L/ bjk

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

Investigation on the Commission's own motion into the matter of post-retirement benefits other than pensions.	)))))	FILED PUBLIC UTILITIES COMMISSION JULY 18, 1990 SAN FRANCISCO OFFICE I.90-07-037

ORDER INSTITUTING INVESTIGATION

Purpose of Investigation

The Commission considers it appropriate at this time to open an investigation to gather information and analyze the potential ratemaking impacts of implementing an accounting statement that is currently being proposed by the Financial Accounting Standards Board (FASB) regarding post-retirement benefits other than pensions (PBOPs). The FASB proposal is scheduled to become effective for fiscal years beginning after December 15, 1991 and if adopted in its present form will have significant effects on the financial statements of the major California utilities. There are indications that the FASB will take some action in the near future.

Our intent in this investigation is to consider the ratemaking effects of PBOPs and to establish consistent general policies and procedures to be applied to all utilities that provide PBOPs.

Discussion

PBOPs constitute all forms of post-retirement benefits, other than pension income. They include benefits such as medical and dental care, life insurance, and legal services. The liability for these benefits has grown tremendously due to the "graying" of America, generous expansion of PBOPs over the past two decades, and higher than average inflation rates for medical costs.

The accounting profession is in agreement that a liability for PBOPs does exist and should therefore be recognized in financial statements just as any other liability is recognized. This accounting statement will require all companies that offer PBOPs to their employees to recognize as a current expense and record as a liability the costs of PBOPs as they are earned by employees rather than when they are paid after employees retire. The only areas of disagreement are in how to implement the statement, recognize the existing unrecorded liability and amortize the unfunded portion of the liability. Preliminary estimates show that the unrecorded liability for California utilities may be in the billions of dollars.

Current tax, accounting and ratemaking policies recognize PBOPs on a pay-as-you-go (cash) basis. This complicates the adoption of the proposed accounting statement because only limited alternatives exist for tax deductible contributions to a PBOPs fund. Although efforts are being made to lobby for a tax law change, these efforts may not be successful. In addition, current accounting requirements and ratemaking policies result in an inter- generational shifting of costs by requiring future generations of ratepayers to pay for the cost of benefits which are earned today while today's ratepayers are paying for benefits which relate to service and benefits earned in prior years. Each year this growing unrecorded liability is being shifted to future ratepayers.

Implementation of the proposed accounting statement will require that companies begin recording the costs of current PBOPs being earned by employees and in addition, a pro-rata portion of the accumulated unrecorded benefits earned in prior years. The California utilities affected by the new accounting statement have alleged that pre-funding of the PBOPs prior to the implementation date can result in certain savings to the ratepayers and stockholders by taking advantage of currently available tax benefits. It is agreed by all parties that a utility's total PBOPs liability will be substantially greater than any amount that can be currently invested in a tax deductible fund; therefore, amounts related to pre-funding represent only a portion of full revenue requirement. Pre-funding has become an issue in two recent proceedings before the Commission. Two energy utilities, Southern California Gas Company (SCG) and Pacific Gas & Electric Company (PG&E) sought recovery in rates for test year 1990 a portion of costs on the estimated PBOPs liability. The Commission rendered differing opinions in those two cases.

In Decision (D.) 89-12-057 the Commission denied PG&E's request for pre-funding of PBOPs, stating that it was premature to pre-fund based on a FASB statement that had not yet been finalized. Instead, the record in this case was kept open, to consider a possible addition to the revenue requirement, once the statement was finalized. Then in D.90-01-016 the Commission agreed to allow SCG to pre-fund a PBOP fund subject to certain conditions. Those conditions made the pre-funded amounts subject to review and refund depending on the results of an investigation which would consider pre-funding.

It has become increasingly clear that accrual accounting for PBOPs will be adopted and that the liability to be recognized at that time will be substantial. While funding these liabilities may produce significant rate shock, the shock may be reduced by authorizing utilities to pre-fund as soon as possible. Therefore, although the statement has not been finalized the need to pre-fund may be advisable. In order to fully evaluate the advantages and disadvantages of pre-funding, our investigation will be bifurcated into two phases. Phase I will be to consider the benefits and detriments of pre-funding and methods of ensuring that those funds are used for PBOPs; Phase II will examine the full impact of the new statement for ratemaking and accounting purposes once it is finalized.

