

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

Application of Pacific Gas and Electric Company for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 2011.

(U 39 M)

Application 09-12-020
(Filed December 21, 2009)

Order Instituting Investigation on the Commission's Own Motion into the Rates, Operations, Practices, Services and Facilities of Pacific Gas and Electric Company.

I.10-07-027
(Filed July 29, 2010)

**OPENING BRIEF OF
PACIFIC GAS AND ELECTRIC COMPANY
ON RATEMAKING TREATMENT OF PG&E'S RETIRED METERS**

PATRICK G. GOLDEN
STEVEN W. FRANK
ANN H. KIM
CRAIG M. BUCHSBAUM

Law Department
PACIFIC GAS AND ELECTRIC COMPANY
Post Office Box 7442
San Francisco, California 94120
Telephone: (415) 973-6642
Fax: (415) 973-5520
Email: CMB3@pge.com

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Attorneys for
PACIFIC GAS AND ELECTRIC COMPANY

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I. INTRODUCTION

Pursuant to the Ruling of Administrative Law Judge (ALJ) David Fukutome dated October 25, 2010, Pacific Gas and Electric Company (PG&E or the Company) hereby submits its Opening Brief on the ratemaking treatment to be applied to PG&E's retired electromechanical meters, removed as a result of PG&E's SmartMeter program. This is the only issue left unresolved by the Settlement Agreement filed in this proceeding by PG&E and 16 other settling parties (the Settling Parties) on October 15, 2010. In Section 3.9(d) of the Settlement Agreement, the Settling Parties agreed to brief this issue separately for the decision of the California Public Utilities Commission (CPUC or Commission).

II. EXECUTIVE SUMMARY

In PG&E's 2011 General Rate Case (GRC) Application (A.) 09-12-020, PG&E requests recovery of the unamortized investment associated with the electromechanical meters that it expects to retire as a result of implementing its SmartMeter program.^{1/} PG&E's request for a

^{1/} PG&E-2, p. 10-3.

return on its unamortized investment follows the ratemaking treatment adopted by the Commission in both of PG&E’s SmartMeter proceedings (A.05-06-028, the “Initial AMI Proceeding” and A.07-12-009, the “Upgrade Proceeding”), which resulted in Decision (D.) 06-07-027 (the “AMI Decision”) and D.09-03-026 (the “Upgrade Decision”).^{2/}

TURN opposes this request on the grounds that PG&E should not receive rate base recovery for meters that are no longer “used and useful” for utility service.^{3/} However, it appears that TURN’s opposition may be attributable to misunderstanding of key accounting principles.^{4/}

Regardless of the basis of TURN’s opposition, the Commission should reject TURN’s argument as an improper attack on the Commission’s prior decisions in the Initial AMI and Upgrade Proceedings. Both of these proceedings adopted PG&E’s ratemaking proposal to treat the retirements of the electromechanical meters with equal and offsetting entries to gross plant and the depreciation reserve, so that there would be no change to net plant (i.e., rate base). PG&E’s adopted proposal also provided that it would then recover the unamortized costs over time consistent with group accounting rules.

Furthermore, even if the Commission had not previously addressed this issue – which it has – the Commission should reject TURN’s argument for the following four reasons.

First, in the Initial AMI and Upgrade Proceedings, the Commission adopted an “incremental cost-benefit analysis” to determine whether the new meters should be installed. This approach essentially asked: Will the new meters pay for themselves on an incremental ratemaking basis (i.e., considering only those costs that *change* on account of implementation)? Under status-quo ratemaking, the old meters would have continued to be depreciated and included in rate base. To justify the programs, however, PG&E was asked to show that the benefits exceeded the costs to customers on a Present Value of Revenue Requirement (PVRR) basis. PG&E did this by using an incremental analysis (i.e., *changes* in revenue requirements

^{2/} AMI stands for Advanced Metering Infrastructure. PG&E’s AMI program is known as the SmartMeter program.

^{3/} TURN-10, p. 9.

^{4/} Tr. Vol. 27, pp. 3498 to 3507, TURN/Finkelstein.

resulting from implementation) to determine potential costs and benefits, as well as projected customer rates.

Had ratepayers been entitled to an *additional* ratemaking benefit from the treatment of the old meters (such as the revenue requirement reduction from taking the meters out of rate base, as TURN now proposes), such a benefit should have been considered an incremental benefit for customers from implementing the program, with rates adjusted accordingly. No party, including TURN, ever made such a proposal. Because the benefits and rates associated with the SmartMeter program were not adjusted based on the reduced revenue requirement of taking the electromechanical meters out of rate base, this is further evidence that the Commission understood that the electromechanical meters would remain in rate base.

Second, TURN's proposal is logically inconsistent with the premise, explicitly acknowledged in the Decisions and implicitly recognized throughout the proceedings, that the utilities would recover all of their costs, subject to specific risk parameters. These specific risk parameters were hotly contested by both DRA and TURN and were the basis for determining the utilities' financial exposure in the event there were cost overruns during implementation. Given the substantial controversy over utility financial exposure on implementation matters that were at least subject to some control by the utility, it is illogical for anyone to now suggest that PG&E should lose \$44 million per year (and more than \$200 million overall) regardless of how PG&E implements the program. Just as ratepayers were not to receive an incremental benefit by removing unrecovered costs from rate base upon implementation, neither were shareholders to bear a significant loss for implementing Commission policy.

Third, TURN's proposal is contrary to the Commission's treatment of special tax benefits derived from the accelerated retirement of the old meters. In its cost-benefit analysis in the AMI Proceedings, the Commission explicitly recognized these benefits, which the utility had used to reduce rate base (i.e., financing costs) in analyzing ratepayer benefits. TURN's proposal in the GRC that the utilities should now be barred from recovering their financing costs of these retired meters, when the accelerated tax benefits associated with an early write-off *of those same costs*

were to be used to lower ratepayers' financing costs, is fundamentally inconsistent and is contradicted by the Commission's treatment of these accelerated tax benefits.

And finally, even if the Commission were to ignore its precedent and analysis in the Initial AMI and Upgrade Proceedings, the Commission should reject TURN's argument on public policy grounds, because adopting TURN's after-the-fact proposal would discourage utilities from embracing other technological change that would displace utility equipment and diminish confidence in fair regulation that is essential for utilities to commit and raise long-term capital to serve customers.

III. PROCEDURAL HISTORY^{5/}

On December 21, 2009, PG&E filed its 2011 GRC Application. Among other things, PG&E requested to amortize the costs of the electromechanical meters that it expects to retire as part of implementing its AMI program.^{6/}

On May 19, 2010, intervenors served their testimony. TURN was the only party to dispute the ratemaking treatment for PG&E's electromechanical meters. TURN argued that, because PG&E's electromechanical meters are no longer "used and useful" for utility service, the Commission should "direct PG&E to remove its \$432 million of removed meters from rate base."^{7/}

On June 4, 2010, PG&E served its rebuttal testimony. On the meter issue, PG&E argued that TURN's recommendation was inconsistent with prior Commission decisions in the AMI and Upgrade Proceedings, which adopted PG&E's proposal that, as to the replaced meters, there would be "reduction[s] to plant of the original cost installed with an equal and offsetting entry to accumulated depreciation" so there would be no change to "net book value" (i.e., rate base), and

^{5/} A more detailed and generic Procedural History is provided on pages 4-6 of the Motion for Adoption of Settlement Agreement, filed October 15, 2010. This Opening Brief focuses on the procedural history related to the electromechanical meters issue.

^{6/} PG&E-2, p. 10-3.

