

**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.

Investigation 10-07-027  
(Filed July 29, 2010)

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

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**I. INTRODUCTION AND EXECUTIVE SUMMARY**

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 Reply 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. Opening Briefs were timely filed by PG&E, the Division of Ratepayer Advocates (DRA), San Diego Gas and Electric Company (SDG&E), Southern California Edison Company (SCE), and The Utility Reform Network (TURN).

PG&E's Opening Brief explained PG&E's position that the unrecovered costs of the retired meters should continue to be included in rate base.<sup>1/</sup> SCE and SDG&E supported PG&E's position, citing Financial Accounting Standards (FAS) 71, Utility Standard Practice (USP) U-4, the extensive record and decisions in the Commission's Advanced Metering

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<sup>1/</sup> PG&E Opening Brief, pp. 1-4; 6-17.

Infrastructure (AMI) proceedings, as well as case law and public policy related to the regulatory compact.<sup>2/</sup>

DRA explains that it “did not submit rebuttal [sic] testimony on the issue” at hand because full deployment of SmartMeter devices has not yet taken place.<sup>3/</sup> DRA requests that, in “subsequent cases where full deployment [of SmartMeter devices] has taken place, DRA may specifically address the issue, and any decision regarding this issue in the PG&E case should not prejudice the right of DRA or other parties to propose another policy.”<sup>4/</sup> DRA further states that it has “no objection to the implementation of the TURN proposal” (discussed below) and suggests that, if “the Commission is not inclined to accept the TURN proposal, it should consider alternatives, such as that included in TURN’s testimony regarding securitization.”<sup>5/</sup> For the reasons described in this Reply Brief, DRA’s last-minute request for the right to re-litigate the retired meters issue in some future proceeding is both unlawful and unreasonable and should be denied.

TURN makes three basic points in arguing that the unrecovered cost of PG&E’s retired meters should be removed from rate base. First, TURN claims that PG&E has failed to meet its burden of proof about the appropriate ratemaking treatment of retired electromechanical meters removed as a result of PG&E’s SmartMeter program.<sup>6/</sup> Second, TURN argues that continued inclusion of the retired meters in rate base is inconsistent with the Commission’s “used and useful” principle.<sup>7/</sup> Third, TURN argues that PG&E’s reliance on the evidentiary record and decisions in the Commission’s AMI proceedings “misconstrues those decisions and ignores the

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<sup>2/</sup> SCE Opening Brief, pp. 2-3; SDG&E Opening Brief, pp. 3-8.

<sup>3/</sup> DRA Opening Brief, p. 2.

<sup>4/</sup> DRA Opening Brief, p. 2.

<sup>5/</sup> DRA Opening Brief, p. 2.

<sup>6/</sup> TURN Opening Brief, pp. 2-6 and 9-11.

<sup>7/</sup> TURN Opening Brief, pp. 6-9.

record evidence to the contrary.”<sup>8/</sup> As explained in this Reply Brief, none of TURN’s contentions has merit.

With respect to TURN’s first argument, PG&E has fully met its burden of proof. The Commission previously authorized PG&E to continue including the retired meters in rate base, and therefore PG&E did not have to include “evidence” to support this ratemaking treatment. Nevertheless, PG&E provided both opening and rebuttal testimony clearly stating its basis for continuing to include the retired meters in rate base.

Regarding TURN’s second argument, TURN’s overly expansive characterization of the “used and useful” principle misstates both the case law, as well as the record in this proceeding. Specifically, in the “used and useful” cases cited by TURN, there was a **net burden** to be shared between ratepayers and shareholders on account of premature retirement of power plants or abandoned projects. In contrast, the Commission determined in the AMI Proceedings that there would be a **net benefit** in the form of a net reduction to rates from implementing the new technology, even while including the old meter costs in rate base and collecting those costs over time. Thus, even for abandoned power plants and prematurely retired power plants (the circumstances in the cases cited by TURN), the Commission has recognized an exception to the “used and useful” principle, and allowed costs to remain in rate base (or accrue a return) where it could be shown that an abandoned project benefitted (or could benefit) customers or a prematurely retired power plant might have a future use. Moreover, the “used and useful” cases cited by TURN allowed for expedited cost recovery of the stranded assets, while the meters at issue here will be recovered over their normal life. Finally, TURN’s “used and useful” argument fails to recognize that PG&E replaced the old, fully functional meters and invested in the new ones, not because the old meters were no longer “used and useful,” but rather at the Commission’s direction in order to implement Commission demand side management policies.

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<sup>8/</sup> TURN Opening Brief, pp. 11-17.

In this respect, the Commission has expressly not applied the “used and useful” precedent to circumstances involving groups of assets retired on account of technological change.

TURN’s third argument about the meaning of the AMI decisions is undermined by the evidence in the various AMI and GRC proceedings that predate the current one. As explained in PG&E’s Opening Brief and reiterated below, the AMI decisions adopted PG&E’s proposed ratemaking treatment for the AMI project without modification, and the Commission’s weighing of costs and benefits for the AMI project clearly did not include the rate benefit associated with removing the electromechanical meters from rate base.

For all of these reasons, the Commission should reject DRA’s and TURN’s request to remove PG&E’s electromechanical meters from rate base.

**II. WHILE THE ISSUE PRESENTED BY TURN IS NARROW, THE COMMISSION’S RESOLUTION OF THE ISSUE HAS THE POTENTIAL TO HAVE A MUCH BROADER AND MORE SIGNIFICANT IMPACT.**

With regard to PG&E’s retired electromechanical meters replaced as a result of the SmartMeter program, TURN clarifies that it is not proposing “any change to PG&E’s proposed amortization that permits it to recover the investment itself,” nor is it challenging “the return that PG&E likely recorded or will record in 2009 and 2010 from its investment in meters that had already been removed from service during those years.”<sup>9/</sup> The only issue contested by TURN is the return that PG&E will earn in 2011, 2012, and 2013 on its investment in the electromechanical meters. While PG&E agrees with TURN that the issue at hand is “relatively narrow,”<sup>10/</sup> PG&E also believes that the arguments made by DRA and TURN raise broader and critically important issues.

Foremost among the broader issues raised by DRA’s and TURN’s briefs is the finality of Commission decisions. As discussed in PG&E’s Opening Brief and reiterated below, the costs and benefits of PG&E’s AMI project were litigated in both the Initial AMI Proceeding

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<sup>9/</sup> TURN Opening Brief, p. 3.

<sup>10/</sup> TURN Opening Brief, p. 3.



(A.05-06-028) and the Upgrade Proceeding (A.07-12-009), which resulted in Decisions 06-07-027 and 09-03-026 (the “AMI Decision” and “Upgrade Decision,” respectively).<sup>11/</sup> TURN’s arguments collaterally attack those decisions and threaten to unbalance the Commission’s careful weighing of costs and benefits.<sup>12/</sup> Similarly, DRA’s last-minute request for the right to re-litigate this same issue in a future, as-yet-undetermined proceeding, calls into question the finality of the Commission’s decisions.

Another related issue raised by TURN’s brief is the degree of confidence that the utilities and the investment community should have in the regulatory compact. Specifically, as SCE argues in its Opening Brief: “Adopting TURN’s proposal would send a clear message to utility investors that their return on capital investments can be confiscated when technological innovations displace that investment. Investors can hardly be expected to fund innovations such as AMI technologies if doing so would result in denial of the expected return on their prior investments.”<sup>13/</sup> It would be contrary to the public interest for the Commission to reverse its prior decisions on PG&E’s investments in AMI technology. Such a reversal would have a chilling effect on future investments in technological innovations.

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<sup>11/</sup> PG&E Opening Brief, pp. 2-3 and 6-15.