Phase I Issues

Pre-funding makes sense only if it can be demonstrated that, on a present value basis, certain benefits can be realized by taking advantage of currently available tax regulations. The options for tax favored funding mechanisms are currently very limited. We would like information from the utilities and other interested parties regarding the available tax options and the merits of each option. In Phase I we will require respondents and other interested parties to provide testimony and comments on the following items:

1. The benefits and detriments to ratepayers if pre-funding of PBOPs is authorized.

2. The revenue requirements resulting from the pre-funding and the justifications for such requests.

3. Timing of authority to receive PBOPs funding through rates.

4. Differential ratemaking treatment of PBOPs costs for different industries, such as telephone vs. energy.

5. Safeguards to ensure that amounts pre-funded will be used only for PBOPs in the future and that ratepayers interests are protected.

6. Available funding vehicles or alternatives for PBOPs, such as a voluntary employee beneficiary association (VEBA) or an employee benefit plan pursuant to Internal Revenue Code Section 401 (h).

7. Proper accounting procedures to provide adequate documentation and audit trails on fund balances and investment activities.

In deciding whether to pre-fund PBOPs, we will require a finding that pre-funding is in the best interest of ratepayers. The respondent utilities will have the burden of demonstrating that this is the case. We shall also require that any pre-funding be limited to amounts that qualify as being deductible for tax purposes. In calculating the revenue requirements, the respondents should only take into consideration the amounts that will be currently deductible as tax expense.

In response to Question 3, we would like the respondents to provide information as to when and how revenue requirements are to be recovered. In addition, we are also interested in receiving comments and input on where the initial funding may come from and how such funding should be treated for ratemaking purposes if there is a lag between receipt of funds in rates and funding of PBOPs. For example, if pre-funding is authorized in March 1991 for calendar year 1991, funds collected through rates in 1991 may be less than what would be currently allowable as tax deductions. If the shareholders advance the balance so that the ratepayers can receive the resulting full tax benefits, should such advance be reimbursable in future rates, or would it be appropriate to include such advance in rate base for future recovery?

The new regulatory framework for Pacific Bell and GTE California may require that we treat these companies differently than other companies. This may also be true for water or energy companies. Therefore, we will direct all respondents to identify circumstances unique to their industry and/or any differences between their companies and other utilities, and also to recommend methods of treating these differences.

Since the finalized FASB statement may differ from the issued draft, the interim revenue requirements authorized for pre-funding purposes should be identified and segregated from other funds. It is reasonable for ratepayers to expect that amounts pre-funded for PBOPs will be used for that purpose and not diverted to other uses. With this expectation, we will direct the respondent utilities to recommend ways to safeguard PBOPs funds and to ensure that these funds are not later diverted through detariffing, spin-offs, or plan changes to non-PBOPs uses.

To go along with the safeguards, special accounting procedures may be necessary to provide proper documentation and tracking of the pre-fund amounts and the resulting income. Respondents should specify in the testimony and comments the accounting methods and/or procedures required to provide the necessary controls.

We are interested in the options available for tax favored funding such as VEBAs as provided for in Internal Revenue Code (IRC) section 501 (c)(9) or the allowance for funding post-retirement medical benefits through a qualified pension plan provided for in IRC section 401 (h). We would also like to consider any other options available currently as well as options which may become available during the course of this investigation.

Phase II Issues

Phase II of this investigation will examine the full effects of the finalized FASB statement for ratemaking and accounting purposes. Specifically, we will examine the following:

1. Consideration and adoption of the finalized accounting statement for ratemaking and accounting purposes.

   a. Determination of attribution method.
   b. Determination of the measurement period.
   c. Method of calculating prior service cost and current service cost.
   d. Employee benefit vesting requirements.
   e. Recognition of gains and losses.
   f. Other components in the accounting statement.

2. Total revenue requirements for funding PBOPs plans and justifications for such requirements.

3. True-up of interim pre-funding revenue requirements to actual funding requirements.

4. Procedure to handle future plan contingencies and changes to safeguard plan assets and ratepayers' interests.

5. Effects of proposed Congressional legislation related to PBOPs.

6. Sources of funding, e.g. utilization of excess pension funds, shareholder contribution, employees, etc..

7. Safeguards and incentives for utilities to engage in good faith negotiations with unions to protect ratepayers' interests and minimize rate shocks.