^{7/} TURN-10, p. 9.

that “[b]ecause of the group depreciation accounting used by PG&E, any un-recovered plant investment will be recovered over the average life of the depreciation group.”^{8/}

On July 6, 2010, PG&E submitted errata reducing the unrecovered meter costs from \$432 million to \$341 million.^{9/} This adjustment reflected PG&E’s agreement with TURN that cost of removal should not be recorded in this GRC balance of unrecovered meter costs.^{10/}

In late July 2010 and continuing during the months thereafter, parties engaged in settlement discussions. On October 15, 2010, PG&E and the other Settling Parties executed a Settlement Agreement and jointly filed a Motion requesting approval of the Settlement Agreement. Section 3.9(b) of the Settlement Agreement provides for a \$44 million reduction in revenue requirement to reflect TURN’s position to allow no rate of return on undepreciated electric and gas meters replaced by SmartMeter devices, with the understanding that the parties will brief the issue for the Commission’s decision. The Settlement Agreement also provides that, if PG&E prevails on the issue, the test year revenue requirement will be increased accordingly, effective January 1, 2011.

On October 25, 2010, ALJ Fukutome directed parties to file their opening briefs on this issue no later than October 29, 2010. This Opening Brief is thus timely filed. Reply briefs on this issue are due on November 15, 2010.

IV. LEGAL STANDARD OF PROOF

The Commission is charged with the responsibility of ensuring that all rates demanded or received by a public utility are just and reasonable.^{11/} As the applicant, PG&E must meet the burden of proving by a preponderance of evidence that it is entitled to the relief it is seeking in this proceeding.^{12/}

^{8/} PG&E-18 v2, p. 8-14, quoting testimony from PG&E’s SmartMeter Upgrade application (A.07-12-009), as adopted by D. 09-03-026.

^{9/} PG&E-28, p. (ii) and p. 28-2. .

^{10/} See TURN-10, p 10, lines 1-7, regarding removal costs.

^{11/} Public Utilities Code Sections 451 and 454.

^{12/} *Southern California Edison’s 2009 GRC Decision*, D.09-03-025, *mimeo*, p. 8.

As described in detail below, PG&E has met its burden of proof by demonstrating that its proposed treatment of the electromechanical meters is consistent with the Commission's decisions and analysis in the Initial AMI and Upgrade Proceedings, and is in the public interest.

V. TURN'S ARGUMENT IS AN IMPERMISSIBLE ATTACK ON THE COMMISSION'S PRIOR AMI DECISIONS.

PG&E's GRC Application proposes to treat the retirements of the electromechanical meters based on its proposals in the Initial AMI and Upgrade proceedings; that is, the meters will remain in rate base and be recovered in rates over a life reflective of meters as a depreciation group.^{13/} This is exactly the ratemaking treatment adopted by the Commission in the Initial AMI Decision and the Upgrade Decision. The Commission should therefore reject TURN's argument regarding the ratemaking treatment for PG&E's electromechanical meters because it has already been decided by the Commission in two prior cases in which TURN was an active participant.

PG&E's Initial AMI application was filed pursuant to various orders and rulings of the Commission emanating from an ongoing rulemaking process – OIR 02-06-001 – involving numerous active parties, including TURN. Assigned Commissioner Peevey directed this rulemaking (“I am resolved that AMI will be the principal focus of our efforts ...”)^{14/}, which ultimately directed the utilities to file applications setting forth an AMI proposal.^{15/}

A ruling from Commission Peevey and ALJ Michelle Cooke in November 2004 provided that the utilities should include, among other things, the following information in their upcoming AMI applications:

A clear description of the *assumptions regarding accelerated cost recovery, ratebase, and tax treatment of existing metering and communication systems that would be replaced* under the utility's proposed deployment of advanced metering infrastructure.^{16/}

^{13/} PG&E-2, p. 10-3, 118 to p. 10-4, 19.

^{14/} Assigned Commissioner Ruling and Scoping Memo (Phase 2) in R.02-06-001, November 24, 2003, *mimeo* at p. 5.

^{15/} Assigned Commissioner and ALJ Ruling in R.02-06-001, November 24, 2004, *mimeo* at pp. 2-3.

^{16/} Assigned Commissioner and ALJ Ruling in R.02-06-001, November 24, 2004, *mimeo* at pp. 3-4 (emphasis added).

This express requirement – to address the accounting treatment of the existing meters – is especially important. This shows that at least as early as 2004, the Commission was aware of the need to address the accounting treatment of the retired meters, and the Commission placed all parties on notice that the utilities’ AMI applications would be addressing these issues.

In accordance with the directive from Assigned Commissioner Peevey and ALJ Cooke, PG&E specifically addressed the ratemaking treatment of the electromechanical meters in the Initial AMI application. PG&E proposed:

3. Retirements of Plant

As the AMI meters are deployed, replaced existing meters will be retired at their original cost. The retirement of these non-AMI meters is accomplished through a simple reduction to plant of the original cost installed with an equal and offsetting entry to accumulated depreciation. ***Therefore, there is no impact to the net book value (plant less accumulated depreciation).*** Because of the group depreciation accounting used by PG&E, any un-recovered book investment will be recovered over the average life of the depreciation group.^{17/}

PG&E’s proposal was contrary to TURN’s current position that rate base should be reduced to account for the undepreciated component of the electromechanical meters. Rather, as shown in the above highlighted text, PG&E’s proposal was that rate base (i.e., net book value) be unaffected by the retirement.

Importantly, neither TURN nor any other party opposed this aspect of PG&E’s Initial AMI application. In the AMI Decision, the Commission approved this aspect of PG&E’s application as follows:

1. Pacific Gas and Electric Company (PG&E) is authorized to deploy the proposed Advanced Metering Infrastructure (AMI) project as described and modified by this decision.
2. PG&E’s electric and gas allocation proposals are approved. PG&E shall file an advice letter in compliance with this decision in not less than 15 days, or more than 30, to implement PG&E’s rate proposals to collect the revenue requirement and modify its preliminary statements for the gas and electric departments establishing the gas and electric balancing accounts as adopted in this decision. The advice letter shall be effective upon its approval by the Commission.^{18/}

^{17/} PG&E-18 v2, pp. 8-13 to 8-14, quoting testimony from PG&E’s Initial AMI application (A.05-06-028), Exhibit 5, page 5-5 (emphasis added), and incorporated by reference.

^{18/} D.06-07-027, *mimeo*, p. 68, Ordering Paragraphs 1 and 2.

In the Upgrade Proceeding, these events were repeated. PG&E again addressed the ratemaking treatment for the electromechanical meters. Specifically, PG&E stated:

As the new solid state meters are deployed, replaced existing meters will be retired at their original cost. The retirement of these meters is accomplished through a simple reduction to plant of the original cost installed with an equal and offsetting entry to accumulated depreciation. ***Therefore, there is no impact to the net book value (plant less accumulated depreciation).*** Because of the group depreciation accounting used by PG&E, any remaining plant investment will be recovered over the remaining life of the depreciation group.^{19/}

Again, this aspect of PG&E's Upgrade application was unopposed, and the Commission approved it as follows:

1. Pacific Gas and Electric Company (PG&E) is authorized to proceed with the proposed SmartMeter Upgrade, subject to the conditions and costs specified in this decision.
2. PG&E's general cost recovery proposal is adopted.^{20/}

TURN was an active participant in both the Initial AMI and the Upgrade Proceedings and contributed substantially to the final decisions in both cases.^{21/} Given that PG&E expressly addressed the issue of the ratemaking treatment to be accorded the electromechanical meters in both the Initial AMI and Upgrade Proceedings (as the Commission directed), and that TURN was an active party to both cases, TURN should not be allowed now to re-litigate those issues in this GRC.

It is possible that TURN has sought to revisit this issue once again based on its apparent misunderstanding of the accounting principles proposed by PG&E and adopted by the CPUC. In both AMI proceedings, PG&E proposed there would be equal and offsetting entries to gross plant and the depreciation reserve, resulting in no change to net book value, and that the costs would be recovered over the average life of the depreciation group. Like all Commission-regulated utilities, PG&E computes rate base based on *net* plant, which is determined by taking

^{19/} PG&E-18 v2, p. 8-14, quoting testimony from PG&E's AMI Upgrade application (A.07-12-009), Exhibit PG&E-4, page 5-4 (emphasis added), and incorporated by reference.

