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Mailed 12/17/99

Decision 99-12-032 December 16, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Pacific Gas and Electric Company, to establish the eligibility and seek recovery of certain electric industry restructuring implementation costs as provided for in Public Utilities Code Section 376.	Application 98-05-004 (Filed May 1, 1998)
San Diego Gas & Electric Company, for (1) a determination of eligibility for recovery under Public Utilities Code Section 376 of certain cost categories and activities, (2) a finding of reasonableness of the costs incurred through 12/31/97, (3) approval of an audit methodology for verifying the eligibility of Section 376 costs for recovery from 1998 through 2001, and (4) approval of a section 376 balancing account mechanism to recover eligible costs.	Application 98-05-006 (Filed May 1, 1998)
Southern California Edison Company, to address restructuring implementation costs pursuant to Public Utilities Code Section 376, in compliance with Ordering Paragraph 18 of D.97-11-074.	Application 98-05-015 (Filed May 1, 1998)

(See Decision 99-05-031 for a list of appearances.)

FINAL OPINION REGARDING PUBLIC UTILITIES CODE SECTION 376 AS APPLIED TO SOUTHERN CALIFORNIA EDISON COMPANY

Summary

In this decision, we adopt the modified settlement presented to us by Southern California Edison Company (Edison) regarding issues related to restructuring implementation costs to which Pub. Util. Code § 376[1] treatment applies. The settling parties joining Edison are the Office of Ratepayer Advocates (ORA), California Association of Cogenerators (CAC), California Farm Bureau Federation (Farm Bureau), California Industrial Users (CIU), California Large Energy Consumers Association (CLECA), California Manufacturers Association (CMA), Energy Producers and Users Coalition (EPUC), The Utility Reform Network (TURN), University of California, and California State University.

As discussed in Decision (D.) 99-09-064, with the addition of one modification, we approve the settlement as being reasonable in light of the whole record, consistent with the law, and in the public interest. We clarify that restructuring implementation costs that are not given § 376 treatment must be recovered prior to the end of the rate freeze. To the extent that such costs are incurred after the rate freeze ends, Edison must request recovery of those costs.

Procedural History

In D.99-09-064, we approved a modified settlement for Edison's externally managed and internally managed restructuring implementation costs. Because we modified the settlement, we provided an opportunity for the settling parties to comment on this change. We approved similar settlements for Pacific Gas and

[1] All statutory references are to the Pub. Util. Code, unless otherwise noted.

Electric Company (PG&E) and San Diego Gas & Electric Company (SDG&E) in D.99-05-031.

On October 8, Edison and the settling parties filed joint comments indicating that they accept the modifications to the settlement, with the caveat that certain clarifications to the modified settlement be accepted. Enron Corp. filed a response to these comments on October 29.

The Modified Settlement

As modified, the proposed settlement resolves the issues in both Phase 1 and Phase 2 of this proceeding. The settlement addresses recovery of 1997 and 1998 restructuring implementation costs as well as the maximum amount that Edison can claim for Pub. Util. Code § 376 treatment related to certain costs, i.e., amounts that might lead to an extension of transition cost recovery after the rate freeze ends. Thus, the proposed settlement resolves all issues identified in the Scoping Memo, as well as the reasonableness of dollar amounts Edison has expended or will expend on restructuring implementation activities for the period 1997 – 2001.

Under the proposed settlement, costs would be separated into two major categories. Externally managed restructuring costs (EMCs) consist of Federal Energy Regulatory Commission (FERC)-approved actual amounts for the Power Exchange (PX) Initial Charge, the start-up and development portion of the ISO Grid Management Charge, Commission-approved Consumer Education Program costs, Electric Education Trust costs, and related customer education costs. Internally managed restructuring costs (IMCs) consist primarily of the costs of direct access implementation and demand PX bidding and settlement systems, and consist specifically of the following Industry Restructuring Memorandum Account (IRMA) subaccounts: Direct Access Implementation Costs, Hourly Interval Meter Installation and Reading Costs, Billing Modification Costs,

Customer Information Release Systems Costs, and Utility Energy Supply Forecast. In addition, costs associated with the Universal Node Identifier System (UNIS) are considered to be internally managed costs.

