NAME: Application of PACIFIC GAS AND ELECTRIC COMPANY to Modify Diablo Canyon Pricing and Adopt a Customer Electric Rate Freeze in Compliance with D.95-12-063

NUMBER: Decision No. 97-05-088, Application No. 96-03-054 (Filed March 29, 1996)

AGENCY: California Public Utilities Commission

CITE: 1997 Cal. PUC LEXIS 453; 178 P.U.R.4th 1

DATE: May 21, 1997

PANEL: [*1] P. Gregory Conlon, President, Henry M. Duque, Josiah L. Neeper, Richard A. Bilas, Jessie J. Knight, Jr., Commissioners

COUNSEL: (See Appendix A for appearances.)

OPINION

Summary

This decision determines the Diablo Canyon Nuclear Power Plant (Diablo Canyon) sunk costs and the incremental cost incentive price (ICIP) of Diablo Canyon power, as well as ancillary matters pertaining to the operational of Diablo Canyon.

The decision finds:

The Diablo Canyon sunk costs as of December 31, 1996 are $3,286,706,000.

The ICIP prices are:

1997	3.26 cents/kWh
1998	3.31 cents/kWh
1999	3.37 cents/kWh
2000	3.43 cents/kWh
2001	3.49 cents/kWh

Approximately $65,000,000 was disallowed from sunk costs because of construction errors.

Nuclear fuel inventory and materials and supplies have been excluded from sunk costs.

The Office of Ratepayer Advocates' 10% rate reduction request (over and above the 10% rate reduction ordered by AB 1890) is denied.

The Utility Reform Network's $2 billion depreciation adjustment is denied.

The Diablo Canyon capacity factor is 83.6% for the 5-year transition period.

The escalation factor used in computing the ICIP is 1.5%, with minor exceptions.

The Diablo [*2] Canyon Independent Safety Committee is continued in existence indefinitely.

The request of the County of San Luis Obispo for property tax relief is denied.

The Diablo Canyon estimated total revenue requirement is:

	(Million of Dollars)
1997	1,900
1998	1,845
1999	1,791
2000	1,739
2001	1,687

A financial verification audit of Diablo Canyon plant accounts is ordered.

I. Background

Ordering Paragraph 23 of Decision (D.) 95-12-063 as modified by D.96-01-009 (Policy Decision) required Pacific Gas and Electric Company (PG&E) to file an application proposing ratemaking treatment for the Diablo Canyon that would price the plant's output at market rates by the end of 2003 and would provide the opportunity to recover all of Diablo Canyon's competition transition costs (transition costs or CTCs) no later than the end of 2005 (later reduced by the Legislature to December 31, 2001). In addition, Ordering Paragraph 23 required that PG&E's proposal include at least one alternative comparable to the ratemaking adopted for the San Onofre Nuclear Generating Station, Units 2 & 3 (SONGS 2 & 3), owned by Southern California Edison Company (Edison) and San Diego Gas & Electric Company [*3] (SDG&E). This application was filed in compliance. PG&E asserts that its proposal would modify the pricing of power from Diablo Canyon to reduce the plant's costs, in its estimation, by over $3.6 billion (net present value).

The primary elements of PG&E's proposal for Diablo Canyon ratemaking are:

a. The current Diablo Canyon fixed price would be replaced by a sunk cost revenue requirement consisting of PG&E's remaining sunk costs in Diablo Canyon as of January 1, 1997, depreciated over no longer than a five-year period. These net sunk costs are estimated to be approximately $3.6 billion as of December 31, 1996. This revenue requirement for sunk costs would eliminate the need for the floor payments provision in the original Diablo Canyon settlement agreement, and therefore PG&E's right to such floor payments in the event of prolonged or permanent plant outages would be deleted. In addition, the basic revenue requirement in the original settlement agreement would be eliminated.

b. PG&E would earn a reduced return on the Diablo Canyon sunk costs, consistent with the calculation of the reduced return adopted in D.96-01-011 and D.96-04-059 adopting the SONGS settlement. Based [*4] on PG&E's current embedded cost of debt and capital structure, this reduced return would be approximately 7.17%.

c. At PG&E's option, PG&E could depreciate the remaining Diablo Canyon sunk costs over fewer years.

d. The current Diablo Canyon escalating price would be replaced by a Diablo Canyon ICIP calculated similarly to the ICIP in the SONGS settlement. The Diablo Canyon ICIP would provide for performance-based recovery of Diablo Canyon's variable costs and future capital additions. The Diablo Canyon ICIP would be based on 1993-1995 recorded variable costs and projected incremental capital costs. The Diablo Canyon ICIP would be based on an average capacity factor of 80%.

e. Certain fixed or safety-related Diablo Canyon costs would continue to be recovered in base rates without reference to Diablo Canyon's performance. These include decommissioning costs, Diablo Canyon Independent Safety Committee expenses, certain permanent closure-related expenses, and certain other expenses. At PG&E's option, recovery of estimated decommissioning costs could be accelerated over the same depreciation period as Diablo Canyon sunk costs.

f. In all other respects, current Diablo Canyon performance-based [*5] ratemaking would continue unchanged until the plant is priced to market in 2001. For example, Diablo Canyon's operation and revenue requirement would continue to be exempt from all CPUC reasonableness reviews, and PG&E's ratepayers and transmission grid would continue to be obligated to take all Diablo Canyon output until the end of 2001, consistent with the existing settlement and the Policy Decision. Diablo Canyon costs would continue to be segregated from other PG&E operations, as required by the original settlement. Finally, the Diablo Canyon settlement as modified by this application would remain PG&E's exclusive method of recovering the costs of Diablo Canyon until the end of 2001.

g. The 2016 termination date in the Diablo Canyon settlement agreement, as specified in D.88-12-083, would be changed to December 31, 2001, and related abandonment payment provisions in the original Diablo Canyon settlement would be replaced with closure cost recovery provisions consistent with the SONGS settlement. As with SONGS 2 & 3, if Diablo Canyon is shut down during its sunk cost recovery period, PG&E's continued recovery of the sunk cost revenue requirement would be subject to CPUC evaluation [*6] under Public Utilities (PU) Code § 455.5. After the sunk cost recovery period, Diablo Canyon would have no restrictions on its operation or on which markets it could sell into, but any subsequent profits would be subject to the same ratepayer/shareholder sharing mechanism adopted by the Commission in its SONGS settlement decision.