^{20/} D.09-03-026, *mimeo*, p. 172, Ordering Paragraphs 1 and 2.

^{21/} *See, e.g.*, D.07-01-012 (granting TURN \$179,515 in intervenor compensation for its substantial contribution to the AMI Decision) and D.10-02-010 (granting TURN \$125,170 in intervenor compensation for its substantial contribution to the Upgrade Decision).

the difference between *gross* plant and the depreciation reserve.^{22/} Under the Commission’s Standard Practice for recording retirements (SP U-4, p. 5), when an asset is retired under group accounting, both gross plant and the depreciation reserve are reduced, leaving the *net* difference that determines rate base unaffected.^{23/} This was the rate treatment proposed by PG&E in the AMI proceedings. As TURN’s witness ultimately conceded during hearings in this GRC, under the normal rules of group asset accounting, retirements do not impact rate base.^{24/} Therefore, TURN’s recommendation – to now reduce rate base on account of PG&E’s retired electromechanical meters – is clearly contrary to the ratemaking proposed by PG&E as part of moving forward with the AMI projects, which the Commission then adopted. TURN’s effort to have that record reconsidered now, after PG&E has already implemented its AMI Program, should be rejected.

VI. TURN’S ARGUMENT IS INCONSISTENT WITH THE COMMISSION’S ANALYSIS IN THE INITIAL AMI AND UPGRADE PROCEEDINGS.

Notwithstanding the specific resolution on the issue at hand in the Initial AMI and Upgrade Proceedings, the Commission should also reject TURN’s argument as inconsistent with the Commission’s extensive analysis in the Initial AMI and Upgrade Proceedings. As discussed below, TURN’s argument is fundamentally at odds with the detailed cost-benefit analysis performed for the AMI project, the analysis of shareholder risks, and the evaluation of accelerated tax benefits.

A. Continued Inclusion Of The Retired Meters In Rate Base Is Consistent With The Commission’s Economic Analysis Of Incremental Ratepayer Benefits And Costs In The Initial AMI And Upgrade Proceedings.

Even if the Commission were to determine that the AMI and Upgrade Decisions do not specifically compel rate base recovery of the electromechanical meters, the Commission should

^{22/} PG&E-2, pp. 14-5 to 14-7.

^{23/} See PG&E-30, pp. 000005, 000009-000010; *See also* 18 CFR Subchapter C, Part 101, Electric Plant Instructions, Item #10 “Additions and Retirements of Electric Plant.”

^{24/} Tr. Vol. 27, 3507: 21 – 25, TURN/Finkelstein.

find that TURN’s proposal to remove the retired meters from rate base is inconsistent with the economic analysis performed in the underlying AMI proceedings.

Both the Initial AMI and Upgrade Proceedings evaluated costs and benefits of the SmartMeter program on an incremental basis. This was done in accordance with the Commission’s directives in OIR 02-06-001, which adopted, among other things, a business case analysis framework for evaluating AMI programs.^{25/} In a July 2004 ruling, Assigned Commissioner Peevey and ALJ Cooke explained the purpose of this analytical framework as follows:

The point to adopting the framework is *to facilitate comparisons of cost and benefit estimates between utilities and scenarios*, not to decide at this point, which scenario is best or should be adopted. This procedural approach is consistent with the November 24, 2003 Scoping Ruling which stated that “[a]t the conclusion of the working group process, the Commission should be in a position to issue a template that will result in the respondent utilities filing applications for authority to implement AMI and recover its costs.”^{26/}

The ruling then provided:

The utilities shall file applications no later than December 15, 2004 that finalize their analysis described in the attachment and propose a particular AMI deployment strategy (none, partial, full) *and associated justification, timing, costs, and cost recovery based on the results of their analysis.*^{27/}

The purpose of these incremental cost-benefit analyses was to see if AMI programs could be “cost justified” weighing the incremental benefits and incremental costs to customers on a PVRP basis.^{28/} In this context, *incremental* meant those costs and benefits that were to *change* as a result of the implementation of the AMI program.

The principal *incremental* economic costs of the Initial AMI and Upgrade programs were the capital costs of installing the new meters and associated information technology costs.^{29/} The

^{25/} Assigned Commissioner and ALJ Ruling of July 21, 2004 in R. 02-06-001.

^{26/} Assigned Commissioner and ALJ Ruling of July 21, 2004 in R. 02-06-001, *mimeo* at p. 2 (emphasis added).

^{27/} Assigned Commissioner and ALJ Ruling of July 21, 2004 in R. 02-06-001, *mimeo* at p. 4 (emphasis added).

^{28/} D.09-03-026, *mimeo*, p. 26.

^{29/} D.09-03-026, Table 3, Adopted Estimates of Incremental Costs, *mimeo*, p. 152. D.06-07-027, Table 1, *mimeo*, p. 29 Stipulated AMI Project Costs, *mimeo*, p. 29.

principal *incremental* benefits were operational and related to the ability of the meters to result in automated processing of bills, rather than requiring meters to be manually read.^{30/}

Notably, in the Initial AMI Proceeding, neither the Commission nor any party identified the elimination of the retired meters from rate base as a possible benefit. In the subsequent Upgrade Proceeding, again, neither the Commission nor any party identified the elimination of the retired meters from rate base as a possible benefit.^{31/}

The extensive incremental analysis of PVRR benefits in both the AMI Decision and the Upgrade Decision, as well as the related discussion of revenue requirement changes resulting from the Upgrade, leaves no doubt that there would be no change in the status quo as to the ratemaking treatment of the electromechanical meters on account of their retirement from service.^{32/} Had it been envisioned, as TURN now argues, that rate base was to be *reduced* when the electromechanical meters were removed from service, ratepayers would have received an incremental benefit (*i.e.*, rate base reduction) from that removal. That is, under TURN's new proposal, ratepayers should have seen an incremental benefit from removal of the electromechanical meters from rate base upon implementation of AMI. The fact that no such *incremental* benefit from rate base removal was identified for customers in any rate, revenue requirement, or PVRR analysis, is conclusive evidence that all parties (including the Commission) envisioned there would be no such rate base benefit for customers.

B. Continued Inclusion Of The Retired Meters In Rate Base Is Consistent With The Commission's Evaluation Of Shareholder Risks From Implementing The AMI Project.

A substantial portion of both the Initial AMI and Upgrade Proceedings were devoted to a careful analysis of the risk that shareholders would bear from implementing the AMI Program.^{33/}

^{30/} D.09-03-026, Table 4, Adopted Estimates of Incremental Benefits, *mimeo*, p. 153; D.06-07-027, Table 2 Stipulated AMI Project Benefits, *mimeo*, at pp. 30.

^{31/} D.09-03-026, pp. 26-29.

^{32/} See D.09-03-026, *mimeo*, pp. 155-156 (discussion of cost recovery), and pp. 166-167 (discussion of revenue requirement changes).

^{33/} See, for example, D.06-07-027, *mimeo*, pp. 12-15. D.09-03-026, *mimeo*, pp. 34-88 and 155-156.

The Initial AMI Decision recognized that PG&E was seeking recovery of all of its costs under a proposal that, if PG&E implemented the AMI Program at the budgeted level, there would be no prudency review regarding full recovery of its costs.^{34/}

During the Upgrade Proceeding, PG&E made a similar proposal to avoid prudency review, provided costs came in under budget. DRA objected to certain aspects of the budget, arguing that the budget should be reduced. A controversy also arose regarding the ratemaking treatment of costs associated with interim meters that had been installed in Kern County but had to be replaced.^{35/} In contrast, the ratemaking treatment of PG&E's electromechanical meters was undisputed.