<sup>12/</sup> All of the utilities’ applications to implement AMI used a cost-benefit analytical framework that had been developed in R.02-06-001, pursuant to a series of rulings (See, for example Rulings in that OIR dated September 19, 2003; November 24, 2003; February 19, 2004, July 21, 2004; and November 24, 2004). This framework was used to justify implementation from a ratepayer perspective. TURN participated extensively in developing the analytical framework for that cost-benefit analysis (See D. 06-06-016, *mimeo*, pp. 7-9, discussing TURN’s efforts in developing that framework and awarding TURN a total of \$204,500 for its contribution on this and other matters addressed in that rulemaking). The costs and benefits of AMI were also litigated in SCE’s AMI Proceeding (A.07-07-026) and resolved by a settlement with TURN that was adopted by the Commission in Decision 08-09-039. See also D.09-04-027 (granting TURN \$145,400 in intervenor compensation for its substantial contribution to D.08-09-039). In A. 05-03-015, SDG&E also litigated and resolved its cost-benefit and other AMI implementation issues through settlement. (Decision 05-08-018, authorizing recovery by SDG&E of costs of pre-deployment activities and Decision 07-04-043, authorizing recovery by SDG&E of AMI deployment costs.) See also, D. 06-04-016, (authorizing recovery by the Utility Consumer Action Network (UCAN) of \$31,000 for contributions made in resolving pre-deployment issues) and D. 09-04-031 (authorizing recovery by UCAN of \$254,000 for contributions made in resolving deployment issues.) All of UCAN’s consultants who derived compensation also consulted with TURN on AMI related matters.

<sup>13/</sup> SCE Opening Brief, p. 3.

### **III. TURN ERRS IN ARGUING THAT PG&E HAS FAILED TO MEET ITS BURDEN OF PROOF REGARDING THE RATEMAKING TREATMENT FOR PG&E'S RETIRED ELECTROMECHANICAL METERS.**

In its Opening Brief, TURN argues that PG&E “has the burden of affirmatively establishing the reasonableness of all aspects of its application,” and alleges that PG&E has failed to meet its burden of proof regarding the ratemaking treatment for the retired electromechanical meters.<sup>14/</sup> While PG&E acknowledges that it bears the burden of proof of proving its case by a preponderance of evidence,<sup>15/</sup> it is untrue that PG&E has failed to meet its burden of proof.

#### **A. Even Though PG&E Did Provide Substantial Evidence on the Issue, PG&E Did Not Have An Affirmative Obligation To Include Evidence On Why Retired Meters That Are Not “Used And Useful” Should Continue To Be Included In Rate Base.**

TURN argues that “PG&E has presented virtually no evidence in support of its request that it be permitted to earn its authorized rate of return on investment.”<sup>16/</sup> Specifically, TURN argues:

TURN’s testimony on this subject highlighted what PG&E’s testimony did not make explicit – the utility’s proposal includes leaving the unamortized meter investment in rate base, even though PG&E acknowledges that the removed meters are no longer “used and useful” after their removal and retirement ... The utility did not present any evidence addressing the question of why plant that it agrees is no longer “used and useful” should remain in rate base.<sup>17/</sup>

In essence, TURN is arguing is that PG&E should have presented explicit justification in its opening testimony for the continued inclusion of the retired meters in rate base, notwithstanding the fact that they are no longer “used and useful.” What TURN’s argument fails to acknowledge is that the broader issue of the appropriate ratemaking treatment for the retired

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<sup>14/</sup> TURN Opening Brief, pp. 2-3.

<sup>15/</sup> *See, e.g.*, PG&E Opening Brief, p. 5.

<sup>16/</sup> TURN Opening Brief, p. 2.

<sup>17/</sup> TURN Opening Brief, pp. 5-6.

electromechanical meters was already litigated and resolved in PG&E's Initial AMI and Update Proceedings, and that PG&E is entitled to rely on the Commission's decisions.

In its opening testimony for the 2011 GRC, PG&E proposed rate base amounts, which included the electromechanical meters replaced by the SmartMeter program. In including the electromechanical meters in rate base, PG&E relied on Commission precedent – in particular, the Commission's AMI Decision and Upgrade Decision, both of which adopted PG&E's proposed ratemaking treatment of the retired meters.<sup>18/</sup> Commission precedent is not “evidence” that needs to be introduced into the record. Rather, Commission precedent constitutes law that is binding on all parties, including TURN.

When TURN filed testimony opposing PG&E's treatment of the retired meters, PG&E submitted rebuttal testimony that quoted from, and incorporated by reference, PG&E's testimony from the AMI proceedings.<sup>19/</sup> The excerpts from PG&E's AMI testimony not only demonstrated that the ratemaking treatment for the electromechanical meters had already been litigated and resolved in the AMI Proceedings, but also constituted evidence in the 2011 GRC for the reasonableness of PG&E's rate base amount.

Contrary to TURN's suggestion, PG&E did not have any obligation to produce “evidence” to rebut TURN's “used and useful” argument. As noted above, the Commission already resolved the broader issue of the appropriate ratemaking treatment for the retired meters in its Initial AMI and AMI Upgrade decisions. As discussed in Section V.C below, to the extent TURN had any concerns that PG&E's proposed ratemaking in the AMI Proceedings violated the “used and useful” principle, TURN should have raised such concerns at that time, particularly

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<sup>18/</sup> TURN puts undue significance on PG&E's use of the word “proposal” to describe its ratemaking treatment for the retired meters, suggesting that PG&E would not “propose” something that was already approved by the Commission. (TURN Opening Brief, pp. 9-10.) TURN's argument is strained and misguided. While the ratemaking treatment for the meters was previously approved by the Commission, PG&E's rate base (which includes the retired meters, as well as numerous other items) is adjusted as part of the GRC process, and therefore must be “proposed” for approval.

<sup>19/</sup> Exh. PG&E-18, v2, pp. 8-13 to 8-14.

since TURN was well-aware of the issue (as explained below). It is inappropriate for TURN to raise this argument now. PG&E is entitled to rely on the Commission’s prior decisions; it is not obligated to introduce “evidence” to rebut every possible argument that TURN could have been raised – but chose not to raise – in the underlying AMI Proceedings giving rise to such decisions.

**B. PG&E’s Testimony Adequately Explained The Relationship Between Rate Base, Net Plant, Retirements, And Depreciation Reserve.**

In conjunction with TURN’s argument that the record fails to support PG&E’s position, TURN cites various sections of the record in an attempt to argue that the record supports its position, not PG&E’s.<sup>20/</sup> According to TURN, the evidentiary record in this GRC supports the following conclusions:

- ffi “Utility plant” must be “used and useful” in rendering utility service.
- ffi PG&E is retiring and replacing its old meters as part of its SmartMeter campaign. PG&E anticipates its remaining investment in the meters it has replaced will be approximately \$341 million in unrecovered costs.
- ffi Once electric meters are retired and replaced with SmartMeter technology, the retired electric meters are no longer “used and useful.”
- ffi In this proceeding, PG&E is proposing to recover the costs of removed meters over an approximately 18-year remaining life. The amortization of the \$341 million in unrecovered costs would result in approximately \$18.9 million annually for each of the years 2011, 2012 and 2013, and each year thereafter through 2028.<sup>21/</sup>

TURN’s citations to record, however, are incomplete. In its argument, TURN betrays its lack of understanding of the fundamental accounting and ratemaking principles at issue in this case.<sup>22/</sup>

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<sup>20/</sup> TURN Opening Brief, pp. 4-6.

<sup>21/</sup> TURN Opening Brief, p. 4.

<sup>22/</sup> See Tr. Vol. 27, 3504:8-12, TURN/Finkelstein (“Q: You understand utility plant and you understand depreciation reserve, correct? Do you understand those two concepts? A: Well, I’m not purporting to understand those concepts for purposes of this cross-examination.”); 3505:10-14 (“Q: Where are the debits

TURN focuses solely on the definition of “utility plant.” TURN fails to acknowledge that the record in the GRC also includes important testimony regarding (1) how the utility records retirements and (2) how the utility uses the depreciation reserve to compute rate base.