The Office of Ratepayer Advocates (ORA, formerly the Division of Ratepayer Advocates (DRA)) opposes much of PG&E's proposal. ORA asserts that residential and small commercial customers should receive a 10% rate reduction beyond any statutory rate reduction; that PG&E's sunk cost estimates are too high; that PG&E's ICIP is too high; and that the County of San Luis Obispo's property tax proposal should be rejected. The Utility Reform Network (TURN, formerly Toward Utility Rate Normalization) opposes much of PG&E's proposal for reasons similar to ORA's. TURN proposes a $2 billion adjustment to PG&E's sunk costs. The County of San Luis Obispo seeks an order requiring PG&E to pay the county $158 million over five years to compensate the county for estimated revenue lost due to accelerated recovery of Diablo Canyon capital costs. The California Industrial [*7] Users, California Farm Bureau Federation, California Large Energy Consumers Association and California Manufacturers Association, and the San Luis Obispo Mothers for Peace all filed briefs on one or more issues.

To understand the issues in this application it is necessary to review the history of Diablo Canyon, and the current Commission decisions and the statutes impacting the modification of Diablo Canyon pricing.

A. History

In 1988, the Commission adopted a settlement of assertions by ORA's predecessor DRA, the Attorney General, and other parties that $4.4 billion of the $5.5 billion cost of constructing Diablo Canyon was imprudently incurred and should be excluded from rate base. The settlement instituted a performance-based pricing mechanism which assigned to PG&E the risk of recovering its costs and return on its investment, and precluded PG&E's recovery of $2.3 billion which it had accrued in the Diablo Canyon Adjustment Account (DCAA). In sum, the settlement was estimated to impose the equivalent of a $2 billion rate base disallowance over the 28-year term of the payment arrangement. (Re PG&E (Diablo Canyon Rate Case) (1988) 30 CPUC2d 189 (D.88-12-083).)

In [*8] 1994, ORA's predecessor DRA petitioned to reopen the 1988 settlement on the basis that, if the settlement pricing arrangement was allowed to continue, PG&E would recover more than 100% of what would be required under traditional ratemaking in the absence of any disallowance. In settlement of that petition, PG&E, ORA's predecessor DRA, and a diverse group of electric consumers renegotiated the 1988 Diablo Canyon settlement prices downward. The 1995 settlement provides for prices that now decline from 10.5 cents/kWh to 9 cents/kWh over the next three years. (D.95-05-043.) Despite this negotiated decrease, Diablo Canyon prices are still higher than the market price for electricity.

B. Commission Decisions

In D.95-12-063, our Policy Decision, the Commission ordered PG&E to file an application with a proposal for ratemaking treatment for the Diablo Canyon nuclear facility that would price its output at market rates by 2003 and completely recover its transition costs by 2005. In this comprehensive decision, the Commission analyzed in detail the nature of transition costs and their method of recoupment. We recognized the primary importance of market valuation to determine transition [*9] costs. The impact of the Policy Decision on Diablo Canyon pricing cannot be overemphasized. Its principles underlay every aspect of this decision and, therefore, we quote extensively.

"The definition of transition costs begins with a recognition that the competitive market will classify utility generation assets as either economic or uneconomic, in whole or in part (such as at particular times of the day or year). In simple terms, a utility asset is uneconomic if its net book value n1 exceeds its market value, and an asset is economic if its market value exceeds its net book value. For a particular utility, its transition costs are the net above-market costs associated with its assets, both economic and uneconomic.

"Transition costs will be quantified at two points. First, we will require the net book value of all utility generation plants to be measured against the market, a process we refer to as market valuation, within five years. Second, plants that continue to operate temporarily within the regulated framework may incur ongoing transition costs by selling their generation for a market price that is less than the cost of producing that power (including return of and return [*10] on investment).

"Transition costs arise from several sources:

"Generation Assets: A particular generation plant's primary contribution to transition costs will be determined when the plant undergoes market valuation. In addition to investment-related costs (the costs of construction and capital improvements and a return on the undepreciated costs), generation-related costs include unavoidable commitments directly related to generation, including nonplant physical assets and contracts for plant parts or services and for fuel or fuel transport. Generation plants may also reveal transition costs in their ongoing operations. Transition costs arise when a plant is unsuccessful in its bid to supply power through the Power Exchange, n2 because if it is unable to sell its power, it has no opportunity to recover its fixed investment costs. Even if a plant is successful in selling its generation, transition costs will also accrue if the market price is too low to allow recovery of the plant's fixed costs. We will allow in transition cost 100% of the asset's net book value and any fixed obligation directly related to the asset.

"Nuclear Power Plant Settlements: The Diablo Canyon settlement [*11] obligates ratepayers to pay a specified cents/kWh price for all energy produced by this plant. To honor this settlement, electricity from this plant will be taken by the grid whenever the energy is produced. To the extent settlement prices are above the prices in the market, as revealed by the Power Exchange, this plant will be uneconomic." (D.95-12-063, pp. 113-115.)

* * *

We recognized that the calculation of transition costs

"may be characterized as either administrative or market-based. Under an administrative approach, we would attempt in our proceedings to assemble reliable information that would help us calculate an estimate of transition costs. Market-based approaches derive an estimated value from observation of the collective actions of buyers and sellers.

"We concur with most of the parties' view that a market-based approach to calculating transition costs associated with utility assets will produce superior results to an administrative approach. (Emphasis added.) An administrative approach to valuing utility assets introduces forecasting error and necessarily relies on numerous assumptions that would likely be contested. For example, this approach requires [*12] long-term forecasts of market prices and assumptions about existing and future QF obligations, discount rates, capacity factors, and other variables. The estimates of overall transition costs presented by the utilities and other parties, using their versions of an administrative approach, ranged from negative $8 billion to $32 billion. n3 To avoid the potential for forecast errors of this magnitude in the transition cost calculation, market-based, observational methods for quantifying transition costs for the uneconomic portion of the utility's generation assets should be employed as much as possible. However, we will use an appropriate administrative approach as necessary to calculate the level of transition costs during the period prior to market valuation of the assets." (D.95-12-063, pp. 125-126.)

* * *

"Prior to market valuation of the utility generation assets, transition costs will be calculated annually. This calculation will include the transition costs associated with the operation of the utilities' generation assets, contractual obligations, and regulatory obligations." (D.95-12-063, p. 128.)