The lack of controversy in both proceedings regarding the ratemaking treatment of these meters made sense because there was no question that the old meters had functioned as intended. It was only because of technological progress and the Commission's objective to pursue demand-side management and advanced metering systems that the old meters were to be removed. The utilities made clear that they did not envision absorbing any costs, provided they implemented the program under budget.^{36/}

To remove the entire cost of the retired meters from rate base, as TURN now proposes, would fundamentally alter the ratemaking approach reflected in the AMI and Upgrade Decisions that formed the basis for PG&E proceeding with AMI implementation. If PG&E implemented the AMI Program at the budgeted level, there would be no further review or reduction to PG&E's costs. In return, shareholders agreed to bear the risk of any cost overruns. Under TURN's proposal, however, the Commission would be forcing PG&E's shareholders to absorb the entire financing costs of the meters – involving hundreds of millions of dollars in capital costs – without just compensation or an opportunity to earn a return on their invested capital. Accordingly, TURN's new proposal is not only fundamentally inconsistent with the Commission's prior analysis, findings and conclusions, it also contrary to the implicit and

^{34/} D.06-07-027, *mimeo*, pp. 13-15.

^{35/} See D.09-03-026, *mimeo*, pp. 50-56.

^{36/} D.09-03-026, *mimeo*, p. 166.

explicit understandings regarding shareholder risk from undertaking these Commission initiated programs.

C. Continued Inclusion Of The Retired Meters In Rate Base Is Consistent With The Commission's Evaluation Of Accelerated Tax Benefits In The Upgrade Decision.

Furthermore, the Commission's analysis in the Upgrade Decision of tax benefits on early retirement of the electromechanical meters also compels the conclusion that the retired meters should continue to be allowed in rate base.^{37/} When meters are retired, an immediate tax deduction is derived based on the remaining tax basis of the meters. The Commission recognized the incremental tax benefit of early retirement of the meters in D.09-03-026.^{38/}

PG&E's testimony in the Upgrade Proceeding specifically provided that the deferred tax benefit from early retirement of the meters (creating a rate base reduction) would be reflected as a revenue requirement offset (this was computed by multiplying the incremental deferred tax resulting from meter retirement by a pre-tax rate of return).^{39/}

It would make no sense, and would be logically inconsistent, for the parties in the Upgrade Proceeding to expect that PG&E would provide a rate base *reduction* for an accelerated write-off of tax basis associated with retired meters, when the underlying costs themselves would not be included in rate base. Stated otherwise, the Commission could not logically take a rate

^{37/} D.09-03-026, *mimeo*, pp. 93-95.

^{38/} D.09-03-026, *mimeo*, p. 134.

^{39/} These benefits were described in PG&E's income tax testimony as follows:

Under the Accelerated Cost Recovery System (ACRS) and MACRS methods (applicable to property placed in service after 1980), PG&E may claim a loss on retirements of existing meters equal to the remaining tax basis in the retired property. As a result of recognizing a loss for tax purposes, but not for book purposes, a deferred tax liability is created that reduces rate base pursuant to Decision 93848 and Decision 88-01-061.

This deferred tax liability reverses as the un-depreciated book balance is recovered through book depreciation. Under the ADR method of depreciation (applicable to property placed in service prior to 1981), a loss is not recognized on ordinary retirements. Instead, the remaining tax basis in the retired property is depreciated over its remaining tax depreciable life. (See A.07-12-009, Ex. PG&E-5, pp. 4-2 to 4-3, incorporated by reference at PG&E-18 v2, p. 8-13, l 25-26).

base reduction for an early write-off for tax purposes of certain costs, yet at the same time say that those underlying costs should not be included in rate base.

TURN's argument that the Commission should now reduce rate base by the costs of the retired meters is also in conflict with the Commission's generic investigation of taxes and ratemaking (OII 24).^{40/} That OII established a matching principle in determining whether tax benefits should be accorded to shareholders or ratepayers and found that, to the extent shareholders rather than customers fund a cost, shareholders (and not ratepayers) should benefit.^{41/} Here, TURN's proposal would be a clear violation of these tax policies. This is because PG&E continues – and will have to continue -- to shoulder the financing costs of the electromechanical meters whether or not they remain in service, for as long as those costs remain unrecovered through depreciation. It would have been contrary to the matching principles of OII 24 for PG&E's shareholders to bear the financing costs of the retired electromechanical meters (by their removal from rate base), but at the same time pass through to customers a benefit from a rate base reduction for the related financing benefits associated with accelerated tax deductions resulting from early retirement of the meters. This leaves only one reasonable interpretation of the Upgrade Decision; namely, because ratepayers were to receive a rate base *benefit* from accelerated tax benefits on account of retirement, it must be presumed that the underlying costs of the retired meters were also to continue to be included in rate base, exactly as PG&E had proposed. TURN's argument to the contrary is illogical and should be rejected

Finally, to the extent normalization rules of the Internal Revenue Code (the "Code") were to apply to these accelerated tax write-offs, TURN's proposal could well be in violation of these requirements by inconsistently treating costs and related tax benefits for ratemaking purposes.

^{40/} D.84-05-036, 15 CPUC2d 42.

^{41/} D.84-05-036, 15 CPUC 2d 42. As to matching tax benefits with inclusion in rate base, the Commission stated with respect to interest deductible during the construction period: "Our primary consideration is the matching of interest expense, with the rate base treatment of the investment. We agree the net method is consistent with the exclusion of CWIP from rate base. If the present ratepayers do not bear the burden of financing new plant, it follows that their rates should not be lower based on the tax consequences of that investment in new plant." 15 CPUC 2d at 47. Also see discussion in OII 24 of disallowed costs and costs borne by shareholders in non-utility operations, where the Commission held tax benefits associated with shareholder borne costs should be assigned to the shareholders. 15 CPUC 2d at 48-49 and 52.

The tax laws require, as a condition of PG&E maintaining eligibility for accelerated tax depreciation, that PG&E adhere to the normalization requirements of the Code.^{42/} The Code provides that procedures and adjustments are inconsistent with a normalization method if they use an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes unless such adjustment or projection is also used with respect to the other two items and with respect to rate base.^{43/} In effect, these rules require that when the Commission makes projections for rate purposes of tax benefits and costs, it must do so consistently. In other words, the IRS could find that it would be "inconsistent" under these rules for the Commission to find that costs *could not be included in rate base*, but that the accelerated tax write-off of those costs *could be used to reduce rate base*.

It must be presumed that neither the Commission nor any party would have proposed such a possible violation of the tax laws. Therefore, the fact that PG&E proposed and the Commission adopted a rate base reduction for tax benefits is further evidence that the Commission and parties intended that the related costs would themselves would be included in rate base. To conclude otherwise would mean that PG&E would have knowingly proposed, and the Commission would have adopted, a ratemaking design in possible violation of tax laws.

VII. TURN'S PROPOSAL ALSO SHOULD BE REJECTED AS A MATTER OF PUBLIC POLICY.

If, notwithstanding the foregoing, the Commission wishes to re-evaluate its prior decisions and analysis in the Initial AMI and Upgrade Proceedings, the Commission should nonetheless reject TURN's argument as contrary to the public interest.

Public utilities such as PG&E are entitled to a reasonable opportunity to earn a fair rate of return on their investments. PG&E reasonably invested in the electromechanical meters to provide utility service to its customers and is entitled to earn a return on that investment. The only reason the electromechanical meters are being taken out of service is that the Commission

^{42/} See discussion of this "normalization" requirement (albeit on a different matter) at PG&E-18 v2, p. 6A-11, line 30 to p. 6A-12, line 20.