8. Monitoring procedures to track plan activities and performance.

After the issuance of the finalized statement, respondents should make a comprehensive analysis of the statement's effects on their own companies and provide testimony and comments to the Commission for its consideration. Responses should include detail analysis of the major components in the statement including those set forth in Item 1 above, the applicability of these on their respective companies and industry, recommended modifications and changes before their adoption for ratemaking and accounting purposes.

In Phase II we will examine the full impact of the statement on the revenue requirements of the affected utilities. The utilities should clearly identify the assumptions used and justify employment of such assumptions in their revenue requirement calculations. We are also very interested in suggestions on ratemaking alternatives that will lessen and smooth out major rate shocks.

We will true-up the interim pre-funding revenue requirements if they are authorized in Phase I. Respondents should provide explanation on material differences; they should report any excess funding or deficit from pre-funding and recommend ways for their final disposition. Hopefully experience from Phase I will provide workable guidelines for Phase II.

There are still many uncertainties because of the nature of this statement and the availability of new benefits. If we adopt accrual accounting for PBOPs, we intend to establish the necessary procedures to safeguard ratepayers' interests from future benefit plan changes and modifications. One of our greatest concerns with converting from cash to accrual accounting for PBOPs is the possibility that funded amounts may be diverted to other uses or captured as additional income for the utilities' shareholders. We are also aware that as with any projection, unanticipated future changes may result in excess amounts in the PBOPs fund. We will direct respondents and other interested parties to propose procedures to handle future plan changes and ways to ensure that any excess fundings be used for the exclusive benefit of ratepayers.

Future Congressional legislation may provide additional ways of funding PBOPs and make them more beneficial than those available today. For example, Congress is considering a bill which, if passed, would allow the transfer or use of excess pension assets for PBOPs. This could be an effective way of funding PBOPs as it would not involve additional charges to ratepayers and it would not result in a loss of tax revenue to the United States Treasury. We will ask the respondent utilities to follow any related Congressional proceedings closely and keep this Commission informed throughout this proceeding of any relevant developments. We will also consider the advisability of this Commission supporting such legislation.

It is a general consensus that the PBOPs liability will be significant. It may be possible that recovery of the costs can come from sources other than ratepayers, for example, shareholders, employees or funds transferred from other reserves. We are interested in exploring all potential sources of funds and would like input from all parties on the viability and flexibility of those funds to reduce the PBOPs expense and liability.

We expect post-retirement benefits to be used as benefits to employees and that they not be manipulated for the purpose of providing a windfall to shareholders. If we authorize full recovery of these benefits, there may be less or no incentive for the utilities to engage in good faith negotiations with employee unions. The companies may have less incentive to negotiate aggressively and may be more agreeable to new benefits because the costs will be automatically passed on to ratepayers. Therefore, we will direct all respondents and other interested parties to suggest ways to safeguard ratepayers' interests in labor negotiations.

Quantification of the transition obligation is one of the more critical calculations that must be made. It will rely heavily on the utilities ability to gather and maintain accurate data on employees and on projected benefits. Our acceptance of amounts calculated for the transition obligation will depend on the reliability of these data tracking systems. Therefore, we intend to review and monitor the data tracking systems to ensure that data is being gathered accurately. To protect ratepayers' interests, we will consider the requirement of a monitoring plan to track plan activities and performance. All respondents and interested parties are required to file testimony and input on the type and requirements of such a monitoring plan.

Procedure

This investigation will proceed in two phases. Phase I will address pre-funding of PBOPs, and will be limited to (1) determination of the benefits of pre-funding, (2) determination of the amount of pre-funding, and (3) determination that pre-funded amounts will be safeguarded against non-PBOPs use.

We do not intend to require utilities to pre-fund if circumstances do not permit pre-funding at this time. We also do not intend to allow pre-funding unless the benefits to ratepayers are clear.

Phase II will address the broader issues of (1) adoption of the new accounting statement after it is finalized, (2) whether it is advisable for this Commission to adopt it for ratemaking purposes, (3) quantification of the transition obligation and the projected annual cost of PBOPs using accrual accounting, (4) how to incorporate it into the ratemaking process, (5) how to merge the pre-funded amounts that may be allowed in Phase I into this ratemaking process, (6) any other factors necessary to consider the new accounting statement and protect ratepayers' interests.