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n1 "By 'net book value,' we mean the original cost recorded in the company's books for a particular asset less any accumulated depreciation and adjusted for deferred taxes, and any other asset or liability account which relates to the asset." [*13]

n2 "Certain nuclear facilities and plants that have undergone market valuation will operate under different conditions, as discussed in the market structure section and below."

n3 "We do not adopt or endorse any of these estimates, but this wide range of estimated costs illustrate our reservations about the administrative approach. Estimates vary significantly due to assumptions used in the calculations."

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C. Statutory Authority

On September 23, 1996, the Governor signed into law Assembly Bill (AB) 1890 which requires electrical corporations to submit to the Commission proposals for cost recovery plans that, similar to PG&E's application, freeze customer rates, and accelerate the recovery of uneconomic transition costs. AB 1890 sets the rate freeze/transition cost recovery period to end on December 31, 2001 (with some limited extensions), and requires that rates for residential and small commercial customers be reduced by no less than 10% beginning in 1998. AB 1890 provides that this rate reduction may be financed by rate reduction bonds, and thereby may extend the transition cost recovery [*14] period for small customers beyond 2002, in the event that such financing benefits those customers.

This Diablo Canyon application, which was underway when AB 1890 was signed into law, is the vehicle for evaluating and adopting appropriate modifications to PG&E's proposed rate freeze and ratemaking mechanism. The provisions of AB 1890 most pertinent to this decision are found in new Public Utilities Code sections:

"367. The commission shall identify and determine those costs and categories of costs for generation-related assets and obligations, consisting of generation facilities, generation-related regulatory assets, nuclear settlements, and power purchase contracts, including, but not limited to, restructurings, renegotiations or terminations thereof approved by the commission, that were being collected in commission-approved rates on December 20, 1995, and that may become uneconomic as a result of a competitive generation market, in that these costs may not be recoverable in market prices in a competitive market, and appropriate costs incurred after December 20, 1995, for capital additions to generating facilities existing as of December 20, 1995, that the commission determines [*15] are reasonable and should be recovered, provided that these additions are necessary to maintain the facilities through December 31, 2001. These uneconomic costs shall be recovered from all customers on a nonbypassable basis and shall:

"(a) Be amortized over a reasonable time period, including collection on an accelerated basis, consistent with not increasing rates for any rate schedule, contract, or tariff option above the levels in effect on June 10, 1996; provided that, the recovery shall not extend beyond December 31, 2001...

"(b) . . . For those assets subject to valuation, the valuations used for the calculation of the uneconomic portion of the net book value shall be determined not later than December 31, 2001, and shall be based on appraisal, sale, or other divestiture."

* * *

"(d) Be adjusted throughout the period through March 31, 2002, to track accrual and recovery of costs provided for in this subdivision. Recovery of costs prior to December 31, 2001, shall include a return as provided for in Decision 95-12-063, as modified by Decision 96-01-009, together with associated taxes."

* * *

"368. Each electrical corporation shall propose a cost recovery plan to the [*16] commission for the recovery of the uneconomic costs of an electrical corporation's generation-related assets and obligations identified in Section 367. The commission shall authorize the electrical corporation to recover the costs pursuant to the plan where the plan meets the following criteria:

"(a) The cost recovery plan shall set rates for each customer class, rate schedule, contract, or tariff option, at levels equal to the level as shown on electric rate schedules as of June 10, 1996, provided that rates for residential and small commercial customers shall be reduced so that these customers shall receive rate reductions of no less than 10 percent for 1998 continuing through 2002. These rate levels for each customer class, rate schedule, contract, or tariff option shall remain in effect until the earlier of March 31, 2002, or the date on which the commission-authorized costs for utility generation-related assets and obligations have been fully recovered. The electrical corporation shall be at risk for those costs not recovered during that time period. Each utility shall amortize its total uneconomic costs, to the extent possible, such that each year during the transition period [*17] its recorded rate of return on the remaining uneconomic assets does not exceed its authorized rate of return for those assets. For purposes of determining the extent to which the costs have been recovered, any over-collections recorded in Energy Costs Adjustment Clause and Electric Revenue Adjustment Mechanism balancing accounts, as of December 31, 1996, shall be credited to the recovery of the costs.

"(b) The cost recovery plan shall provide for identification and separation of individual rate components such as charges for energy, transmission, distribution, public benefit programs, and recovery of uneconomic costs. The separation of rate components required by this subdivision shall be used to ensure that customers of the electrical corporation who become eligible to purchase electricity from suppliers other than the electrical corporation pay the same unbundled component charges, other than energy, a bundled service customer pays....

"(h) An example of a plan authorized by this section is the document entitled "Restructuring Rate Settlement" transmitted to the commission by Pacific Gas and Electric Company on June 12, 1996."

Setting forth the portions of AB 1890 above [*18] is for ease of reference in discussing our interpretation of AB 1890 in conjunction with D.95-12-063 as applied to Diablo Canyon sunk costs and ICIP. We have not set forth all the pertinent statutes involved in this decision. In our discussion of ORA's request for additional rate reductions, TURN's request for disallowance of capital costs, and the County of San Luis Obispo's request for a special charge, we will refer to other statutes.

D. SONGS Comparability

In D.95-12-063, our Policy Decision, we required PG&E to file an application proposing the ratemaking treatment for Diablo Canyon under electric industry restructuring. In ordering PG&E to file this application, we expressed concern that the disparate ratemaking treatment of Diablo Canyon and the SONGS Units 2 & 3, owned by Edison and SDG&E, may create inequities for ratepayers in different parts of the state. Therefore, we ordered PG&E to include in its Diablo Canyon ratemaking application at least one alternative comparable to the ratemaking we adopted for SONGS. (We placed the same SONGS comparability requirement on Edison when we ordered Edison to propose ratemaking treatment for its share of the Palo Verde nuclear [*19] plant under electric industry restructuring.)

In response to our order PG&E filed this application. PG&E claims that this application would price Diablo Canyon power until December 31, 2001 under performance-based ratemaking comparable to that adopted by the Commission for SONGS 2 & 3. Under SONGS pricing, Diablo Canyon sunk costs will earn a reduced return on equity (90% of embedded cost of debt), and Diablo Canyon operating costs will be recovered only if the plant performs well. In addition, Diablo Canyon will be priced at market levels at the end of 2001 (15 years earlier than under existing ratemaking and two years earlier than SONGS).