^{43/} Internal Revenue Code §168(i)(9)(B)(ii).

directed utilities such as PG&E to propose investments in AMI technology as a necessary predicate to demand response programs and other important public policies. So long as PG&E has not recovered its investment in those meters, PG&E will remain burdened by the continuing financing costs. It is only fair that shareholders should continue to recover their reasonable capital costs when property otherwise used and useful is replaced at the behest of the Commission.

For the Commission to adopt a different approach would be poor public policy and would discourage utilities from embracing technological change. It would also place shareholder and ratepayer interests in conflict when they should be aligned. Replacement of old utility equipment that has become technologically obsolete should be replaced where it can be shown that ratepayers would benefit on an incremental basis. Yet, if TURN's approach were adopted, shareholders would be required to suffer a loss on account of pursuing a project that otherwise would benefit customers. It would be patently unfair (and would be poor public policy) to require utilities to confer *additional* benefits on customers at shareholder expense, when a replacement project has been otherwise shown to benefit customers. Indeed, it would discourage utilities from ever pursuing technological change, even where warranted.

Similarly, it would be poor public policy for the Commission to encourage programs with one ratemaking assumption, but then adopt another once the program is implemented. PG&E did not propose implementation of AMI based on the understanding that it would suffer hundreds of millions of dollars of stranded investment that would earn no return. If the Commission were to re-write today the conditions upon which the AMI programs were implemented, the utilities would rightly ask what other elements of the regulatory compact might be open for revision. In the long run, the financial health of the utility and its customers depends on perceptions by investors that they will be treated fairly when they make long-run investments in the State's utilities. Adopting TURN's proposal, in light of the long record of AMI within the state, would diminish those perceptions of fairness and thus harm customers over the long run.

VIII. CONCLUSION

TURN's proposal to remove PG&E's electromechanical meters from rate base amounts to a fundamental, after-the-fact change to the rules of ratemaking addressed by the Commission in the Initial AMI and AMI Upgrade Decisions. Accordingly, the Commission should reject TURN's argument, PG&E's rate base should be restored, and its revenue requirements for 2011 increased by an additional \$44 million as provided for in Section 3.9(d) of the Settlement Agreement filed by the Settling Parties on October 15, 2010.

Respectfully Submitted,

PATRICK G. GOLDEN
STEVEN W. FRANK
ANN H. KIM
CRAIG M. BUCHSBAUM

By: _____ /s/
CRAIG M. BUCHSBAUM

Pacific Gas and Electric Company
77 Beale Street
San Francisco, CA 94105
Telephone: (415) 973-4844
Facsimile: (415) 973-0516
E-Mail: CMB3@pge.com

Attorneys for
PACIFIC GAS AND ELECTRIC COMPANY

Dated: October 29, 2010

CERTIFICATE OF SERVICE

I, the undersigned, state that I am a citizen of the United States and am employed in the City and County of San Francisco; that I am over the age of eighteen (18) years and not a party to the within cause; and that my business address is Pacific Gas and Electric Company, Law Department B30A, 77 Beale Street, San Francisco, California 94105.

On **October 29, 2010**, I served a true copy of:

**OPENING BRIEF OF
PACIFIC GAS AND ELECTRIC COMPANY
ON RATEMAKING TREATMENT OF PG&E'S RETIRED METERS**

by electronic mail, or (for those parties without valid electronic mail addresses) by placing it for collection and mailing, in the course of ordinary business practice, with other correspondence of Pacific Gas and Electric Company, enclosed in a sealed envelope, with postage fully prepaid, addressed to:

All parties on the official service lists for
A.09-12-020 and **I.10-07-027**.
(See attached service lists).

I certify and declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on **October 29, 2010**.

/s/
Rene Anita Thomas

**THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
EMAIL SERVICE LIST**

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a2mx@pge.com;akhan@visiumfunds.com;anders@opentopensightseeing.com;ASteinberg@SempraUtilities.com;atrowbridge@daycartermurphy.com;bcragg@goodinmacbride.com;beg@cpuc.ca.gov;BermanEconomics@gmail.com;bfinkelstein@turn.org;bkc7@pge.com;blaising@braunlegal.com;bpf2@pge.com;brbarkovich@earthlink.net;case.admin@sce.com;cem@newsdata.com;CentralFiles@SempraUtilities.com;ckt@cpuc.ca.gov;cmkehrlein@ems-ca.com;dao@cpuc.ca.gov;dbp@cpuc.ca.gov;dbyers@landuselaw.com;dfb@cpuc.ca.gov;dfdavy@well.com;dgeis@dolphingroup.org;dietrichlaw2@earthlink.net;dkf@cpuc.ca.gov;dlf@cpuc.ca.gov;dmarcus2@sbcglobal.net;douglass@energyattorney.com;edwardoneill@dwt.com;enriqueg@greenlining.org;epoole@adplaw.com;filings@a-klaw.com;francis.mculty@sce.com;fsmith@swater.org;garrick@jbsenergy.com;hayley@turn.org;HEmmrich@SempraUtilities.com;IErgovic@Jefferies.com;info@dcisc.org;janreid@coastecon.com;jdangelo@catapult-llc.com;jheckler@levincap.com;jimross@r-c-s-inc.com;joyw@mid.org;judypau@dwt.com;julien.dumoulin-smith@ubs.com;jweil@aglet.org;K1Ch@pge.com;kerntax@kerntaxpayers.org;kjsimonsen@ems-ca.com;kkm@cpuc.ca.gov;KMelville@SempraUtilities.com;kmills@cfbf.com;kris.vyas@sce.com;lauren.duke@db.com;lawcpucases@pge.com;lex@consumercal.org;ljt@cpuc.ca.gov;lmh@eslawfirm.com;martinhomec@gmail.com;mdjoseph@adamsbroadwell.com;mmattes@nossaman.com;mramirez@swater.org;mrw@mrwassoc.com;naaz.khumawala@baml.com;nes@a-klaw.com;nms@cpuc.ca.gov;pgg4@pge.com;pk@utilitycostmanagement.com;pucservice@dralegal.org;pucservice@dralegal.org;ram@cpuc.ca.gov;regclfp@gmail.com;RegRelCPUCCases@pge.com;rkoss@adamsbroadwell.com;rmccann@umich.edu;rmp@cpuc.ca.gov;rnevis@daycartermurphy.com;rschmidt@bartlells.com;salleyoo@dwt.com;samuelk@greenlining.org;scott.senchak@decade-llc.com;sean.beatty@mirant.com;SGM@cpuc.ca.gov;stephaniec@greenlining.org;steven@iepa.com;sue.mara@rtoadvisors.com;thomas.long@sfgov.org;txb@cpuc.ca.gov;vidhyaprabhakaran@dwt.com;wem@igc.org;wendy@econinsights.com;will.mitchell@cpv.com;william.sanders@sfgov.org;wtaylor@hansonbridgett.com;Yim@ZimmerLucas.com;zango@zimmerlucas.com;

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA SERVICE LIST

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CPUC DOCKET NO. A0912020 - I1007027

Total number of addressees: 99

PACIFIC GAS AND ELECTRIC COMPANY
77 BEALE ST, B30A
SAN FRANCISCO CA 94105-1814
Email: lawcpucases@pge.com
Status: INFORMATION

KATHY CHAN
PACIFIC GAS AND ELECTRIC COMPANY
77 BEALE ST, RM 996
SAN FRANCISCO CA 94177
Email: K1Ch@pge.com
Status: INFORMATION

ALICIA MCMAHON GOV/PLANNING REGUL. CASE
COORDINATOR
PACIFIC GAS AND ELECTRIC
77 BEALE ST RM. 996, MAIL CODE B9A
SAN FRANCISCO CA 94105
Email: a2mx@pge.com
Status: INFORMATION

PATRICK G. GOLDEN ATTORNEY
PACIFIC GAS AND ELECTRIC COMPANY
77 BEALE ST, MAIL CODE B30A
SAN FRANCISCO CA 94105
FOR: Pacific gas & Electric Company
Email: pgg4@pge.com
Status: PARTY