The settlement addresses both eligibility for § 376 treatment and cost recovery. The settlement proposes that the externally managed costs be recovered on a dollar-for-dollar basis, based on actual amounts including payments or credits, or other amounts billed or assigned to Edison, whether these amounts exceed or are less than those estimated. Edison will track its EMCs through the earlier of the date Edison is determined to have recovered its transition costs or through December 31, 2001. The parties agree that Edison should recover the revenue requirement associated with actual expenditures on IMCs, capped at $160 million. In the event that Edison spends less than $160 million on IMCs, ratepayers would be responsible only for those actual amounts incurred. Of the $160 million in capped IMCs, $58.593 million is eligible for § 376 treatment. Thus, the amounts that are eligible for § 376 treatment, i.e., could displace transition cost recovery, are the actual EMCs and $58.593 of the IMCs. Edison forecasts EMCs of $151.407 million; therefore, the anticipated total of costs eligible for § 376 treatment is $210 million.

The proposed settlement also identifies Other Industry Restructuring Costs as Power System Control Modifications, Meter Certification, Electric Supply Settlement System, Generation ISO/PX Settlement, Billing, and Bidding systems, and Western Power Exchange Project. Parties agree that costs associated with these functions will be treated as generation going forward costs. Therefore, these costs would not be treated as transition costs, but as costs of operating in the market. Specifically, these costs will be allocated to generation plants based on plant output during the first quarter of 1999. If a plant is market valued, the

costs allocated to that plant would be reallocated to the remaining plants of that particular fuel type.

Edison agrees not to seek transition cost recovery under § 375 for any new or existing employee performing activities described in Application (A.) 98-05-015. This agreement does not affect Edison's existing request for recovery of specified employee-related transition costs in the Annual Transition Cost Proceeding (A.98-09-008).

Finally, the proposed settlement defines Substantial Future Regulatorily Required Restructuring Costs as costs for new restructuring-related programs that represent a substantial departure from the current restructuring-related programs. The settlement provides a process by which such unanticipated costs may be recovered by application or advice letter, if all signatory parties agree that the program is substantial and if Edison makes a good faith effort to resolve issues. Parties need not agree on the resolution of such issues and may support or oppose such a filing before FERC or this Commission. However, parties agree that such costs will not be eligible for § 376 treatment. The parties define "substantial" in this context as programs required by a FERC or Commission decision that imposes costs of $2.0 million or greater in revenue requirement prior to January 1, 2002, for a single restructuring-related, direct access, ISO, or PX program.

During the rate freeze period, the settling parties propose that the externally and internally managed costs be recovered through the Transition Revenue Account (TRA). Once the rate freeze ends and the TRA is eliminated, the revenue requirement associated with these costs will be recovered through a rate component adopted in Edison's post-transition ratemaking application (A.99-01-016 *et al.*). After the Commission adopts such a methodology, Edison will file an annual advice letter to establish the rate to recover the IMC and EMC

revenue requirement. Except for this advice letter, neither the reasonableness of IMC or EMC costs nor the cost recovery mechanism requires any further filing or request by Edison or any approval by this Commission.

Edison will enter the total amount of EMCs and § 376 IMCs in a new account, the "CTC Displacement Tracking Account." Edison will then compare the total amount entered in this account to its Transition Cost Balancing Account (TCBA). At the end of the transition period, if the TCBA reflects an undercollection that is less than or equal to the amount recorded in the CTC Displacement Tracking Account, then Edison would be entitled to recover the TCBA undercollection after the transition period. If the TCBA reflects an undercollection of transition costs greater than the amounts recorded in the CTC Displacement Tracking Account, Edison would recover the amount in the CTC Displacement Tracking Account.

Finally, the parties agree that internally developed software can be expensed for tax purposes, but that the tax treatment of other computer software and capital assets must be capitalized. Edison has identified $10 million of other assets that must be capitalized for tax purposes, regardless of ratemaking treatment. Parties agree that these costs will be expensed in computing regulatory book expense, but capitalized and depreciated in computing regulatory tax expense. Deferred taxes will be computed on all book-tax differences caused by this treatment, which will earn a return at the reduced transition cost rate of return and will be included in the TRA. Additional expenditures or costs incurred after December 31, 1998, that are treated as expenses for ratemaking, but which must be capitalized for tax purposes, will receive the same treatment.