Specifically, TURN fails to recognize PG&E’s record evidence showing (1) that **net book value** (i.e., the difference between the book value of unretired plant and the depreciation reserve) is what determines rate base, and (2) that **retirements** are accounted for with equal and offsetting entries to plant and the **reserve** (so there would ordinarily be no change in net book value from a retirement). PG&E’s prepared testimony in this GRC specifically states how the depreciation reserve is computed (and the plant account) are impacted by a retirement:

**Reserve** is the accumulated depreciation recorded for the plant to date.  
When an item of plant is retired, the plant and reserve are both reduced....<sup>23/</sup>

As noted during cross examination of TURN’s witness, this treatment is expressly provided for in utility Standard Practice U-4.<sup>24/</sup> It is also provided for in the FERC uniform system of accounts.<sup>25/</sup> PG&E explicitly stated that it would follow this treatment of retirements in the AMI proceedings, and it identified no exception to this treatment for the retirements of the meters in this GRC.<sup>26/</sup>

TURN also ignores PG&E’s rate base testimony in this GRC. That testimony specifically states that rate base is computed based on “(1) **utility plant**; plus (2) working

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and credits when you have a retirement? A: Well...I’m not appearing here as an expert about the application of the Standard Practice.”); 3506:23-27 (“Q: Do you know what a debit does to a liability account? A: Maybe I’m misunderstanding you. The debit entry – I guess I’m not sure what the debit entry would do to that debit.”); 3510:6-15 (“Q: Would it be fair to say that under normalization accounting the idea is to recognize timing benefits through a rate base reduction?...A: I don’t know. I don’t have an independent knowledge of what the normalization practices are.”).

<sup>23/</sup> Exh. PG&E-2 p. 10-9.

<sup>24/</sup> Tr. Vol. 27, 3505:12 to 3507:26, TURN/Finkelstein. *Also see* PG&E -20, USP U-4, pp. 5, 9-11.

<sup>25/</sup> 18 CFR Subchapter C, Part 101, Electric Plant Instructions, Item #10 “Additions and Retirements of Electric Plant.”

<sup>26/</sup> See Exh. PG&E-18, v2, pp. 8-13 to 8-14, quoting from testimony in the Initial AMI and Upgrade Proceedings.

capital; plus (3) Tax Reform Act deferrals; less (4) customer advances; less (5) deferred taxes; and less (6) **depreciation reserve**.<sup>27/</sup> That testimony then refers back to the testimony on the computation of the depreciation reserves, which includes the specific reference to the treatment of retirements set forth above.<sup>28/</sup> Therefore, when PG&E proposed in the AMI Proceedings that there would be no change to “net plant” because of the “equal and offsetting entries to plant and the depreciation reserve,” PG&E was explaining, consistent with normal utility accounting rules, that it would not be making any rate base adjustment on account of retirement of the old meters.

#### IV. TURN’S EXPANSIVE INTERPRETATION OF THE “USED AND USEFUL” PRINCIPLE IS MISGUIDED.

In support of its argument that continued inclusion of the retired meters in rate base is prohibited by the “used and useful” principle, TURN cites several Commission decisions, none of which control here.<sup>29/</sup> TURN’s analysis of Commission precedent is flawed for the following reasons.

First (as explained in Section A.1. below), each of the decisions cited by TURN applied the “used and useful” principle to abandoned projects and power plants that have been removed from service.<sup>30/</sup> In those decisions, the Commission allowed the unrecovered costs to be recovered rapidly (over four or five years). In the case of the AMI program, all of the IOUs have proposed to collect the unrecovered costs over nearly 20 years.

Second (as explained in Section A.2. below), the cases cited by TURN address events (i.e., project abandonments and premature retirements) in which the Commission had to determine how to share a **cost burden** between ratepayers and shareholders. In the matter at hand, there is no burden to share, because the retired meters were removed based on a

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<sup>27/</sup> Exh. PG&E-2, pp. 14-4 to 14-7 (emphasis added).

<sup>28/</sup> Exh. PG&E-2, p. 14-7.

<sup>29/</sup> TURN Opening Brief, pp. 6-9.

<sup>30/</sup> Id.

Commission Order determining that the replacement would result in a net benefit to customers, even assuming the unrecovered meter costs would remain in rate base.

Third (as explained in Section A.3. below), all of the “used and useful” cases cited by TURN involve individual projects that became uneconomic or inoperable. In contrast, the instant case involves millions of meters that performed exactly as intended and would have continued to operate but for the Commission’s directives.

Fourth (as explained in Section A.4. below), TURN’s analysis of the “used and useful” cases fails to recognize the significance of Public Utilities Code Section 455.5, which effectively limits the “used and useful” principle to power plants.

Fifth (as explained in Section B. below), TURN fails to address another “used and useful” case that is more analogous to the instant situation. In the only decision PG&E has found that has addressed extraordinary retirements within a group, the Commission allowed the utility (Pacific Bell) to recover its costs over time, subject to an exception not applicable here.

And finally (as explained in Section C. below), TURN fails to address why the utilities, who have acted in compliance with the Commission’s directives regarding AMI technology, should be treated far worse than the utilities in TURN’s cited power plant and abandoned project cases.

Thus, even if the matter had not previously been resolved by the Initial AMI and Upgrade Decisions (which it has), general Commission precedent supports PG&E’s position that, under the special circumstances of AMI, the cost of the retired meters would remain in rate base and be recovered over time.

**A. TURN Fails To Acknowledge That The Power Plant and Abandoned Project Decisions are Distinguishable From The Facts Presented By The Retired Meters.**

TURN’s cited cases for the “used and useful” principle are all distinguishable from the instant situation. In the cases cited by TURN, the power plants had become uneconomic to operate (Humboldt, Geysers 16, or several SDG&E plants) or were never operable (LNG). In

those cases, the Commission removed the undepreciated costs from rate base, but it also allowed for rapid recovery of the unamortized balance over a shortened period of four or five years. These key distinguishing facts are never mentioned in TURN's brief. Moreover, in the power plant cases, the Commission relied on the "used and useful" principle to determine how a net burden should be shared between ratepayers and shareholders, whereas in the instant case of the AMI program, the Commission already determined that there would be a net benefit, such that no "sharing" of the burden needed to occur.

**1. All Of The "Used And Useful" Cases Cited By TURN Allowed For Cost Recovery Over An Expedited Timeframe, Unlike The Nearly 20-Year Recovery Period Authorized By The AMI Decisions.**

The first case chronologically cited by TURN involved disallowing rate base on an abandoned LNG project that was never placed in service (D.84-09-089).<sup>31/</sup> The Commission allowed recovery over four years of project costs associated with the production, shipment, storage and conversion of LNG, but disallowed inclusion in rate base. The next three decisions chronologically, as cited by TURN, all involved generation stations that were prematurely retired because they could not be operated economically.<sup>32/</sup>

In Decision 85-08-046, the Commission allowed cost recovery over an expedited four-year period for Humboldt Unit 3, which was retired when it could no longer be operated without making uneconomic upgrades.

In Decision 85-12-108, the Commission allowed cost recovery over an expedited five-year period for several SDG&E generation stations that were prematurely retired for economic reasons.

In Decision 92-12-057, the Commission similarly allowed cost recovery over an expedited five-year period for Geysers 15, a generation plant that could no longer be operated.

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<sup>31/</sup> TURN Opening Brief, p. 7.

<sup>32/</sup> TURN Opening Brief, pp. 7-9.



In all of these cases, the Commission removed the plants from rate base but allowed expedited cost recovery. In contrast, in the AMI Proceedings, PG&E proposed – and the Commission approved – that the retired electromechanical meters would be recovered over the normal 18-year period.

**2. All Of The “Used And Useful” Cases Cited By TURN Involve The Sharing Of Net Burdens, Unlike The AMI Project That Provides A Net Benefit.**

The retired meters removed as a result of the SmartMeter program present a distinguishable set of facts from the cases cited by TURN. The AMI Proceedings found that moving forward with implementation of the SmartMeter program would provide ratepayers a net benefit, even assuming the unrecovered costs of the retired meters would remain in rate base. In contrast, the abandoned project and prematurely retired power plant situations addressed in the cases cited by TURN (including predecessor decisions) concern how a net burden should be shared between ratepayers and shareholders. In that context, a careful analysis of the abandonment and premature power plant retirement cases shows why the “used and useful” principle, as applied in those decisions, is not applicable to circumstances surrounding AMI implementation.