Truman L. Burns
CALIF PUBLIC UTILITIES COMMISSION
ENERGY COST OF SERVICE & NATURAL GAS BRANCH
505 VAN NESS AVE RM 4205
SAN FRANCISCO CA 94102-3214
Email: txb@cpuc.ca.gov
Status: STATE-SERVICE

Belinda Gatti
CALIF PUBLIC UTILITIES COMMISSION
ENERGY DIVISION
505 VAN NESS AVE AREA 4-A
SAN FRANCISCO CA 94102-3214
Email: beg@cpuc.ca.gov
Status: STATE-SERVICE

Karl Meeusen
CALIF PUBLIC UTILITIES COMMISSION
EXECUTIVE DIVISION
505 VAN NESS AVE RM 5217
SAN FRANCISCO CA 94102-3214
Email: kkm@cpuc.ca.gov
Status: STATE-SERVICE

CASE ADMINISTRATION
PACIFIC GAS & ELECTRIC COMPANY
77 BEALE ST, MC B9A
SAN FRANCISCO CA 94177
Email: RegRelCPUCcases@pge.com
Status: INFORMATION

BRUCE P. FRASER
PACIFIC GAS & ELECTRIC COMPANY
77 BEALE ST, B9A
SAN FRANCISCO CA 94105
Email: bpf2@pge.com
Status: INFORMATION

BRIAN K. CHERRY DIRECTOR, REGULATORY
RELATIONS
PACIFIC GAS AND ELECTRIC COMPANY (39)
77N BEALE ST., PO BOX 770000, MC B10C
SAN FRANCISCO CA 94177
FOR: Pacific Gas and Electric Company
Email: bkc7@pge.com
Status: PARTY

Donna-Fay Bower
CALIF PUBLIC UTILITIES COMMISSION
ENERGY COST OF SERVICE & NATURAL GAS BRANCH
505 VAN NESS AVE RM 4205
SAN FRANCISCO CA 94102-3214
Email: dfb@cpuc.ca.gov
Status: STATE-SERVICE

David K. Fukutome
CALIF PUBLIC UTILITIES COMMISSION
DIVISION OF ADMINISTRATIVE LAW JUDGES
505 VAN NESS AVE RM 5042
SAN FRANCISCO CA 94102-3214
Email: dkf@cpuc.ca.gov
Status: STATE-SERVICE

Donald J. Lafrenz
CALIF PUBLIC UTILITIES COMMISSION
ENERGY DIVISION
505 VAN NESS AVE AREA 4-A
SAN FRANCISCO CA 94102-3214
Email: dlf@cpuc.ca.gov
Status: STATE-SERVICE

SCOTT MURTISHAW
CALIFORNIA PUBLIC UTILITIES COMMISSION
EMAIL ONLY
EMAIL ONLY CA 0
Email: SGM@cpuc.ca.gov
Status: STATE-SERVICE

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Richard A. Myers
CALIF PUBLIC UTILITIES COMMISSION
ENERGY DIVISION
505 VAN NESS AVE AREA 4-A
SAN FRANCISCO CA 94102-3214
Email: ram@cpuc.ca.gov
Status: STATE-SERVICE

Dao A. Phan
CALIF PUBLIC UTILITIES COMMISSION
ENERGY COST OF SERVICE & NATURAL GAS BRANCH
505 VAN NESS AVE RM 4205
SAN FRANCISCO CA 94102-3214
Email: dao@cpuc.ca.gov
Status: STATE-SERVICE

Nicholas Sher
CALIF PUBLIC UTILITIES COMMISSION
LEGAL DIVISION
505 VAN NESS AVE RM 4007
SAN FRANCISCO CA 94102-3214
Email: nms@cpuc.ca.gov
Status: STATE-SERVICE

JAMES WEIL DIRECTOR
AGLET CONSUMER ALLIANCE
PO BOX 1916
SEBASTOPOL CA 95473
FOR: Aglet Consumer Alliance
Email: jweil@aglet.org
Status: PARTY

KAREN TERRANOVA
ALCANTAR & KAHL, LLP
33 NEW MONTGOMERY ST, STE 1850
SAN FRANCISCO CA 94105
Email: filings@a-klaw.com
Status: INFORMATION

RICHARD MCCANN
ASPEN ENVIRONMENTAL GROUP
8801 FOLSOM BLVD, STE 290
SACRAMENTO CA 95826-3250
Email: rmccann@umich.edu
Status: INFORMATION

REED V. SCHMIDT
BARTLE WELLS ASSOCIATES
1889 ALCATRAZ AVE
BERKELEY CA 94703-2714
Email: rschmidt@bartlewells.com
Status: INFORMATION

David Peck
CALIF PUBLIC UTILITIES COMMISSION
ELECTRICITY PLANNING & POLICY BRANCH
505 VAN NESS AVE RM 4103
SAN FRANCISCO CA 94102-3214
Email: dbp@cpuc.ca.gov
Status: STATE-SERVICE

Robert M. Pocta
CALIF PUBLIC UTILITIES COMMISSION
ENERGY COST OF SERVICE & NATURAL GAS BRANCH
505 VAN NESS AVE RM 4205
SAN FRANCISCO CA 94102-3214
Email: rmp@cpuc.ca.gov
Status: STATE-SERVICE

Clayton K. Tang
CALIF PUBLIC UTILITIES COMMISSION
ENERGY COST OF SERVICE & NATURAL GAS BRANCH
505 VAN NESS AVE RM 4205
SAN FRANCISCO CA 94102-3214
Email: ckt@cpuc.ca.gov
Status: STATE-SERVICE

DAN GEIS
AGRICULTURAL ENERGY CONSUMERS ASSN.
925 L ST, STE 800
SACRAMENTO CA 95814
FOR: Agricultural Energy Consumers Association
Email: dgeis@dolphingroup.org
Status: PARTY

EDWARD G. POOLE
ANDERSON & POOLE
601 CALIFORNIA ST, STE 1300
SAN FRANCISCO CA 94108-2812
Email: epoole@adplaw.com
Status: INFORMATION

BARBARA R. BARKOVICH
BARKOVICH & YAP, INC.
44810 ROSEWOOD TERRACE
MENDOCINO CA 95460
Email: brbarkovich@earthlink.net
Status: INFORMATION

ROBERT BERMAN
BERMAN ECONOMICS
1915 GRAND COURT
VIENNA VA 22182
Email: BermanEconomics@gmail.com
Status: INFORMATION

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SCOTT BLAISING
BRAUN BLAISING MCLAUGHLIN, P.C.
915 L ST, STE 1270
SACRAMENTO CA 95814
Email: blaising@braunlegal.com
Status: INFORMATION

CALIFORNIA ENERGY MARKETS
425 DIVISADERO ST. STE 303
SAN FRANCISCO CA 94117-2242
Email: cem@newsdata.com
Status: INFORMATION

JOHN LARREA
CALIFORNIA LEAGUE OF FOOD PROCESSORS
1755 CREEKSIDE OAKS DRIVE, STE 250
SACRAMENTO CA 95833
Email: regclfp@gmail.com
Status: INFORMATION

WILLIAM K. SANDERS DEPUTY CITY ATTORNEY
OFFICE OF THE CITY ATTORNEY
1 DR. CARLTON B. GOODLETT PLACE, RM 234
SAN FRANCISCO CA 94102-4682
FOR: City and County of San Francisco
Email: william.sanders@sfgov.org
Status: PARTY

MARC D. JOSEPH
ADAMS BROADWELL JOSEPH & CARDOZO
601 GATEWAY BLVD. STE 1000
SOUTH SAN FRANCISCO CA 94080
FOR: Coalition of California Utility Employees
Email: mdjoseph@adamsbroadwell.com
Status: INFORMATION