PG&E provided the following table to show comparability with SONGS.

	SONGS	Diablo Canyon
Reduction in CTCs	$235 million (NPV)	$4.0 billion (NPV)
Rate of Return on Equity	7.00% (Edison) 6.77% (SDG&E)	6.77%
Break Even Capacity Factor	78%	80%
Incremental Cost Incentive Prices		
1997	3.85 cents/kWh	3.59 cents/kWh
1998	4.00 cents/kWh	3.71 cents/kWh
1999	4.00 cents/kWh	3.86 cents/kWh
2000	4.05 cents/kWh	4.04 cents/kWh
2001	4.10 cents/kWh	4.32 cents/kWh
2002	4.15 cents/kWh	market
2003	4.15 cents/kWh	market
Post-2003	market	market
ICIP Annual Cost Escalation, O&M, and A&G	3.7%	3.1%
Post-Transition Profit Sharing	Yes	Yes
Plant Shutdown Review	Yes	Yes

[*20]

PG&E determined its ICIP,for the most part, based upon a three-year average of historical costs escalated by an annual inflation factor. PG&E did this because the SONGS ICIP relied upon a similar formula. And it based the amount of sunk costs eligible for accelerated recovery by the amount on its books at the beginning of the recovery period, similar to SONGS.

PG&E believes its proposal applies the performance-based ratemaking principles adopted by this Commission in the SONGS case to derive a price which balances the upside potential for additional revenues by PG&E's shareholders against the additional downside operating risks assumed by those same shareholders. PG&E believes that the SONGS decision had included this upside potential reward if the plant performs better than average, in order to compensate SONGS for the additional risk of nonrecovery of its operating costs if the plant performs poorly.

We cannot accept PG&E's characterization of its risks and rewards. Currently, as ORA reminds us, all of PG&E's Diablo Canyon revenues are performance-based, and it has the full risk of plant operation and investment recovery. Because of AB 1890 the major risk of PG&E's recovering $[*21] 3.5 billion in sunk costs has been removed. Under AB 1890 PG&E will receive the uneconomic portion of its Diablo Canyon investment (which it assesses as at least $3.5 billion) regardless of how Diablo Canyon performs. Rather than waiting an additional 15 years to recover sunk costs under present pricing, and being at risk all those years, PG&E is permitted recovery of uneconomic costs in five. It is difficult to understand how this benefit metamorphoses into "downside risk." We recognized this, even if PG&E did not, when we reduced the utility's authorized return on equity for investment subject to accelerated cost recovery. (D.95-12-063, pp. 120-125.)

TURN and ORA dispute PG&E's restrictive interpretation of SONGS comparability. They submit that the SONGS decision stands for the proposition that an ICIP mechanism can be an appropriate means of recovering a price representing the incremental costs of operating a plant during the period of accelerated sunk cost recovery. However, the details of both the plant-specific ICIP mechanism and the terms of the sunk recovery should be determined based on plant-specific facts. They assert that if we find that there are material differences [*22] between the Diablo Canyon plant and the SONGS plant, we can adopt an outcome that varies from the specifics of the ICIP and sunk cost recovery mechanisms adopted for SONGS, and still meet the standard of SONGS comparability.

As we review the elements of sunk costs and ICIP we will consider comparability to SONGS, but as a preliminary matter we believe the parties, especially PG&E, have placed too much emphasis on whether or not a particular cost is or is not comparable to SONGS. The table above, presented by PG&E as showing "comparability" is baffling. The same table with different numbers would also show "comparability." n4 To be more specific, when considering the most basic element of ratemaking, the rate, the table shows that during the 1997-2001 period SONGS ICIP rate increases from 3.85 cents/kWh to 4.10 cents/kWh or 6.5%; during that same period PG&E's proposed ICIP rate increases from 3.59 cents/kWh to 4.32 cents/kWh or 20%. A 20% increase in rates is not comparable to a 6.5% increase in rates. The difference in plant, the difference in costs, foretells a different result.

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n4 Regarding "comparability" TURN makes a telling point: Edison suffered a $345 million disallowance of the original construction costs of SONGS (1986) 22 CPUC 2d 124, D.86-10-069); no disallowance was ever adopted for Diablo Canyon and PG&E does not include any comparable disallowance in its proposal.

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II. ORA's Proposed Additional 10% Rate Reduction

ORA contends that PG&E's proposed sunk cost recovery and ICIP prices should be adjusted to reflect reduced risks and reasonable expectations, with the savings applied toward a 10% residential and small commercial customer rate reduction in addition to the 10% reduction required by AB 1890. ORA points out that PG&E bases its requested sunk cost recovery on the amount of rate base that would exist had Diablo Canyon been depreciated under normal cost-of-service ratemaking, instead of the performance-based mechanism that it has operated under since 1988. PG&E ignores the fact that Diablo Canyon has not been subject to the reasonableness review component of cost-of-service ratemaking. If Diablo Canyon had been subject to traditional ratemaking, it would have been exposed to a disallowance of $4.4 billion of its $5.5 billion construction costs. PG&E's proposed sunk cost recovery would eliminate the operating risks originally allocated to PG&E in settlement of the disputed $4.4 billion disallowance.

ORA argues that, even apart from reallocating risk back to customers, PG&E's proposed ICIP prices and requested sunk cost recovery [*24] are inflated and should be reduced. PG&E's proposed ICIP prices disregard Diablo Canyon's recent historic performance and decreasing operating costs. Despite the fact that Diablo Canyon's historic operating costs have decreased and can reasonably be expected to continue to be contained in the future as PG&E prepares for competition in the market, PG&E's proposed ICIP prices assume that Diablo Canyon operating costs will increase. PG&E's proposed ICIP prices further assume that Diablo Canyon's performance will reflect its lifetime average capacity factor, including its early years of relatively poor performance due to typical start-up problems. ORA believes that Diablo Canyon's performance in recent years during the mature operation of the plant is much more representative of what can be expected over the next five years.

Based on its assumptions of sales and costs over the next five years, as well as its proposed ICIP prices and requested sunk cost recovery for Diablo Canyon, PG&E asserts that it can recover essentially all of its CTC by 2002 if rates are frozen at current levels. ORA claims that by adjusting PG&E's proposed ICIP prices and requested sunk cost recovery, and correcting [*25] PG&E's forecast of future sales revenues, $400 million/year will be collected over and above the revenue requirement necessary to allow PG&E to recover its CTC under a rate freeze.