In an early abandoned project decision (D.92497, December 3, 1980), the Commission addressed the issue of burden sharing as follows:

**We are concerned with the increasing magnitude of abandoned project costs and the frequency of abandonments, the cost of which we are routinely being asked to place on the ratepayers' shoulders.** We are also concerned with the increasing burden being placed on the stockholders who in the past have invested in utility stocks as a reliable income stock with some growth possibilities and with very little risk. Although the costs in this case are small in comparison to some abandonment costs, such as those of Sundesert, **this in itself is not sufficient justification for placing the entire burden either on the stockholder or the ratepayer.** . . . We cannot emphasize too strongly the necessity of examining each case on an individual basis to arrive at an equitable decision.<sup>33/</sup>

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<sup>33/</sup> D. 92497, 4 CPUC 2d 725, 777; 1980 Cal. PUC LEXIS 1024 at \*115 to \*116 (emphasis added.)

The Commission then established a general principle that, to share the burden of the cost of an abandoned project, the utility would ordinarily recover its direct investment over a relatively short period (typically four years), but with no return. The Commission described this policy in the context of the LNG project abandonment as follows:

As set forth in D.83-12-068 as modified by D.84-05-100, our policy of rate recovery for abandoned plants provides **for a sharing of costs between ratepayers and shareholders** during periods of great uncertainty. Under this policy, if the applicants declared the LNG project abandoned, we would allow them to recover their direct expenditures, but not their AFUDC.<sup>34/</sup>

The Commission noted that, even for project abandonments, the Commission had recognized an exception where benefits could be shown to customers:

A review of the exceptional cases is presented in D.92497 dated December 5, 1980. In these abandoned project cases we allocated the direct feasibility costs to ratepayers and AFUDC costs to shareholders. The costs borne by ratepayers were then amortized over a period of years. **We have allowed the utility to rate-base a portion of the unamortized costs only when the residual value or potential benefits were likely to accrue to ratepayers.** Otherwise, we considered such treatment as an inappropriate shifting of risk to the ratepayers.<sup>35/</sup>

The Commission then determined that, for LNG, nothing of benefit remained for customers, and therefore the usual ratemaking for abandoned projects would apply. In a concurring opinion, Commissioner Grimes described the justification for the result as follows:

In the decision before us today, we find that the extraordinary conditions surrounding the LNG project justify a sharing of the risk between stockholders and ratepayers. The good news for stockholders is that the companies will be reimbursed, through rates and through the resale of salvageable items, for all expenses directly incurred in pursuing this project. But the decision does not allow the companies to recover the carrying costs of money borrowed to pursue the project, nor will they be allowed to earn a profit on investments in failed projects.

Although the companies argue that a LNG terminal might be needed some day, it is clear that a substantially new case would have to be made for the multi billion dollar project. New studies would be necessary to assess

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<sup>34/</sup> D. 84-09-089, 16 CPUC 2d 205, 230; 1984 Cal. PUC LEXIS 1013 at \*77 (emphasis added.)

<sup>35/</sup> D. 84-09-089, 16 CPUC 2d 205, 229; 1984 Cal. PUC LEXIS 1013 at \*74 (emphasis added.)

need and environmental impacts. This decision acknowledges that the original project proposal has lapsed and that the LNG Terminal Act is not applicable to future projects....

**It should be noted, in closing, that the approach being adopted splits the burden of the project expenses.** Ratepayers do pay for non-beneficial expenses and shareholders suffer the expense of unsuccessful investment. The equities are not precise, but the result is a clear recognition that while utilities are to be supported in their efforts to meet demand through uncertain times, they must always remain economically sensitive to the risks of failure.<sup>36/</sup>

Significantly, there is one abandonment case - -- PG&E's Montezuma coal project ---that is unusual in that the overall abandoned project resulted in a net gain.<sup>37/</sup> In that case, the Commission addressed whether PG&E would be allowed to recover AFUDC (i.e., a rate of return) on property that never became used and useful, as a reduction to the gain ratepayers were realizing on account of the sale. The Commission held:

We will allow PG&E its direct costs of approximately \$ 14.3 million. Also, we will allow PG&E carrying costs of \$ 4.3 million. That sum is equal to the AFUDC accumulated for the Montezuma project through December 31, 1981, by which date PG&E had received bids conforming to its instructions and had accepted Sunedco's bid. (D.82-12-121, Findings of Fact 17-19.) **We allow the carrying costs because ratepayers derived substantial benefits from the project, in the form of profits from the sale, even though the project never produced electricity. Thus, PG&E is entitled to its carrying costs through the date indicated.**<sup>38/</sup>

The Commission's decision involving the Montezuma project is relevant here because, like Montezuma, the AMI project results in "net benefits" for customers, even with the meters that were replaced by the project (and, hence, no longer used and useful) continuing to earn a return.

The Commission's decisions addressing premature power plant retirements also involved an analysis of burden sharing, not net benefits. For example, in the case of SDG&E's proposal to "store" power plants that could no longer be operated economically, the Commission

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<sup>36/</sup> D. 84-09-089, 16 CPUC 2d 205, 241; 1984 Cal. PUC LEXIS 1013 at \*104 to \*105 (emphasis added).

<sup>37/</sup> See D.83-12-068, as modified by D.84-05-100, 15 CPUC 2d 123, 1984 Cal. PUC LEXIS 1100.

<sup>38/</sup> D. 84-05-100, 15 CPUC 2d 123, 127; 1984 Cal. PUC LEXIS 1100 at \*10 (emphasis added).

determined that as to those plants likely to remain retired, there should be a sharing of the burden:

The specific ratemaking treatment for these plants will essentially follow the suggestion of UCAN. The UCAN position is that the undepreciated balance of the prematurely retired plants be amortized over five years with no return earned. The FEA recommended a longer period - nine years or three rate cases. We find that the UCAN has shown that the two rate case periods or about five years **provides an appropriate sharing of the burden** between the ratepayers and shareholders.<sup>39/</sup>

However, the Commission did provide an exception to the “used and useful principle” for one unit that might eventually benefit customers:

We will adopt the company's suggestion for South Bay 3. We find that it is the last to be stored, assume that it is, therefore, the most economical of the stored plants, and because of the uncertain reliability inherent in SDG&E's resource plan we will allow SDG&E to treat it as plant held for future use. Moreover, South Bay 3 is useful as a "yardstick" in bargaining for firm purchased power....

**We believe that both ratepayers and shareholders benefit by retaining the newer more efficient plants in rate base and excluding the older fossil fuel plants.**<sup>40/</sup>

The Commission similarly focused on who should bear the burden of unrecovered costs in the Humboldt and Geysers 15 Decisions, rejecting, in the case of Humboldt, PG&E's attempt to bring other power plants that may have operated for longer than intended into consideration:

With respect to PG&E's equity argument, we observe that plants which have exceeded their estimated useful lives have been fully depreciated. Thus, the shareholder already has recovered his entire investment and a fair return on that investment from the ratepayer. The ratepayer who has paid for the entire plant is entitled to receive any additional benefit from the plant's continued operation. In the case of a premature retirement, the ratepayer typically still pays for all of the plant's direct cost even though the plant did not operate as long as was expected. The shareholder recovers his investment but should not receive any return on the undepreciated plant. **This is a fair division of risks and benefits.**<sup>41/</sup>

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<sup>39/</sup> D. 85-12-108, 20 CPUC 115, 143; 1985 Cal. PUC LEXIS 1112 at \*57 to \*58 (emphasis added).

<sup>40/</sup> D. 85-12-108, 20 CPUC 115, 143; 1985 Cal. PUC LEXIS 1112 at \*56 to \*57 (emphasis added).

<sup>41/</sup> D. 85-08-046, 18 CPUC 2d 592, 599; 1985 Cal. PUC LEXIS 687 at \*22 (emphasis added).