Comments on Modified Settlement

The settling parties seek to clarify the modification adopted in D.99-09-064 and explain that the settlement is essentially a five-year budget for internally-managed restructuring-related costs, a budget intended to cover the period 1997 –2001. During this period, the settling parties explain that the settlement is intended to allow Edison to recover up to the revenue requirement associated with $160 million in expenditures. Therefore, the settling parties believe that if Edison incurs costs for any amount of this $160 million during the rate freeze period, but does not recover these costs prior to the end of the rate freeze, Edison may not defer to the post rate-freeze period any costs incurred during the rate freeze. However, settling parties seek to clarify that if Edison incurs costs after the rate freeze that relate to the $160 million in IMCs, Edison may recover the revenue requirement associated with these costs within the five-year budget and the $160 million cap, according to the procedures proposed in the settlement.

Enron filed a response to the settling parties' comments. Enron objects to this interpretation and contends that if Edison incurs costs after the rate freeze, Edison must file a new application to recover those costs, i.e., they cannot be recovered after the rate freeze absent specific Commission action.

Discussion

As we discussed in D.99-09-064, Rule 51.1(e) provides that the Commission must find a settlement "reasonable in light of the whole record, consistent with the law, and in the public interest" in order to approve the settlement. We determined that the settlement meets these criteria, with the addition of one modification. Specifically, we stated that restructuring-related costs incurred during the rate freeze period must be recovered prior to the end of the rate freeze:

> We do not anticipate that restructuring-related costs would be required after the rate freeze. By definition, the transition period is over and restructuring is implemented. The Commission may authorize other ongoing costs to be recovered in future proceedings. As we have stated in several decisions,[2] the rate freeze provided for in § 368(a) is a freeze and not a deferral. Although the costs for establishing direct access programs are not included in the rate levels frozen at the June 10, 1996 levels, we are approving a settlement that specifically does not grant § 376 treatment to these costs. Therefore, we clarify that recovery of restructuring-related costs incurred during the rate freeze cannot be deferred until the rate freeze is over, but must be recovered from headroom during the transition period. In other words, before the rate freeze ends, Edison must ensure that it recovers these costs through the TRA, which is the ratemaking approach proposed by the settlement. (D.99-09-064, mimeo. at p. 18.)

We do not accept the clarifications provided by the settling parties. We cannot agree that Edison may recover restructuring implementation costs incurred after the rate freeze without further authorization. Most recently, we adopted D.99-10-057, which provides specific guidance related to cost recovery and the end of the rate freeze:

> AB 1890 creates a rate freeze period during which the utility must live with the revenues it receives, which fluctuate according to sales. AB 1890 does not provide exceptions to the rate freeze on the basis that the utility may not have collected all the revenues it anticipated or failed to recover otherwise reasonable costs. AB 1890 allows recovery of transition costs by way of a nonbypassable surcharge, but also imposes certain risks with regard to the rate freeze. We may not overlook the law's intent in order to hasten the end of the rate freeze. We may not ignore the law even if no party objects to proposals that contravene it, or by finding that the law does not serve other regulatory objectives.

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[2] See, e.g., D.97-10-057, D.97-11-074, D.98-03-059, and D.99-05-051.

> No utility may carry over any costs from the TRA or the TCBA or any other account from costs incurred during the rate freeze into the post rate freeze period. The TRA need not be zero or overcollected for the rate freeze to end.... Moreover, the Commission will not delay the end of the rate freeze to resolve pending proceedings in which the utilities seek authority to recover costs.
>
> The end of the rate freeze occurs on the date the utility has recovered 'commission-authorized costs for utility generation-related assets and obligations,' as set forth in § 368(a) and with the exceptions and conditions set forth in § 367 and 376. This is the sole criterion for determining the end of the rate freeze. (D.99-10-057, mimeo. at pp. 15-16, Finding of Fact 5, Conclusions of Law 3, 4, and 5.)