ORA recommends that the Commission apply this savings to fund a 10% rate reduction for small customers in addition to any rate reduction financed by rate reduction bonds under AB 1890 or, at the very least, reduce the amount of the mandated rate reduction to be financed with rate reduction bonds. This will lower the amount of additional costs that will result from revenue bond financing, and could allow small customers, along with other customers, to see an end to CTC payments by 2002. ORA asserts that using the identified cost savings to fund a small customer rate reduction, either entirely or in part, is consistent with AB 1890's mandate to implement a rate reduction of no less than 10% for small customers while allowing PG&E a reasonable opportunity to recover its transition costs under a rate freeze ending no later than 2002. TURN supports ORA.

PG&E's position is that AB 1890 imposes a rate freeze on PG&E's electric rates at June 10, 1996 levels, starting immediately and extending through December [*26] 31, 2001, in order to permit PG&E to accelerate recovery of its CTC over that period of time. The only exception to this rate freeze is a 10% rate reduction for residential and small commercial customers to be financed by the issuance of rate reduction bonds authorized by AB 1890. The California Industrial Users, the California Large Energy Consumers Association, and the California Manufacturers Association strongly support PG&E on this point.

Those in opposition to ORA argue that ORA's proposed 10% rate reduction for residential and small commercial customers contradicts the provisions prohibiting cost-shifting found in both the Commission's policy decision and AB 1890 and is also preempted by the intent and language of AB 1890 confirming the bond-financed rate reduction for those customers as the only exception to the statutorily-mandated rate freeze for all electric utility customers. n5 They believe that ORA's proposal is defective and unlawful on several grounds. First, the proposal contradicts the provisions in the Commission's Policy Decision and AB 1890 calling for allocation of transition costs among utility customers in direct relation to existing rate allocations and relationships. [*27] Thus, as stated in the Policy Decision:

"Transition costs will be allocated to all customer classes using an equal percentage of marginal cost (EPMC) methodology, unless specific circumstances justify a different approach. Marginal cost pricing for electric services using the EPMC methodology is well established, and using this approach for the allocation of transition costs ensures a fair allocation among all customers classes and prevents inter- and intraclass cost-shifting. Using this approach also preserves the cost allocation that we have previously reviewed and approved." (Mimeo., p. 142.)

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n5 In this decision we express no opinion regarding the necessity of bond financing to fund the AB 1890 10% rate reduction.

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In similar fashion, AB 1890 provides that utilities' uneconomic costs shall be recovered from all customers on a non-bypassable basis and shall:

Be allocated among the various classes of customers, rate schedules, and tariff options to ensure that costs are recovered from these classes, rate [*28] schedules, contract rates, and tariff options, including self-generation deferral, interruptible, and standby rate options in substantially the same proportion as similar costs are recovered as of June 10, 1996, through the regulated retail rates of the relevant electric utility.... (PU Code § 367(e)(1).)

It is the intent of the Legislature to require and enable electrical corporations to monetize a portion of the competition transition charge for residential and small commercial consumers so that these customers will receive rate reductions of no less than 10% for 1998 continuing through 2002. Electrical corporations shall, by June 1, 1997, or earlier, secure the means to finance the competition transition charge by applying concurrently for financing orders from the Public Utilities Commission and for rate reduction bonds from the California Infrastructure and Economic Development Bank. (PU Code § 330(w).)

The opponents cite PU Code § 330(w) in support of their argument that rate reductions solely for residential and small commercial customers in excess of 10% authorized by AB 1890 are improper. The opponents are not averse to further rate reductions; they are averse to one group's [*29] being favored and other groups' having to bear additional costs.

Their witness testified that ORA's rate reduction for residential and small commercial customers would come at the direct expense of larger customers. Section 367(e)(1) of AB 1890 requires that transition costs be allocated among the various classes of customers, rate schedules, and tariff options to ensure that costs are recovered from all customers in substantially the same proportion as similar costs are recovered as of June 10, 1996. By granting small customers an initial 10% rate reduction (in addition to the 10% rate reduction mandated by AB 1890), ORA's proposal would reduce utility cash flow during the CTC recovery period and would thus delay the date upon which full recovery of utility generation-related CTC is achieved. This delay in CTC recovery would mean that larger customers will have to pay CTC for a longer period of time (until the utility achieves full recovery) because smaller customers will be paying less than their full share of CTC. ORA's proposed rate reduction for residential and other small customers would reduce the component of those customers' rates which is used to pay for CTC recovery. Because [*30] larger customers would have to pay CTC longer and pay more CTC in the aggregate, the ORA proposal would cause precisely the type of cost-shifting that D.95-12-063 and AB 1890 prohibit.

Discussion

We believe ORA's interpretation of AB 1890 is incorrect.

In this section of the opinion we discuss only the statutory basis for ORA's proposed additional 10% rate reduction for small customers. We assume, for this purpose, that there are adequate funds for the reduction. This assumption of adequate funds for the rate reduction ($2 billion over five years) does not assume that adequate funds remain to amortize uneconomic assets over the five-year period of the rate freeze. Estimating revenues and expenses over five years is highly speculative. We do not know PG&E's uneconomic costs, nor do we know the revenues available to meet those costs. Both this Commission and the Legislature have made the policy decision to grant utilities the opportunity to recover their uneconomic costs as they compete in the restructured electricity market. Removing $2 billion from the sum potentially available for CTC substantially impedes achieving this policy goal. The $2 billion is not lost to ratepayers. [*31] The $2 billion will offset CTC and advance the date when the rate freeze terminates.

To accede to ORA's request would be discriminatory, benefiting one class of customers at the expense of all other classes. ORA gives no compelling reason to support this dichotomy. It points to the legislative desire to reduce residential rates by 20% (PU Code § 330(a)), n6 but we do not read the statute so narrowly. That language must be reconciled with the directive to pay off CTC and to assure no cost-shifting. As the opponents assert, the Legislature has provided that transition costs must be recovered from all customers in substantially the same proportion as similar costs are recovered as of June 10, 1996. ORA's proposal would delay CTC recovery, thereby burdening large utility customers with the obligation to pay CTC for a longer period of time because smaller customers will be paying less than their full share of CTC. This cost-shifting is prohibited by statute (PU Code § 367(e)(1)) n7 and by our Policy Decision (D.95-12-063 at 142). n8 As the additional 10% will impede CTC amortization and will clearly cause cost shifting, we will not adopt ORA's interpretation of § 330(a). Having removed [*32] the underpinning for ORA's additional 10% rate reduction, we lack a reason to favor one class of ratepayer at the expense of another.