In the case of Geysers 15, the Commission relied on this precedent in ruling that PG&E could not offset the shorter life of Unit 15 against other plants having a longer life, using rules of group accounting. The Commission did offer that PG&E could raise the group accounting argument later, if it could make a stronger showing.<sup>42/</sup>

The Commission decisions discussed above demonstrate that the Commission will share the burden of costs between ratepayers and shareholders when there is an abandonment or premature retirement caused by economic conditions. Here, however, the Commission has determined that the triggering event -- the implementation of the SmartMeter program and the replacement of the electromechanical meters -- results in a net ratepayer benefit, even assuming the cost of the retired meters remain in rate base. Because the Commission has determined that there is a “net benefit” from AMI implementation, there is no need, as indicated in the exceptions to rate base exclusion in abandonment and premature power plant retirement cases, for the Commission to address the allocation of net burdens using the “used and useful” principle.”

**3. All Of The “Used And Useful” Cases Cited By TURN Involve Individual Projects That Become Uneconomic Or Inoperable, Not Group Assets That Would Continue To Be Operable But For The Express Directives Of The Commission To Replace Them.**

In addition to the foregoing, the cases cited by TURN are distinguishable because they involved individual assets that became uneconomic or inoperable, not millions of individual electromechanical meters that would have continued to be used in providing utility service but for Commission-initiated policies. The considerations surrounding an individual asset (or project) that fails to perform are far different from those surrounding millions of individual assets that are replaced at the express direction of the Commission, and the ratemaking treatment afforded to each should similarly be distinguishable.

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<sup>42/</sup> D. 92-12-057, 47 CPUC 2d 143, 267: 1992 Cal. PUC LEXIS 971 at \*84.

Unlike a single asset that did not perform as envisioned and could no longer be economically operated, the millions of electromechanical meters performed exactly as intended and would have continued to operate but for the Commission’s policies. The Commission recognized this when it directed that, in order for the utilities to justify replacing the electromechanical meters, the new meters would have to be cost-justified on an incremental basis. Under such circumstances, the used and useful precedent applicable to retired power plants should be irrelevant.

**4. TURN’s Legal Analysis Of The “Used And Useful” Cases Fails To Acknowledge Public Utilities Code Section 455.5.**

TURN’s legal analysis also does not discuss Public Utilities Code Section 455.5, which was adopted in 1990 (after the Humboldt and SDG&E Decisions, as well as the Pacific Bell decision discussed below). This provision of the Code reinforces PG&E’s position that the “used and useful” principle should be more narrowly construed than envisioned by TURN. Section 455.5 requires the Commission to be notified of any “electric, gas, heat or water . . . .generation or production facility” that has been removed from service for more than nine months (i.e., that is no longer used and useful) and authorizes the Commission to eliminate the consideration “of the value” of such a facility from rates (i.e., by taking the unrecovered costs out of rate base).<sup>43/</sup> Had the Legislature wished to extend the Commission’s “used and useful” principle to distribution plant or groups of assets, the Legislature certainly had a vehicle in Section 455.5 to have done so. Instead, Section 455.5 is expressly limited to power plants.

**B. TURN Fails To Discuss Analogous Commission Precedent Addressing Groups of Assets that Are Prematurely Retired Because of Technological Change.**

Despite its extensive discussion of the used and useful principle for abandoned projects and prematurely retired power plants, TURN does not discuss the Commission decision that is

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<sup>43/</sup> Section 455.5 was specifically cited and deemed relevant by the Commission in reaching its finding in Decision 92-12-057 that Geysers 15 should no longer be included in rate base.

most on point: Decision 83-08-031 involving the early retirement of Pacific Bell's telephone assets. The question addressed in that case is whether investments in telephone equipment that was being replaced by more modern equipment should be removed from rate base. Under group accounting, the Commission recognized the utility would ordinarily fully recover its costs, notwithstanding the early retirements. However, Pacific Bell appeared to be encouraging the replacements via a "migration strategy," which led to the question of whether the Commission should allow the continued inclusion in rate base of the unrecovered costs (also called "stranded investment" in the decision).

The Commission described the migration and related rate base issue as follows:

The migration strategy involved coaxing Bell System equipment customers to replace installed equipment with newer, more modern, Bell System equipment. This was done through special marketing strategies and pricing structures. The displaced older equipment was not always fully depreciated or reusable at other locations. Under the group depreciation accounting method used by Pacific the undepreciated investment is left on the books as rate base even though the asset is retired. This comes about because under group depreciation retired equipment is considered fully depreciated regardless of its age at retirement.<sup>44/</sup>

The lead intervenor argued that rate base treatment should be disallowed for the stranded costs, to the extent cause by the migration strategy. In rebuttal, Pacific Bell argued that the retirements were being caused by technological change and economic factors and not by its marketing practices.<sup>45/</sup> After considering the evidence, the Commission concluded:

The record in this proceeding indicates that earlier than anticipated retirements are the largest cause of the decline in Pacific's book depreciation reserve as a per cent of plant. Growth fluctuations are a secondary cause. Whether we call this condition a reserve deficiency or a stranded investment does not matter. Whether the problem has been caused by the economic trends of the day, the migration strategy, or, most likely, some combination of the two, does make a difference. The difference lies in how costs are allocated between Pacific's shareholders and ratepayers. **That portion not resulting from the migration strategy should be paid by ratepayers.**<sup>46/</sup>

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<sup>44/</sup> D. 83-08-031, 12 CPUC 2d 150, 153; 1983 Cal. PUC LEXIS 1071 at \*6.

<sup>45/</sup> D. 83-08-031, 12 CPUC 2d 150, 165; 1983 Cal. PUC LEXIS 1071 at \*12 and at \*32 to \*33.

<sup>46/</sup> D. 83-08-031, 12 CPUC 2d 150, 167; 1983 Cal. PUC LEXIS 1071 at \*37 to \*38 (emphasis added.)

In the Pacific Bell decision, the Commission allowed full recovery of the utility's retired equipment, including their inclusion in rate base, except for those retirements caused by Pacific Bell's affirmative marketing practices designed to enhance sales of the Bell System. Contrary to TURN's arguments based on the distinguishable decisions, the Commission was not required to remove the retired equipment from rate base simply because they were no longer "used and useful." Rather, the Commission considered the specific facts and circumstances surrounding the retired assets and concluded that continued inclusion in rate base was appropriate.

The Pacific Bell decision supports the position proposed by PG&E in the AMI proceedings, adopted by the Commission in those decisions, and reflected in PG&E's rate base proposal in this GRC: that is, the retired equipment should continue to be included in rate base notwithstanding their premature retirement from service. The meters in question operated as intended and could have continued in operation. Their retirement was not caused by PG&E's marketing practices but as a result of PG&E filing an Application -- required by the Commission -- to present an incremental business case analysis concerning AMI. Under such a situation it is entirely appropriate that the meters, like the equipment that was retired early in the Pacific Bell decision, continue to be recovered over time and included in rate base -- exactly as proposed by PG&E and adopted by the Commission in the AMI Proceedings.

**C. TURN Fails To Address Why The Utilities Should Receive No Return For Nearly Twenty Years.**

In addition to the legal deficiencies described above, TURN fails to recognize that, while the utilities could have proposed alternative ratemaking treatment for the retired meters to avoid stranded costs, the utilities explicitly chose not to do so in the AMI Proceedings. As explained in SCE's Opening Brief, "under group accounting utilities could have proposed to significantly reduce the recovery period to match the shortened lives," which would have "recovered the investment so that the assets would be fully depreciated by the end of the deployment of the AMI



meters.”<sup>47/</sup> However, “SCE (like PG&E) has not proposed this because of the impact it would have on rates. Instead, SCE (like PG&E) has proposed to recover the remaining capital costs of the retired electromechanical meters in rate base over what would have been their remaining book lives had they not been replaced.”<sup>48/</sup> In other words, while the utilities in the power plant cases received expedited cost recovery for their inoperable or uneconomic assets, PG&E and the other IOUs chose not to request such expedited recovery for their retired meters in the AMI Proceedings to avoid the accompanying rate spike on customers.

