otherwise, it should be clarified.

THEREFORE, good cause appearing, **IT IS ORDERED** that:

1. The second sentence of item 6, at the top of page 4 (mimeo.) of Resolution E-3580 is restated to read:

> During the term of this Agreement, PG&E should be seeking to reduce, recover, or offset its fixed A&G expenses through the various methods other than reallocation that were set out as examples in D.97-08-056 when approved in relevant proceedings. These methods include recovering fixed A&G expenses through these

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Agreements and reducing overhead by
implementing various cost reduction programs.

2. Rehearing of Resolution E-3580 as clarified herein is denied.

This order is effective today.

Dated August 5, 1999, at San Francisco, California.

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