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n6 "It is the intent of the Legislature that a cumulative rate reduction of at least 20% be achieved not later than April 1, 2002, for residential and small commercial customers, from the rates in effect on June 10, 1996...."

n7 Uneconomic costs shall "Be allocated among the various classes of customers...to ensure that costs are recovered from these classes...in substantially the same proportion as similar costs are recovered as of June 10, 1996..."

n8 Transition costs will be allocated in a manner which "ensures a fair allocation among all customer classes and prevents inter-and intraclass cost-shifting."

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III. TURN's Depreciation Adjustment

In our 1988 settlement decision (D.88-12-083) we approved rates which the parties estimated would impose the equivalent of a $2 billion disallowance over the 28-year term of the settlement. The most important feature of the settlement, [*33] and the most novel, was the shift of the risk of operating Diablo Canyon from the ratepayers to PG&E. No reasonableness review of construction costs was done; no disallowance was ordered. Rather, PG&E was to assume the risk of recovering all of its Diablo Canyon construction costs. Now, in this application, PG&E proposes to amortize the remaining sunk cost investment of $3.5 billion over the next five years. This in effect, passes the risks of operation for the remaining 20 years of the settlement back to the ratepayers, to be paid off in five years.

A. TURN

TURN believes this result to be unfair to ratepayers and proposes that the Commission should reclassify as depreciation expenses the past revenues that exceeded a reasonable return under traditional ratemaking, and to treat the original write-off as an imputed disallowance. TURN argues that the Commission cannot allow PG&E to reap the benefits of two fundamentally different ratemaking approaches--traditional cost-of-service and performance-based ratemaking (PBR)--while bearing virtually none of the costs and risks of either method. TURN recommends that its estimated $2.15 billion in revenues that PG&E has collected [*34] to date under the settlement agreement in excess of what it would have collected under cost-of-service ratemaking for that same period be credited against any sunk cost recovery that the utility is granted in this proceeding. This, TURN believes, would effectively serve as the proxy for traditional ratemaking treatment. TURN says that if PG&E is to recover Diablo Canyon costs just as if the plant were subject to traditional ratemaking treatment, the Commission must adjust the sunk costs associated with the plant to better approximate what would have happened under such regulatory treatment.

Should the Commission decide to allow PG&E to retain some of the benefits it has collected over the first eight years under the settlement's ratemaking treatment without completing the term of that agreement, TURN has an alternative proposal. In that event, the Commission should at minimum credit the utility's customers with 50% of the excess revenues that PG&E has accrued from Diablo operations since July 1, 1988. This 50% figure corresponds to the 50% share of Diablo Canyon operating profits that shareholders will be allowed to retain after 2001, when ratepayers have paid off the accelerated [*35] sunk cost recovery and thereby largely eliminated the utility's remaining risk of Diablo Canyon investment recovery.

TURN contends that its proposal is a much fairer balance of risks and rewards from the perspective of PG&E's customers than the balance that would be struck under PG&E's proposed treatment. Given the history of the plant, the terms of the settlement agreement, and the Commission's decision that the adoption of that package would be a reasonable outcome for future ratemaking purposes, the Commission must recognize the inappropriateness of the treatment PG&E is now seeking. PG&E is proposing to shed the risk of operating Diablo Canyon for the remaining 20 years of the settlement, and effectively cash out its remaining sunk cost investment of $3.5 billion over the next five years. Rather than embrace PG&E's request to treat the settlement as if it never existed for purposes of accelerating sunk cost recovery, the Commission should make reasonable adjustments to the sunk costs eligible for recovery on an accelerated basis.

TURN asserts that we have the authority to impose a conversion adjustment when changing from performance-based ratemaking to a new cost recovery mechanism [*36] based on traditional cost-of-service ratemaking principles. (Re Southern California Edison (1976) 79 CPUC 758, 765; D.85731.) Performance to date has allowed the utility to collect revenue that could well be offset by poor performance later in the plant's life. The risk-shifting aspects of PG&E's sunk cost acceleration proposal warrant a conversion adjustment. TURN avers that its reclassification of past earnings in excess of a reasonable return as depreciation expenses in determining the plant's remaining sunk costs is an appropriate adjustment.

TURN declares that its proposal is not only consistent with AB 1890, it is the only proposal before the Commission that is consistent with existing statutory requirements applicable to Diablo Canyon ratemaking. Section 367 directs the Commission to "identify and determine" the costs and categories of costs that may warrant accelerated recovery pursuant to Section 367(a). The Legislature did not say that the Commission shall allow recovery of every dollar claimed by the utilities; the use of the phrase "identify and determine" indicates that the Commission is vested with the authority to exercise some amount of discretion in identifying [*37] the costs to which accelerated recovery should apply. Section 367(b) makes even clearer that the Legislature expected the Commission to make a "determination of the costs eligible for recovery" as part of its effort to implement AB 1890.

Finally, in interpreting the relevant sections of AB 1890, the Commission should keep in mind that Diablo Canyon costs are the only costs that were never found reasonable and for which the Legislature did not specifically excuse the utility from demonstrating their reasonableness. PG&E would have the Commission treat the Diablo Canyon costs as if they had been specifically exempted from reasonableness review. Had the Legislature intended that outcome, it would have so stated. TURN submits that Sections 367 and 368 should be read together as providing for the recovery of the costs of nuclear settlements only insofar as those costs are reasonable.

TURN reasons that however the Commission interprets AB 1890, we would still need to consider the impact of PU Code § 463. Subsection (a) of that statute states:

"For purposes of establishing rates for any electrical or gas corporation, the commission shall disallow expenses reflecting the direct or indirect [*38] costs resulting from any unreasonable error or omission relating to the planning, construction, or operation of any portion of the corporation's plant which cost, or is estimated to have cost, more than fifty million dollars.... Nothing in this section prohibits a finding by the commission of other unreasonable or imprudent expenses. This subdivision is a clarification of the existing authority of the commission, is not intended to limit or restrict any power or authority of the commission conferred by any other provision of law, and applies to all matters pending before the commission. This section does not prohibit the commission from establishing rates for an electrical or gas corporation on a basis other than an allowed rate of return on undepreciated capital costs."