The Pacific Bell case is instructive on this point as well. In addition to requesting continued inclusion of stranded costs in rate base, Pacific Bell also proposed to collect the costs of assets that were being displaced by technological innovation more rapidly by changing the way remaining depreciation lives are treated, in that case by changing from the “straight line remaining life method” to a more rapid “equal life group (ELG) method.” The Commission rejected Pacific Bell’s request and stated:

We are persuaded by the staff’s showing that, in the long run, ELG is more costly to the ratepayers with no corresponding benefit to Pacific. **Our present straight line remaining life method recovers all of Pacific’s investment (even, eventually, any stranded investment) and Pacific, in the meantime, receives a return on its undepreciated investment (rate base) so that, in the long run, Pacific loses nothing.**<sup>49/</sup>

PG&E (and the other utilities) have in effect proposed a form of the Commission’s preferred outcome in Pacific Bell decision. By deferring recovery, but continuing to include the unrecovered costs in rate base, PG&E (and the other utilities) cost ratepayers less in the short run and are made whole over time. The alternative -- to have accelerated recovery over the shortened life of the electromechanical meters -- would have clearly cost ratepayers more in the

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<sup>47/</sup> SCE Opening Brief, p. 2.

<sup>48/</sup> SCE Opening Brief, pp. 2-3.

<sup>49/</sup> D. 83-08-031, 12 CPUC 2d 150, 168; 1983 Cal. PUC LEXIS 1071 at \*42 (emphasis added.)

near term, and would have altered the incremental cost-benefit analysis used to justify the project from a ratepayer perspective.

TURN, however, disregards the Commission's analysis in the AMI Proceedings and seems to want to have it both ways: extended rate recovery and no inclusion in rate base. TURN's brief never explains why it would be reasonable for these unrecovered costs (stranded on account of Commission policies and technological change) to be collected over eighteen years without a return, when abandoned projects and uneconomical power plants prematurely retired are recovered over four or five years. Stated otherwise, TURN never answers why any reasonable ratemaking proposal would have the shareholders be treated *worse* in this situation than for abandoned projects or prematurely retired power plants. The Commission, therefore, should find the TURN proposal, which includes making no adjustment to the 18-year recovery period while denying utilities a rate of return, is unreasonable.

**V. TURN'S INTERPRETATION OF THE AMI PROCEEDINGS AND DECISIONS IS INACCURATE AND UNSUPPORTED BY THE EVIDENCE.**

In its Opening Brief, PG&E explained in detail how TURN's position is an impermissible collateral attack on the Commission's prior AMI decisions, as well as inconsistent with the careful balancing of costs and benefits reflected in those decisions.<sup>50/</sup> TURN takes the entirely opposite viewpoint, arguing that PG&E's argument is inconsistent with the AMI Upgrade Decision, PG&E's GRC testimony, and internal documents from late 2009.<sup>51/</sup> As described below, TURN's arguments are inaccurate and unsupported by the evidence.

**A. TURN Fails To Explain Why The Commission Should Reverse Its AMI Decisions Adopting PG&E's Ratemaking Treatment For The Retired Meters.**

TURN argues that PG&E's interpretation of the AMI decisions is "not supported" because the "cost recovery section of D.09-03-026 begins with a description of PG&E's 'general

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<sup>50/</sup> PG&E Opening Brief, pp. 6-15.

<sup>51/</sup> TURN Opening Brief, pp. 11-17.

proposal” but does not explicitly describe the treatment of the retired meters.<sup>52/</sup> TURN argues that, “when Ordering Paragraph 2 of that decision adopts ‘PG&E’s general cost recovery proposal,’ it can only be reasonably read to refer to the general cost recovery proposal” and that “the decision’s silence on any and all issues regarding cost recovery associated with the existing meters to be replaced” means that “the Commission did not intend for the decision to address any element of that cost recovery.”<sup>53/</sup>

PG&E disagrees. Ordering Paragraph 2 of the AMI Upgrade Decision has no limiting language; it simply states that “PG&E’s general cost recovery proposal is adopted.” It is well established that Ordering Paragraphs take precedence over discussions in the body of a decision. Furthermore, it is reasonable to assume that, had the Commission intended to adopt only the elements discussed in the decision rather than the totality of the ratemaking proposal, it could have done so in that Ordering Paragraph or included a separate Ordering Paragraph stating that: “Issues related to cost recovery of existing meters shall be considered in a separate proceeding.” The Commission did not do so. To the contrary, elsewhere in the AMI Upgrade Decision, the Commission more broadly states the elements of PG&E’s cost recovery proposal: “PG&E’s cost recovery proposal seeks to recover the **entire** costs of the SmartMeter Program Upgrade from Customers.”<sup>54/</sup> Thus, the Commission was not silent about PG&E’s intent to have broad-based recovery of its costs.

**B. TURN Fails To Explain Why The Commission Should Ignore The Careful Weighing Of Costs And Benefits Reflected In The AMI Decisions.**

As described in PG&E’s Opening Brief, a substantial portion of the Upgrade Decision addresses an incremental analysis weighing project benefits against project costs.<sup>55/</sup> The purpose of the incremental cost-benefit analysis was to see if the program could be “cost justified” by

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<sup>52/</sup> TURN Opening Brief, p. 13.

<sup>53/</sup> TURN Opening Brief, p. 13.

<sup>54/</sup> D.09-03-026, *mimeo*, p167 (emphasis added.)

<sup>55/</sup> D.09-03-026, *mimeo*, p. 26, cited in PG&E Opening Brief, pp. 11-12.

weighing the incremental benefits and incremental costs (*i.e.*, those costs and benefits that *change* as a result of the AMI program) to customers on a present value revenue requirement (PVRR) basis.<sup>56/</sup> The principal *incremental* economic costs were the capital costs of installing the new meters and associated software,<sup>57/</sup> while the principal *incremental* benefits were operational costs related to the automated rather than manual nature of the meters and billing.<sup>58/</sup>

If any party or the Commission had envisioned that rate base was to be *reduced* when the electromechanical meters were removed from service, then the Commission would have identified an additional incremental benefit in the form of rate base reduction. However, neither the Commission nor any party identified the elimination of the retired meters from rate base as a possible benefit.<sup>59/</sup> Therefore, such an outcome was clearly never considered.

TURN's interpretation of the AMI Upgrade Decision is not only unsupported by the history of that proceeding, it is also illogical. TURN's interpretation presumes that PG&E would be seeking full recovery of its "entire" costs, but be willing to assume the burden of financing \$340 million of stranded costs for nearly 20 years. Given the significant litigation over the costs and benefits of the AMI project, it defies logic to suggest that PG&E intended to assume the loss of the carrying costs of the electromechanical meters but did not identify such loss as part of the cost/benefit analysis in the AMI Proceedings.

The Commission should also reject TURN's argument that the Commission could not have considered this cost recovery because it would not be an incremental cost. TURN claims:

If the decision's discussion of PG&E's cost recovery proposal refers only to the proposal's treatment of "incremental" costs, and in PG&E's view the remaining investment in removed meters and any return on that investment is not an "incremental" cost, it is hard to understand how even

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<sup>56/</sup> D.09-03-026, *mimeo*, p. 26.

<sup>57/</sup> 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.

<sup>58/</sup> 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.

<sup>59/</sup> D.09-03-026, *mimeo*, pp. 26-29.

PG&E could contend that the discussion in D.09-03-026 addresses ratemaking treatment for the remaining investment in removed meters.<sup>60/</sup>

TURN's argument misstates PG&E's position. The analysis of incremental costs (and benefits) was intended to focus on the impact to customers from implementing AMI. Had PG&E treated the retired meters differently than an ordinary retirement (*e.g.*, by accelerating recovery or agreeing to remove the replaced plant from rate base) there would have been an incremental cost (or benefit) on a PVRR basis from implementing the AMI program. Again, the fact that no incremental benefit or cost was identified means acceptance of status quo ratemaking for the retired meters, consistent with the Commission's directive that the treatment of the retired meters be addressed.

As a fallback argument, TURN claims that PG&E's testimony in the AMI Proceedings addressed only amortization of costs, not their inclusion in rate base.