ORDER

Therefore, IT IS ORDERED that:

1. An investigation is instituted on the Commission's own motion into the ratemaking treatment of PBOPs.

2. The scope of this investigation includes, but is not limited to the issues and questions regarding the treatment of PBOPs as discussed in the body of this investigation.

3. The utilities listed in appendix A are made respondents to this investigation.

4. On or before 30 days after issuance of this investigation, each respondent utility, the Division of Ratepayer Advocates and any other interested party shall file testimony and comments on the following:

a. The benefits and detriments to ratepayers if pre-funding of PBOPs is authorized.

b. The revenue requirements resulting from the pre-funding and the justifications for such requests.

c. Timing of authority to receive PBOPs funding through rates.

d. Differential ratemaking treatment of PBOPs costs for different industries, such as telephone vs. energy.

e. Safeguards to ensure that amounts pre-funded will be used only for PBOPs in the future and that ratepayer interests are protected.

f. Available funding vehicles or alternatives for PBOPs.

g. Proper accounting procedures to provide adequate documentation and audit trail on fund balances and investment activities.

5. For Phase II of this investigation, within 90 days after the finalized accounting statement on PBOPs is issued, each respondent utility shall provide the assigned Administrative Law Judge (ALJ) with testimony and comments on the following:

a. The results of its analysis on the effects of the finalized statement on its financial position and the statement adoption for ratemaking and accounting purposes.

b. The total revenue requirements for funding PBOPs plan and justifications for such requirements.

c. True-up of its interim pre-funding revenue requirement.

6. Within 90 days after the finalized accounting statement is issued, each respondent utility, the Division of Ratepayer Advocates, and other interested parties shall provide the assigned ALJ with testimony and comments on the following:

a. Procedures to handle future plan contingencies and changes to safeguard plan assets and ratepayers' interests.

b. Effects of proposed Congressional legislation related to PBOPs.

c. Potential sources of funding for PBOPs.

d. Safeguards and incentives for utilities to have good faith negotiation with unions to protect ratepayers' interest and minimize rate shocks.

e. Monitoring procedures to track plan activities and performance.

7. The assigned ALJ shall set prehearing conferences as necessary to set hearings, schedule testimony, establish the service list, set the Phase II testimony schedule, and resolve procedural issues as needed. The assigned ALJ shall also set workshops to be conducted by the Commission Advisory and Compliance Division, as necessary.

8. Parties should use the official service list for serving testimony. Parties shall file an original and twelve (12) copies of any testimony or comments with the Commission's Docket Office. Subsequent to their initial filings, parties shall serve their Phase I testimony and all subsequent pleadings on respondents by obtaining the established service list from the Process Office after the initial filings are due.

9. The Executive Director shall serve this order, by mail, on all respondents.

This order is effective today.

Dated July 18, 1990, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULLETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY

NEAL J. SHULMAN, Executive Director

ENERGY UTILITIES

PACIFIC GAS & ELECTRIC COMPANY
77 BEALE STREET ROOM 1087
SAN FRANCISCO CA 94106
ATTENTION: THOMAS LONG
MANAGER, REVENUE REQUIREMENTS

PACIFIC POWER & LIGHT COMPANY
920 S.W. SIXTH AVENUE ROOM 1224
PORTLAND OR 97204
ATTENTION: ROBERT SIRVAITIS
DIRECTOR OF PRICING & REGULATORY

SAN DIEGO GAS & ELECTRIC COMPANY
P.O.BOX 1831
SAN DIEGO CA 92112
ATTENTION: JOE KLOBERDANZ
REGULATORY AFFAIRS MANAGER

SIERRA PACIFIC POWER COMPANY
P.O.BOX 10100
RENO NV 89510
ATTENTION: CLIFF PHILLIPS
V.P., TREASURY

SOUTHERN CALIFORNIA EDISON COMPANY
P.O.BOX 800
ROSEMEAD CA 91770
ATTENTION: WES C. MOODY
MANAGER OF REVENUE REQUIREMENTS

SOUTHERN CALIFORNIA GAS COMPANY
P.O.BOX 3249 TERMINAL ANNEX
LOS ANGELES CA 90051
ATTENTION: DAVID B. FOLLETT
MANAGER REVENUE SERVICES