This legislation was enacted in 1985, prior to the Commission's adoption of D.88-12-088. In uncodified language, the Legislature described in some detail how the bill would apply to the Commission's review of the expenses associated with the Diablo Canyon power plant, ending that discussion with the following statement:

This section does not apply if the commission establishes the rates for the Diablo Canyon [*39] Nuclear Power Plant on a basis other than an allowed rate of return on undepreciated capital costs.

Stats. 1985, c. 1212, § 2.

TURN argues that the 1988 Diablo Canyon settlement relieved the Commission from its obligation under Section 463 to disallow the unreasonable costs resulting from PG&E's errors and omissions in the planning, construction, and operation of Diablo Canyon. By establishing a system of performance-based pricing for Diablo Canyon output, the 1988 settlement set future rates "on a basis other than an allowed rate of return on undepreciated capital costs." (Section 463(a).) But in its application here, PG&E is requesting a change in that pricing system. The sunk costs for which PG&E now seeks recovery represent its undepreciated capital costs in the plant. And it is those sunk costs to which the authorized rate of return will apply. Indeed, PG&E characterizes its proposal as attempting to relate the sunk costs for Diablo Canyon to those that would have been recovered under cost-of-service ratemaking. This treatment places them squarely within the provisions of Section 463. TURN concludes that nothing in AB 1890 implicitly or explicitly repeals Section 463. Thus [*40] in order to adopt PG&E's sunk cost recovery proposal, we must first "disallow expenses reflecting the direct or indirect costs resulting from any unreasonable error or omission relating to the planning, construction, or operation of Diablo." TURN believes its proposal to treat the original write-off as an imputed disallowance would serve as an adequate substitute for the disallowance that would likely occur were a full-fledged reasonableness review performed. ORA supports TURN.

As a further modification TURN proposes a $214 million depreciation adjustment to reflect questionable timing of depreciation practice changes. This in addition to its proposed $2.15 billion depreciation offset.

B. PG&E

PG&E states that the evidence shows that through 1995, it actually has collected over $1.6 billion less under the Diablo Canyon settlement than it would have collected under traditional ratemaking without a disallowance. More importantly, this does not include the unquantified benefits that have accrued to customers because the Diablo Canyon settlement shifted the operating risks of the plant almost entirely to PG&E's shareholders.

Regardless of the parties' respective views on [*41] past Diablo Canyon ratemaking, PG&E argues that TURN's and ORA's recommended disallowances should be rejected for one obvious legal reason: They are patent violations of the statutory prohibition on retroactive ratemaking, and unconstitutionally confiscatory as well. n9 It has long since been established in California that once rates have been determined to be just and reasonable and have been put into effect no longer subject to refund, regulators may not adjust such rates retroactively, either directly or indirectly. TURN and ORA are seeking to adjust Diablo Canyon sunk costs solely on the basis of their conclusion that past Diablo Canyon rates were excessive because of PG&E's earnings under such rates. They cannot--in the guise of an "adjustment" or "offset" to Diablo Canyon sunk costs included in future PG&E rates--retroactively reduce the revenues earned by PG&E under the performance-based rates which implemented the 1988 settlement (and its 1995 modification) between 1988 and today.

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n9 PU Code § 728; Pacific Tel. & Tel. Co. v. Public Util. Com. (1965) 62 Cal. 2d 634, 650-652, and cases cited therein; see also Duquesne Light Co. v. Barasch (1988) 488 U.S. 299, 315; 102 L. Ed. 2d 646; 109 S. Ct. 609, 619 ("[A] State's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions"). PG&E asserts that TURN's and ORA's "prior excess earnings" recommendations also are confiscatory in that they would force PG&E to rebate to ratepayers prior earnings already vested in PG&E under the 1988 Diablo Canyon ratemaking settlement, as modified prospectively in 1995.

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In reference to TURN's Section 463 argument, PG&E says the answer is simple. Because of AB 1890, the Commission's SONGS decision, and PG&E's application, Diablo Canyon costs will be recovered under nontraditional ratemaking exempt from Section 463, and therefore Section 463's prohibition simply does not apply.

PG&E points out that SONGS pricing itself is incentive ratemaking, not traditional ratemaking. Under SONGS pricing, unlike traditional ratemaking, sunk costs receive a significantly reduced return, 40% below the utility's authorized return on equity on other utility assets. Second, unlike traditional ratemaking, PG&E's proposal limits PG&E's ability to recover all its generation-related capital costs--including Diablo Canyon--to no later than the end of 2001 under a rate freeze. Thus, regardless of the level of Diablo Canyon capital cost recovery and performance-based revenues, PG&E will be prohibited from recovering in CPUC-jurisdictional rates any remaining Diablo Canyon capital costs or expense if it has not fully recovered those costs prior to December 31, 2001 under the rate freeze. Moreover, by no later than the end of 2001, Diablo Canyon will be excluded from cost-of-service [*43] ratemaking and instead will be priced at market prices, 15 years earlier than under either traditional ratemaking or the current Diablo Canyon performance-based ratemaking. And after 2001, PG&E will bear all the risks of recovery of on-going Diablo Canyon capital and operating costs, and at the same time will be required to share any benefits from the plant equally with ratepayers.

Third, even if SONGS pricing were not incentive pricing exempt from Section 463, PG&E believes AB 1890 effectively supersedes any application of Section 463 to Diablo Canyon costs. This is because PU Code Section 368(h), added by AB 1890, endorses and authorizes PG&E to recover its transition costs under the terms of the Restructuring Rate Settlement it transmitted to the Commission on June 12, 1996. The Restructuring Rate Settlement, by its terms, approves and authorizes PG&E to collect Diablo Canyon CTCs under ratemaking comparable to SONGS pricing. In addition, Section 367(a), added by AB 1890, requires the Commission to allow utilities to fully recover their generation-related costs, including "generation-related assets and obligations," "generation facilities," generation-related regulatory assets," [*44] "nuclear settlements," and "restructurings, renegotiations or terminations thereof," that may become uneconomic as a result of a competitive generation market. AB 1890's express reference to "nuclear settlements" and "restructurings" thereof indicates it intended PG&E to fully recover CTCs associated with Diablo Canyon.