But even if the Commission were to agree that D.09-03-026 addresses by implication issues regarding the cost recovery associated with existing meters, it would only have addressed the issues directly raised in the parties' testimony in that proceeding. As quoted in PG&E's rebuttal testimony in this GRC, the utility's SmartMeter testimony only made reference to the recovery of the existing investment in the existing meters, WITHOUT any explicit reference to whether that existing investment should earn the utility's authorized return during the recovery period.<sup>61/</sup>

Once again, TURN has either misread the utility testimony or misunderstood the basic utility accounting principle that rate base is determined as the difference between plant and the depreciation reserve. In the AMI Proceeding, PG&E specifically stated that the retirements would be treated with equal and offsetting charges to both the plant account and the depreciation reserve, with no change in net plant.<sup>62/</sup> PG&E also stated that it would recover all costs consistent over the life of the depreciation group.

Even if PG&E had not been explicit (which it was), it is illogical to infer, as TURN suggests, that PG&E would have proposed such an extended recovery period with no return. If

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<sup>60/</sup> TURN Opening Brief, pp. 13-14.

<sup>61/</sup> TURN Opening Brief, p. 14 (emphasis in original).

<sup>62/</sup> See PG&E Opening Brief, p. 8, n. 19, *quoting* testimony from PG&E's AMI Upgrade application.

there had been any doubts that PG&E intended to be made fully whole for these costs, they should have been eliminated based on the overall context of the decision, including the Commission’s analysis of rate impacts (PVRR), the intent of PG&E to be made whole for implementing the project provided it performed within budget and the treatment of the special tax benefits from early retirement.

**C. TURN Fails To Explain Why It Did Not Raise The Used And Useful Argument In PG&E’s AMI Proceedings, When TURN Was Clearly Aware Of The Issue.**

In interpreting the AMI Upgrade Decision, TURN argues that, “if the Commission had intended to excuse PG&E from the ‘used and useful’ rule with regard to the investment in existing meters, it would have at least mentioned that element of its decision.”<sup>63/</sup> As discussed above, however, TURN’s interpretation of the “used and useful” principle is overly expansive and misguided. Moreover, the Commission had no reason to address an argument that was not raised by any party in PG&E’s AMI Proceeding, including TURN.

TURN in particular has no grounds for complaint on this point, given the fact that it was making the same “used and useful” argument elsewhere prior to the AMI Upgrade hearings and decision. In April 2008, TURN argued in SCE’s Initial AMI Proceeding (A.07-07-026): “Indeed, the Commission, in its zeal to authorize any utility AMI project, ignored its own long-standing policy on funding utility capital projects, which requires both a ‘used and useful’ finding as well as a reasonableness review, when it authorized Edison’s earlier AMI pre-deployment funding request.”<sup>64/</sup> Less than a month later, in SCE’s 2009 GRC (A.07-11-011), TURN Witness Finkelstein submitted prepared testimony that “TURN...expects to recommend that the Commission remove from rate base all of the plant that Edison acknowledges is no

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<sup>63/</sup> TURN Opening Brief, p. 14.

<sup>64/</sup> Opening Brief of The Utility Reform Network Concerning Southern California Edison Company’s Application for Approval of Advanced Metering Infrastructure Deployment Activities and Cost Recovery Mechanism, filed April 4, 2008, in A.07-07-026.

longer 'used and useful' in the provision of electric service to Edison customers...[including] meters that Edison replaced in the course of its Advanced Meter Infrastructure program...<sup>65/</sup>

TURN subsequently cross-examined SCE's 2009 GRC witness on whether the retired meters would be "used and useful":

MR. FINKELSTEIN: Q As I understand your testimony, Edison expects to have all of the existing meters replaced by the end of 2012; is that correct?

A Yes. I wouldn't necessarily say all of them, but nearly all of them will be replaced by 2012.

Q And your proposed amortization period would collect the remaining net investment in those replaced meters through 2026; is that correct?

A In addition to the cost incurred to retire those units, yes.

Q Well, would the remaining net investment in those replaced meters be included in rate base?

A Yes.

Q So would Edison be continuing to collect a rate of return on the net investment in the replaced meters?

A Yes, we would...

Q Is it your understanding that -- are you familiar at all with the term **used and useful** in providing utility service?

A I am.

Q And is it your understanding that a plant needs to be **used and useful** in providing utility service in order to be in rate base?

A That's typically one of the conditions, yes.

Q So how would the meters that have been removed and replaced be **used and useful** in providing utility service after their removal?

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<sup>65/</sup> Prepared Testimony of Robert Finkelstein, submitted April 29, 2008, in A.07-11-011, I.08-01-026.

A Well, it wouldn't be used and useful. But typically, the shareholders are allowed to recover their cost in investment in capital. This was in lieu of -- this proposal was in lieu of proposing an -- the proper way of depreciating this would be to shorten the remaining life over the period there we were going to replace it. So we felt that in lieu of doing that which would exacerbate costs during that period was to propose an amortization over the remaining life. In doing so, yes, it would create some rate base impacts over the remaining life.<sup>66/</sup>

Despite the briefing, testimony, and cross-examination quoted above, TURN did not raise the “used and useful” argument either in its briefing in SCE’s 2009 GRC or in opposition to the ratemaking treatment proposed by the utilities in their respective AMI Proceedings.<sup>67/</sup> Indeed, as previously noted, PG&E’s ratemaking proposal in the AMI Proceedings was unopposed. TURN raised the “used and useful” argument in both SCE’s 2009 GRC and AMI Proceedings, but for some reason decided not to include the argument in any of its briefs. Having remained silent, TURN cannot now claim that the Commission erred in its AMI Decisions by failing to reject an argument that TURN refused to brief.

**D. TURN Errs In Suggesting That The Commission’s AMI Decisions Should Be Corrected For “A Mistake Of Omission.”**

TURN argues that, even if the Commission agrees with PG&E, it should take this opportunity to “correct what clearly is a mistake of omission.”<sup>68/</sup> The Commission, however, should find there is no need for such a “correction” because there was no “mistake.” As shown above, TURN was well aware of the “used and useful” principle at the time of the AMI Proceedings and chose not to pursue it in PG&E’s AMI Proceedings or, for that matter, in SCE’s AMI or GRC proceedings.

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<sup>66/</sup> Tr. Vol. 16, 1769-1770, in A.07-11-011, emphasis added. *See also id.*, 1771-1775 (ALJ DeAngelis seeking further clarification on this issue). While the transcript from SCE’s 2009 GRC is not in the record of this 2011 GRC, to the extent that the Commission deems it helpful, the Commission may take official notice of it.

<sup>67/</sup> Notably, TURN did raise the “used and useful” issue in SCE’s 2009 GRC opposing Operations and Maintenance costs for the San Gorgonio Project. *See* Opening Brief of The Utility Reform Network in Southern California Edison Company’s Test Year 2009 General Rate Case, filed July 28, 2008 in A.07-11-011.

<sup>68/</sup> TURN Opening Brief, p. 15.



Moreover, as explained in this Reply Brief, the “used and useful” principle invoked by TURN has been selectively applied and has no evident application to groups of assets that are otherwise used and useful, but replaced to implement Commission policies or on account of technological change. This point was made clear in the Pacific Bell decision (discussed earlier), which concluded (without dispute) that when technological change is the cause of an early retirement of groups of assets, similar to meters, the utility is entitled to recover its costs, including a return. The Commission is not obligated to explain why it has accepted deferred recovery of costs (which virtually all ratepayer advocates routinely encourage), rather than imposing more costs on current customers.

**VI. TURN’S AND DRA’S REMAINING ARGUMENTS ARE WITHOUT MERIT AND SHOULD BE REJECTED.**

In addition to the foregoing arguments, TURN and DRA raise additional arguments in opposition to PG&E’s continued inclusion of the retired meters in rate base.

First, TURN claims, in effect, that the rules of group accounting do not apply, because this situation involves an extraordinary retirement of one type of meter and their replacement with another, not one involving an ordinary retirement.<sup>69/</sup> TURN misstates PG&E’s argument. In the AMI Proceedings, PG&E proposed a specific ratemaking treatment for these retirements, consistent with rules of group accounting. While PG&E knew that its retirements were not ordinary, it explicitly provided in its AMI testimony for group accounting-type rules (status quo ratemaking) to be applied. As noted above, PG&E’s ratemaking proposal in the AMI Proceedings (which is being implemented in this GRC) explicitly provided for equal and offsetting reductions to both plant and the depreciation reserve (so there is no change to “net plant,” i.e., rate base), along with a deferred rate recovery period.