SOUTHWEST GAS COMPANY
P.O.BOX 98510
LAS VEGAS NV 89193-8510
ATTENTION: EDWARD KULAS
REGULATORY AFFAIRS DEPARTMENT

TELECOMMUNICATIONS UTILITIES

CITIZENS UTILITIES COMPANY OF CALIFORNIA
P.O.BOX 496020
REDDING CA 96049-6020
ATTENTION: ARTHUR J. SMITHSON
ASST. V.P. & GENERAL MANAGER

CONTEL OF CALIFORNIA
P.O.BOX 12000
BAKERSFIELD CA 93389
ATTENTION: JEFFRY B. CUTHERELL
ASST. VICE PRESIDENT

CP NATIONAL CORPORATION
P.O.BOX 8192
WALNUT CREEK CA 94596-8192
ATTENTION: KIM MAHONEY
DIRECTOR-REVENUE REQUIREMENTS

GTE CALIFORNIA INCORPORATED
ONE GTE PLACE (RC 3412)
THOUSAND OAKS CA 91362-3811
ATTENTION: KEITH KRAMER
V.P.-REGULATORY & GOV. AFFAIRS

PACIFIC BELL
140 NEW MONTGOMERY STREET
SAN FRANCISCO CA 94105
ATTENTION: M.J. MILLER
EXEC. DIRECTOR STATE REGULATORY

ROSEVILLE TELEPHONE COMPANY
P.O.BOX 969
ROSEVILLE CA 95661
ATTENTION: ROBERT L. DOYLE

A T & T COMMUNICATIONS OF CALIFORNIA, INC.
795 FOLSOM STREET ROOM 220
SAN FRANCISCO CA 94107
ATTENTION: ROBERT B. STECHERT
V.P. GOVERNMENT AFFAIRS

WATER UTILITIES

AZUSA VALLEY WATER COMPANY
P.O.BOX W
AZUSA CA 91702
ATTENTION: EDWARD HECK
SECRETARY/TREASURER

CALIFORNIA-AMERICAN WATER COMPANY
P.O.BOX 1627
NATIONAL CITY CA 92050-0321
ATTENTION: J.S. BARKER
TREASURER

CALIFORNIA WATER SERVICE COMPANY
1720 NORTH FIRST STREET
SAN JOSE CA 95112
ATTENTION: STAN FERRARO
VICE PRESIDENT

DEL ESTE WATER COMPANY
430 TENTH STREET
MODESTO CA 95353
ATTENTION: WILLIAM R. BEARD
VICE PRESIDENT

DOMINGUEZ WATER CORPORATION
21718 SOUTH ALAMEDA STREET
LONG BEACH CA 90810
ATTENTION: J.S. TOOTLE
V.P.-FINANCE

EAST PASADENA WATER COMPANY
3725 EAST MOUNTAIN VIEW AVENUE
PASADENA CA 91107
ATTENTION: SHIRLEY J. KING
OFFICE MANAGER

GREAT OAKS WATER COMPANY
P.O.BOX 23490
SAN JOSE CA 95153
ATTENTION: BETTY ROEDER
PRESIDENT

PARK WATER COMPANY
9750 WASHBURN ROAD
DOWNEY CA 90241-9961
ATTENTION: LEIGH K JORDAN
V.P.-REVENUE REQUIREMENTS

SAN GABRIEL VALLEY WATER COMPANY
P.O.BOX 6010
EL MONTE CA 91734
ATTENTION: MICHAEL L. WHITEHEAD
PRESIDENT

SAN JOSE WATER COMPANY
P.O.BOX 229
SAN JOSE CA 95196
ATTENTION: FRED R. MEYER
VICE PRESIDENT

SANTA CLARITA WATER COMPANY
22722 WEST SOLEDAD CANYON ROAD
SANTA CLARITA CA 91350
ATTENTION: W.J. MANETTA, JR.
CHIEF EXECUTIVE

SOUTHERN CALIFORNIA WATER COMPANY
P.O.BOX 76893
LOS ANGELES CA 90076-0893
ATTENTION: SUSAN CONWAY
MANAGER-REGULATORY AFFAIRS

SUBURBAN WATER SYSTEMS
16340 EAST MAPLEGROVE STREET
LA PUENTE CA 91744-1399
ATTENTION: JOEL A. DICKSON
V.P.-FINANCE & ADMIN.

VALENCIA WATER COMPANY
28769 CASTAIC CANYON ROAD
VALENCIA CA 91355
ATTENTION: RICHARD HACKNEY
CHIEF EXECUTIVE

END OF APPENDIX A