WILLIAM MITCHELL
COMPETITIVE POWER VENTURES, INC.
55 2ND ST, STE 525
SAN FRANCISCO CA 94105
Email: will.mitchell@cpv.com
Status: INFORMATION

VIDHYA PRABHAKARAN
DAVIS WRIGHT & TREMAINE LLP
505 MONTGOMERY ST, STE 800
SAN FRANCISCO CA 94111
Email: vidhyaprabhakaran@dwt.com
Status: INFORMATION

DAVID J. BYERS, ESQ. ATTORNEY
MCCRACKEN, BYERS & HAESLOOP, LLP
870 MITTEN ROAD
BURLINGAME CA 94010
FOR: California City-County Street Light Association
Email: dbyers@landuselaw.com
Status: PARTY

KAREN NORENE MILLS ATTORNEY
CALIFORNIA FARM BUREAU FEDERATION
EMAIL ONLY
EMAIL ONLY CA 0
FOR: California Farm Bureau Federation
Email: kmills@cfbf.com
Status: PARTY

JACK D'ANGELO
CATAPULT CAPITAL MANAGEMENT LLC
650 5TH AVE, 32ND FLR
NEW YORK NY 10019
Email: jdangelo@catapult-llc.com
Status: INFORMATION

RACHAEL E. KOSS
ADAMS BROADWELL JOSEPH & CARDOZA
601 GATEWAY BLVD, STE 1000
SOUTH SAN FRANCISCO CA 94080
FOR: Coalition of California Utility Employee
Email: rkoss@adamsbroadwell.com
Status: PARTY

JAN REID
COAST ECONOMICS CONSULTING
3185 GROSS ROAD
SANTA CRUZ CA 95062
Email: janreid@coastecon.com
Status: INFORMATION

ALEXIS K. WODTKE STAFF ATTORNEY
CONSUMER FEDERATION OF CALIFORNIA
520 S. EL CAMINO REAL, STE. 340
SAN MATEO CA 94402
FOR: Consumer Federation of California
Email: lex@consumercal.org
Status: PARTY

JUDY PAU
DAVIS WRIGHT TREMAINE LLP
EMAIL ONLY
EMAIL ONLY CA 00000-0000
Email: judypau@dwt.com
Status: INFORMATION

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SALLE E. YOO
DAVIS WRIGHT TREMAINE LLP
505 MONTGOMERY ST, STE 800
SAN FRANCISCO CA 94111
Email: salleyoo@dwt.com
Status: INFORMATION

SCOTT SENCHAK
DECADE CAPITAL
EMAIL ONLY
EMAIL ONLY CA 00000-0000
Email: scott.senchak@decade-llc.com
Status: INFORMATION

WILLIAM F. DIETRICH ATTORNEY
DIETRICH LAW
2977 YGNACIO VALLEY ROAD, NO. 613
WALNUT CREEK CA 94598-3535
Email: dietrichlaw2@earthlink.net
Status: INFORMATION

MELISSA A. KASNITZ ATTORNEY
DISABILITY RIGHTS ADVOCATES
2001 CENTER ST, FOURTH FLR
BERKELEY CA 94704-1204
FOR: Disability Rights Advocates
Email: pucservice@dralegal.org
Status: PARTY

WENDY L. ILLINGWORTH
ECONOMIC INSIGHTS
320 FEATHER LANE
SANTA CRUZ CA 95060
Email: wendy@econinsights.com
Status: INFORMATION

CAROLYN KEHREIN
ENERGY MANAGEMENT SERVICES
2602 CELEBRATION WAY
WOODLAND CA 95776
Email: cmkehrein@ems-ca.com
Status: INFORMATION

NORA SHERIFF
ALCANTAR & KAHL
33 NEW MONTGOMERY ST, STE 1850
SAN FRANCISCO CA 94105
FOR: Energy Producers & Users Coalition
Email: nes@a-klaw.com
Status: PARTY

RALPH R. NEVIS
DAY CARTER & MURPHY LLP
3620 AMERICAN RIVER DR., STE 205
SACRAMENTO CA 95864
Email: rnevis@daycartermurphy.com
Status: INFORMATION

LAUREN DUKE
DEUTSCHE BANK SECURITIES INC.
60 WALL ST
NEW YORK NY 10005
Email: lauren.duke@db.com
Status: INFORMATION

KARLA GILBRIDE
DISABILITY RIGHTS ADVOCATES
2001 CENTER ST, 4TH FLR
BERKELEY CA 94704-1204
Email: pucservice@dralegal.org
Status: INFORMATION

Laura J. Tudisco
CALIF PUBLIC UTILITIES COMMISSION
LEGAL DIVISION
505 VAN NESS AVE RM 5032
SAN FRANCISCO CA 94102-3214
FOR: Division of Ratepayers Advocate
Email: ljt@cpuc.ca.gov
Status: PARTY

LYNN HAUG
ELLISON, SCHNEIDER & HARRIS L.L.P.
2600 CAPITAL AVE, STE 400
SACRAMENTO CA 95816
Email: lmh@eslawfirm.com
Status: INFORMATION

KEVIN J. SIMONSEN
ENERGY MANAGEMENT SERVICES
646 E. THIRD AVE.
DURANGO CA 81301
FOR: Energy Management Services
Email: kjsimonsen@ems-ca.com
Status: PARTY

BRIAN T. CRAGG
GOODIN MACBRIDE SQUERI, DAY & LAMPREY
505 SANSOME ST, STE 900
SAN FRANCISCO CA 94111
FOR: Engineers and Scientists of California Local 20
Email: bcragg@goodinmacbride.com
Status: PARTY

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Total number of addressees: 99

DONN DAVY
EMAIL ONLY
EMAIL ONLY CA 0
Email: dfdavy@well.com
Status: INFORMATION

DAVID MARCUS
PO BOX 1287
BERKELEY CA 94701
Email: dmarcus2@sbcglobal.net
Status: INFORMATION

STEVEN KELLY POLICY DIRECTOR
INDEPENDENT ENERGY PRODUCERS ASSOCIATION
1215 K ST, STE 900
SACRAMENTO CA 95814
FOR: Independent Energy Producers Association
Email: steven@iepa.com
Status: PARTY

GARRICK JONES
JBS ENERGY
311 D ST
WEST SACRAMENTO CA 95605
Email: garrick@jbsenergy.com
Status: INFORMATION

IVANA ERGOVIC
JEFFERIES & COMPANY, INC.
520 MADISON AVE, 19TH FLR
NEW YORK NY 10022
Email: IErgovic@Jefferies.com
Status: INFORMATION

MICHAEL TURNIPSEED EXEC. DIR.
KERN COUNTY TAXPAYERS ASSOCIATION
331 TRUTUN AVE
BAKERSFIELD CA 93301
FOR: Kern County Taxpayers Association
Email: kerntax@kerntaxpayers.org
Status: INFORMATION

JAMES J. HECKLER
LEVIN CAPITAL STRATEGIES
595 MADISON AVE
NEW YORK NY 10022
Email: jheckler@levincap.com
Status: INFORMATION

ANN L. TROWBRIDGE
DAY CARTER MURPHY LLC
3620 AMERICAN RIVER DRIVE, STE 205
SACRAMENTO CA 95864
FOR: Merced Irrigation District/Modesto Irrigation District
Email: atrowbridge@daycartermurphy.com
Status: PARTY

NAAZ KHUMAWALA
MERRILL LYNCH, PIERCE, FENNER & SMITH
EMAIL ONLY
EMAIL ONLY CA 0
Email: naaz.khumawala@baml.com
Status: INFORMATION

SEAN P. BEATTY
MIRANT CALIFORNIA, LLC
PO BOX 192
PITTSBURGH CA 94565
Email: sean.beatty@mirant.com
Status: INFORMATION