Therefore, to the extent that Edison incurs restructuring-related costs after the end of the rate freeze, we cannot adopt an interpretation that provides for the recovery of such costs, simply because the settlement assumed a 5-year budget for implementation. More likely, this 5-year plan was developed to conform to the statutory end of the rate freeze. This interpretation is consistent with the settling parties' approach to EMCs, which are tracked according to the time period when transition costs are recovered. Furthermore, as we stated in D.99-09-064, we do not assume that restructuring-related costs would be required after the end of the rate freeze. If we authorize other programs, Edison may certainly apply for recovery of those programs. Similarly, if Edison makes expenditures for IMCs after the rate freeze ends, Edison may apply for recovery of these costs.

We do not intend, however, that this interpretation should interfere with the tax normalization rules. As the settling parties explain, there are certain expenditures that must be capitalized for tax purposes under applicable tax laws, regardless of their ratemaking treatment. We recognize that this requirement will result in book and tax timing differences that may lead to revenue requirements associated with the remaining deferred taxes. Obviously, we do

not intend to create a violation of the tax normalization rules and we will allow Edison to continue to recover the revenue requirement associated with the remaining deferred tax to be in fully compliance with the Internal Revenue Code and associated regulations. In order to allow our staff to fully review such transactions, we will require Edison to separately identify recovery of these costs through the TRA and through the rate component adopted in A.99-01-016 *et al.*

The principal hearing officer has ensured that a complete record was developed in this proceeding. Evidentiary hearings were held prior to the submission of the settlement, as delineated in D.99-09-064. Based on that record and the clarifications provided in this decision, it is within our broad, plenary powers to find that the modified settlement is reasonable, consistent with the law, and in the public interest.

Therefore, we will adopt the modified settlement as discussed in D.99-09-064 and as further clarified by this decision.

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. No party filed comments.

Findings of Fact

1. Restructuring-related costs incurred during the rate freeze period must be recovered prior to the end of the rate freeze.

2. D.99-10-057 provides specific guidance related to cost recovery and the end of the rate freeze.

3. To the extent that Edison incurs restructuring-related costs after the end of the rate freeze, we cannot adopt an interpretation that provides for the recovery of such costs, simply because the settlement assumed a 5-year budget for implementation.

4. We do not assume that restructuring-related costs would be required after the end of the rate freeze.

5. If we authorize other programs, Edison may certainly apply for recovery of those programs. Similarly, if Edison makes expenditures for IMCs after the rate freeze ends, Edison may apply for recovery of these costs.

6. There are certain expenditures that must be capitalized for tax purposes under applicable tax laws, regardless of their ratemaking treatment. This requirement will result in book and tax timing differences that may lead to revenue requirements associated with the remaining deferred taxes.

7. Consistent with Rule 51.7, the settling parties filed joint comments regarding whether the modified settlement, as discussed in D.99-09-064, was acceptable. The parties provided clarifications of their interpretation of D.99-09-064, which we herein reject.

Conclusions of Law

1. As modified by D.99-09-064 and as clarified by this decision, the settlement before us is reasonable in light of the whole record, consistent with the law and in the public interest, and should be approved.

2. It is within our discretion and in keeping with our broad, plenary powers to modify a settlement to ensure that the settlement is in the public interest and is consistent with the law.

3. We do not intend to create a violation of the tax normalization rules; therefore, we will allow Edison to continue to recover the revenue requirement associated with the remaining deferred tax in order to be in full compliance with the Internal Revenue Code and associated regulations.

4. This order should be effective today, so that the settlement may be implemented expeditiously.

FINAL ORDER

IT IS ORDERED that:

1. The settlement agreement proposed by Southern California Edison Company, California Farm Bureau Federation, California Large Energy Consumers Association, California Manufacturers Association, the Cogeneration Association of California, the Energy Producers and Users Coalition, the Office of Ratepayer Advocates, the Utility Reform Network, the University of California, the State University of California, and California Industrial Users for Approval of Settlement Agreement, filed on May 18, 1999, is adopted, as modified by Decision (D.) 99-09-064 and clarified by this decision. The settlement agreement is set forth in Attachment 1 of D.99-09-064.
2. Application (A). 98-05-004, A.98-05-006, and A.98-05-015 are closed.

This order is effective today.

Dated December 16, 1999, at San Francisco, California.

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