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<sup>69/</sup> TURN Opening Brief, pp. 10-11.

Second, TURN claims that its position regarding PG&E's retired meters is supported by accounting documents showing that PG&E changed its judgment sometime in 2009 regarding possible write-offs of obsolete metering equipment.<sup>70/</sup> TURN specifically argues:

The clear implication of PG&E's internal document is that the utility had previously determined that at least some portion of the costs associated with "obsolete metering equipment" had previously been deemed NOT recoverable from customers and WOULD be written off. The utility's claim that the SmartMeter decision issued in 2006 resolved the disputed issue in its favor lacks credibility when PG&E's own internal accounting practices were contrary to that claim until some point in 2009.<sup>71/</sup>

TURN has mischaracterized the selection from PG&E's 2009 "Financial and Business Highlights." The reference to "obsolete metering equipment" pertains to first-generation AMI equipment installed in Kern County, which had been approved in the Initial AMI Decision but became obsolete based on PG&E's then-pending proposal to adopt new solid state metering systems. PG&E established a reserve for the Kern County meter costs pending a decision in the AMI Upgrade Proceeding on the ratemaking treatment for the stranded costs. When the AMI Upgrade Decision (issued in late 2009) resolved the ratemaking treatment of the Kern County meters, PG&E reversed the reserve because the amounts "have been deemed recoverable from customers."<sup>72/</sup>

TURN's argument about the "clear implication" of PG&E's 2009 "Financial and Business Highlights" is illogical. Given that PG&E's general ratemaking proposal was identical between the Initial AMI Proceeding (which was decided in 2006) and the AMI Upgrade Proceeding (which was decided in 2009), it makes no sense that PG&E would reverse a reserve in 2009. In addition, the dollar amounts referenced in TURN's exhibit (\$8 million monthly variance and \$30 million year-to-date variance) are grossly disproportionate to the dollars at

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<sup>70/</sup> TURN Opening Brief, pp. 16-17.

<sup>71/</sup> TURN Opening Brief, p. 17, citing Exh. TURN-20, p. 12 (emphasis in original).

<sup>72/</sup> Exh. TURN-20, p. 12.

issue in the AMI Upgrade Decision, which involved hundreds of millions of dollars in AMI meter costs.

Third, TURN takes issues with the statement in PG&E's testimony that collecting costs over 18 years was consistent with the treatment received by SCE in its GRC.<sup>73/</sup> TURN complains that there was no proof for PG&E's assertion and that, therefore, the SCE GRC provides no support for PG&E's proposal.

TURN was unable to find anything in the decision specifically addressing or approving such cost recovery treatment for retired electric meters. The only relevant Finding of Fact states, in part, "SCE has not shown that SmartConnect ... will occur in TY 2009." Thus PG&E's claim that the SCE GRC decision supports adoption of its proposal lacks sufficient support.<sup>74/</sup>

Contrary to TURN's suggestion, PG&E's is not seeking to rely on the SCE GRC as a basis for its ratemaking treatment. As argued throughout its Opening Brief, PG&E is relying on its proposals made and adopted in the PG&E AMI Decisions.

With regard to the reference to SCE's GRC, TURN should be aware of that record since, as quoted above, it cross examined SCE's witness on the ratemaking treatment embedded in its revenue requirements and was aware that meters were being retired during that GRC cycle. Moreover, SCE's brief in this 2011 GRC supports PG&E's interpretation of the SCE ratemaking process:

Like the other utilities, at the Commission's direction SCE filed an application for approval of its AMI deployment (A.07-07-026), which was resolved by D.08-09-039. The business case SCE submitted as part of that application analyzed the costs and benefits of the AMI investment on an incremental basis, assuming status quo ratemaking treatment of the retired electromechanical meters. TURN raised no objection to this assumption, and settled all disputed aspects of SCE's application except for the demand response benefits of the investment. **SCE followed this same approach in its 2009 GRC. No party contested it there and SCE's pending 2012 GRC also follows it.**<sup>75/</sup>

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<sup>73/</sup> TURN Opening Brief, p. 17.

<sup>74/</sup> TURN Opening Brief, p. 17.

<sup>75/</sup> SCE Opening Brief, p. 3 (emphasis added).

Accordingly, to the extent PG&E has made references to the treatment of SCE, TURN's objections to those references should be disregarded.

Fourth, TURN declares that removing the plant from rate base "will have no impact on [PG&E's] ability to provide safe and reliable utility service during the period covered by this general rate case."<sup>76/</sup> While PG&E agrees there would be no negative impact during this GRC cycle, PG&E believes that the Commission's adoption of TURN's position could well undermine investor confidence in the fairness of Commission regulation. In the long-run, the Commission's adoption of TURN's recommended reversal of the Commission's AMI Decisions may well have a chilling effect on investor confidence, thereby affecting PG&E's ability to provide safe and reliable utility service.

Finally, the Settlement filed in this proceeding leaves a single remaining issue to be litigated: whether the cost of the unrecovered meters, that are being amortized over 18 years, should be included in rate base. DRA's open-ended suggestion to consider alternatives in this GRC is inconsistent with this limited scope of review and should be rejected.

The only "alternative" that has been actually been proposed in this proceeding is securitization, for which there is only a limited record, with sufficient uncertainty regarding implementation that the Commission would be ill-advised to consider it as a substitute for rate base treatment in this GRC. Securitization involves replacing utility financing with ratepayer financing using a dedicated rate component. TURN's testimony claims this would produce ratepayer savings by achieving lower cost financing than rate base recovery, and that financing could be implemented using techniques similar to the financing used on the Ratepayer Reduction Bonds under AB 1890 and PG&E's bankruptcy. TURN acknowledges, however, that securitization may well require legislation (as was the case for those prior examples).<sup>77/</sup>

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<sup>76/</sup> TURN Opening Brief, p. 1.

<sup>77/</sup> Exh. TURN-10, p. 10, lines 8-14.

In rebuttal, PG&E's testimony addressed whether securitization might be possible, stating:

It may be. However, it raises a number of significant issues and is outside the scope of this proceeding. TURN is correct that new state legislation would be required to enable such a securitization, and PG&E does not know whether such legislation could be passed.<sup>78/</sup>

PG&E continues to believe such proposal would require legislation, the prospects of which would be uncertain. As PG&E's witness on financing matters testified, before such a proposal could be pursued, a number of significant issues also would need to be resolved.<sup>79/</sup> Because of the limited record, the uncertainties regarding implementation and other unresolved issues, the Commission should not consider securitization to be a viable alternative to rate base inclusion in this GRC.

## VII. CONCLUSION

TURN was an active participant in the AMI Proceedings. It raised the "used and useful" argument regarding the retired meters, first generally in SCE's AMI Proceeding and then specifically in SCE's 2009 GRC, but chose not to include the argument in its briefs in either case. TURN could have challenged PG&E's ratemaking proposal in the AMI Proceedings, but it chose not to do so. TURN could have raised the reduction to rate base as an added benefit to customers in the Commission's lengthy consideration of the costs and benefits of the AMI program. Again, it did not choose to do so. Instead, TURN waited until after the Program was mostly complete to raise this argument against PG&E for the first time in this GRC.

TURN's reliance on prior Commission decisions interpreting the "used and useful" principle is also without merit. The cases cited by TURN are distinguishable and do not support TURN's position. TURN overlooks the most relevant case, the Pacific Bell decision, which validates PG&E's position.

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<sup>78/</sup> Exh. PG&E-18, v2, p. 11A-21.

<sup>79/</sup> Id.

In sum, TURN's proposal to remove PG&E's electromechanical meters from rate base amounts to a fundamental, after-the-fact change to the ratemaking treatment adopted 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,

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PACIFIC GAS AND ELECTRIC COMPANY

Dated: November 15, 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 **November 15, 2010**, I served a true copy of:

**REPLY 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 **November 15, 2010**.

\_\_\_\_\_  
*/s/*  
*Rene Anita Thomas*

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