JOY A. WARREN
MODESTO IRRIGATION DISTRICT
1231 11TH ST
MODESTO CA 95354
Email: joyw@mid.org
Status: INFORMATION

MRW & ASSOCIATES, LLC
EMAIL ONLY
EMAIL ONLY CA 0
Email: mrw@mrwassoc.com
Status: INFORMATION

MARTIN A. MATTES ATTY AT LAW
NOSSAMAN LLP
50 CALIFORNIA ST, 34TH FLR
SAN FRANCISCO CA 94111-4799
Email: mmattes@nossaman.com
Status: INFORMATION

THOMAS J. LONG
OFFICE OF THE CITY ATTORNEY
CITY HALL, RM 234
SAN FRANCISCO CA 94102
Email: thomas.long@sfgov.org
Status: INFORMATION

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WILLIAM D. TAYLOR
HANSON BRIDGETT LLP
500 CAPITAL MALL, STE 1500
SACRAMENTO CA 95814
FOR: Open Top Sightseeing San Francisco, LLC
Email: wtaylor@hansonbridgett.com
Status: PARTY

JIM ROSS
RCS, INC.
500 CHESTERFIELD CENTER, STE 320
CHESTERFIELD MO 63017
Email: jimross@r-c-s-inc.com
Status: INFORMATION

KEITH MELVILLE
SAN DIEGO GAS & ELECTRIC COMPANY
101 ASH ST, HQ 13D
SAN DIEGO CA 92101
FOR: San Diego Gas & Electric/Southern California Gas
Company
Email: KMelville@SempraUtilities.com
Status: PARTY

MANUEL RAMIREZ
SAN FRANCISCO PUC - POWER ENTERPRISE
1155 MARKET ST, 4TH FLR
SAN FRANCISCO CA 94103
Email: mramirez@sflower.org
Status: INFORMATION

EDWARD W. O'NEILL
DAVIS WRIGHT TREMAINE LLP
505 MONTGOMERY ST, STE 800
SAN FRANCISCO CA 94111-6533
FOR: South San Joaquin Irrigation District
Email: edwardoneill@dwt.com
Status: PARTY

HERB EMMRICH SAN DEIGO GAS & ELECTRIC
COMPANY
SOUTHERN CALIFORNIA GAS CO., GT14D6
555 WEST 5TH ST
LOS ANGELES CA 90013
Email: HEmmrich@SempraUtilities.com
Status: INFORMATION

KRIS G. VYAS
SOUTHERN CALIFORNIA EDISON COMPANY
QUAD 3-B
2244 WALNUT GROVE AVE
ROSEMEAD CA 91770
Email: kris.vyas@sce.com
Status: INFORMATION

ANDERS NIELSEN
OPEN TOP SIGHTSEEING SAN FRANCISCO, LLC
5500 TUXEDO ROAD
HYATTSVILLE MD 20781
Email: anders@opentopightsighting.com
Status: INFORMATION

SUE MARA
RTO ADVISORS, LLC
164 SPRINGDALE WAY
REDWOOD CITY CA 94062
Email: sue.mara@rtoadvisors.com
Status: INFORMATION

CENTRAL FILES (CP31E)
SAN DIEGO GAS AND ELECTRIC CO.
8330 CENTURY PARK COURT
SAN DIEGO CA 92123
Email: CentralFiles@SempraUtilities.com
Status: INFORMATION

FRASER D. SMITH CITY AND COUNTY OF SAN
FRANCISCO
SAN FRANCISCO PUBLIC UTILITIES COMM
1155 MARKET ST, 4TH FLR
SAN FRANCISCO CA 94103
Email: fsmith@sflower.org
Status: INFORMATION

CASE ADMINISTRATION
SOUTHERN CALIFORNIA EDISON COMPANY
2244 WALNUT GROVE AVE, RM 370
ROSEMEAD CA 91770
Email: case.admin@sce.com
Status: INFORMATION

ANDREW STEINBERG
SOUTHERN CALIFORNIA GAS CO.
555 W. 5TH ST, GT 14D6
LOS ANGELES CA 90013-1034
Email: ASteinberg@SempraUtilities.com
Status: INFORMATION

SCOTT WILDER
SOUTHERN CALIFORNIA GAS CO., GT14D6
555 W. 5TH ST
LOS ANGELES CA 90013-1034
Status: INFORMATION

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Total number of addressees: 99

FRANCIS MCNULTY ATTORNEY
SOUTHERN CALIFORNIA EDISON COMPANY
2244 WALNUT GROVE AVE
ROSEMEAD CA 91770
FOR: Southern California Edison
Email: francis.mcnulty@sce.com
Status: PARTY

ENRIQUE GALLARDO
THE GREENLINING INSTITUTE
1918 UNIVERSITY AVE., 2ND FLR
BERKELEY CA 94704-1051
Email: enriqueg@greenlining.org
Status: INFORMATION

ROBERT FINKELSTEIN
THE UTILITY REFORM NETWORK
115 SANSOME ST, STE 900
SAN FRANCISCO CA 94104
Email: bfinkelstein@turn.org
Status: INFORMATION

JULIEN DUMOULIN-SMITH ASSOCIATE ANALYST
UBS INVESTMENT RESEARCH
1285 AVE OF THE AMERICAS
NEW YORK NY 10019
Email: julien.dumoulin-smith@ubs.com
Status: INFORMATION

ASHAR KHAN
VISIUM ASSET MANAGEMENT
EMAIL ONLY
EMAIL ONLY NY 0
Email: akhan@visiumfunds.com
Status: INFORMATION

DANIEL DOUGLASS ATTORNEY
DOUGLASS & LIDDELL
21700 OXNARD ST, STE 1030
WOODLAND HILLS CA 91367
FOR: Western Power Trading Forum/Alliance for Retail
Energy Markets/Equinix, Inc./Direct Access Customer
Coalition
Email: douglass@energyattorney.com
Status: PARTY

BARBARA GEORGE
WOMEN'S ENERGY MATTERS
PO BOX 548
FAIRFAX CA 94978-0548
FOR: Womern's Energy Matters
Email: wem@igc.org
Status: PARTY

STEPHANIE C. CHEN
THE GREENLINING INSTITUTE
EMAIL ONLY
EMAIL ONLY CA 0
FOR: The Greenlining Institute
Email: stephaniec@greenlining.org
Status: PARTY

SAMUEL S. KANG
THE GREENLINING INSTITUTE
1918 UNIVERSITY AVE, 2ND FLR.
BERKELEY CA 94704
Email: samuelk@greenlining.org
Status: INFORMATION

HAYLEY GOODSON
THE UTILITY REFORM NETWORK
115 SANSOME ST, STE 900
SAN FRANCISCO CA 94104
FOR: The Utility Reform Network
Email: hayley@turn.org
Status: PARTY

PAUL KERKORIAN
UTILITY COST MANAGEMENT LLC
6475 N. PALM AVE, STE 105
FRESNO CA 93704
Email: pk@utilitycostmanagement.com
Status: INFORMATION

ROBERT RATHIE
WELLINGTON LAW OFFICE
857 CASS ST, STE D
MONTEREY CA 93940
Email: info@dcisc.org
Status: INFORMATION

MARTIN HOMEC
EMAIL ONLY
EMAIL ONLY CA 00000-0000
FOR: Women's Energy Matters
Email: martinhomec@gmail.com
Status: INFORMATION

ANDREW YIM
ZIMMER LUCAS PARTNERS
535 MADISON AVE., 6TH FLR
NEW YORK NY 10022
Email: Yim@ZimmerLucas.com
Status: INFORMATION

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Total number of addressees: 99

ADAR ZANGO ANALYST
ZIMMER LUCAS PARTNERS
535 MADISON - 6TH FLR
NEW YORK NY 10022
Email: zango@zimmerlucas.com
Status: INFORMATION