Responding to TURN's proposed $214 million depreciation adjustment, PG&E explains that changes to its depreciation calculations were the result of normal changes as depreciation methods evolve, and were consistent with Commission guidelines.

C. Discussion

We consider here the applicability of Section 463. Section 463 continues to be a part of the Public Utilities Code. Nothing in AB 1890 explicitly repealed this section, and we can find no new law which explicitly or specifically supersedes it. We recognize that the current state of ratemaking for Diablo Canyon and the electric industry in general bears little resemblance to traditional ratemaking (however that is defined). But Section 463 does not require that traditional ratemaking apply in regard to Diablo Canyon for it to be applicable. Section 463 is, in fact, only applicable in the situation when ratemaking [*45] is determined on a basis involving "an allowed rate of return on undepreciated capital costs."

PG&E's application here is consistent in structure with our Policy Decision, the Restructuring Rate Settlement, and AB 1890. The application calls for a complex set of parameters, including "SONGS-like" treatment of various elements such as the ICIP. For the purpose of considering Section 463, we find that the heart of PG&E's application is its proposal for recovery of all remaining undepreciated capital costs, including an allowed rate of return. The amount of capital costs to be recovered and the allowed rate of return are specified. These key elements squarely place this application within the boundary of Section 463. The fact that the mechanism for recovery of the undepreciated capital costs differs significantly from traditional regulation is not the point.

We are well aware that PG&E is asking to recover all of Diablo Canyon's sunk costs as if all those costs had been found reasonable and included in rate base. TURN makes the convincing point that ratepayers should be responsible only for reasonable costs and that Diablo Canyon has never undergone a reasonableness review. We have reviewed [*46] our original decision approving the Diablo Canyon settlement and remind the current parties that in our 1988 decision we said "the case before this Commission is of unprecedented size in terms of costs and filings. Over 150,000 pages of prepared testimony and exhibits were filed for the reasonable phase alone." (30 CPUC2d at 229.) It took years to prepare that case for trial. It is apparent to us that we cannot resuscitate it. ORA describes the task as "overwhelming." Before a decision could be rendered the rate freeze would have ended on its own terms and Diablo Canyon would have been removed from rate base along with its overmarket pricing, in compliance with AB 1890.

Section 463 requires us to disallow certain plant-related costs above $50,000,000 "including any expenses resulting from delays caused by any unreasonable error or omission." While we will not reopen the Diablo Canyon reasonableness review or the subsequent settlements, TURN is correct that we are compelled by AB 1890 to identify and determine the costs and categories of costs that may warrant accelerated recovery. At minimum, this means we must disallow known and admitted errors or omissions above $50,000,000. Nevertheless, [*47] using the proxies recommended by TURN seems to be grasping at straws. They have no relationship, in our opinion, to any possible disallowance. In the Diablo Canyon settlement decision we found that PG&E admitted to error of no more than $100,000,000 (30 CPUC2d at 281, Finding of Fact 5.) There was no dispute that an error was made by PG&E and its contractors (30 CPUC2d at 269, 271.) We will disallow from current sunk costs the depreciated value of $100,000,000, under the formula:

$100,000,000 x depreciated value of original plant * / undepreciated value of original plant

* The depreciated value of original plant equals the current depreciated value of the entire plant less the depreciated value of all capital additions to December 31, 1996.

We see no reason to adopt TURN's proposed $214 million depreciation adjustment. PG&E's depreciation changes did not diverge from generally accepted depreciation principles.

IV. Sunk Costs

PG&E proposes to recover its remaining Diablo Canyon sunk costs over a depreciation period of five years or less. During this period, PG&E would recover in base rates a Diablo Canyon sunk cost revenue requirement (DCSCRR) based on the accelerated [*48] cost recovery period and a reduced return consistent with the SONGS 2 & 3 settlement. The DCSCRR would replace the fixed price in the current Diablo Canyon settlement agreement.

PG&E contends that Diablo Canyon sunk costs include plant in service, including: (1) Diablo Canyon electric utility plant; (2) common utility plant attributable to Diablo Canyon (including allocation of common plant); and (3) construction work in progress (CWIP). Diablo Canyon sunk costs also include working capital amounts, such as: (1) nuclear fuel inventories; (2) materials and supplies inventories; and (3) prepayments. Diablo Canyon sunk costs also include deferred charges including: (1) vacation pay deferral; (2) deferred capitalized interest; (3) Diablo Canyon utility Asset II established under the 1988 Diablo Canyon settlement; and (4) FASB 109 gross-up related to Diablo Canyon plant and utility assets. Deductions from Diablo Canyon sunk costs include (1) accumulated deferred income tax; (2) deferred investment tax credit; (3) FASB 109 deferred taxes; and (4) depreciation.

PG&E's forecasted end-of-year (EOY) 1996 Diablo Canyon sunk costs are:

Diablo Canyon Power Plant
1996 End-of-Year Sunk Cost
(Thousand of Dollars)

		EOY 1996 Sunk Cost
	Plant in Service	
1.	Electric Utility Plant	$6,602,404
2.	Common Utility Plant	150,365
3.	Construction Work in Progress	8,921
4.	Total Plant in Service	$6,761,690
	Working Capital	
5.	Nuclear Fuel	78,086
6.	Materials & Supplies	77,774
7.	Prepayments	4,322
8.	Total Working Capital	160,182
	Deferred Charges	
9.	Vacation Pay Deferral	6,245
10.	Deferred Capitalized Interest	4,296
11.	Diablo Canyon Utility Asset II	167,634
12.	SFAS No. 109 Deferred Charges	501,928
13.	Total Deferred Charges	680,103
	Deductions	
14.	Accumulated Deferred Taxes on Income	832,292
15.	Deferred Investment Tax Credit	159,373
16.	SFAS No. 109 Deferred Taxes	805,226
17.	Total Deductions	1,796,891
18.	Depreciation Reserve	2,292,596
19.	End-of-Year Depreciated Sunk Cost	3,512,488
20.	CPUC Jurisdiction	$3,501,353

[*49]

TURN argues that a significant policy issue arises with respect to Diablo Canyon. TURN says that because Diablo Canyon never was subject to rate case review, its sunk cost calculations require more scrutiny and perhaps revision.

Capital additions to SONGS, Palo Verde, and non-nuclear generating units have been implicitly found to be prudent. Depreciation rates and methods of calculation were set in rate cases for those units. For Diablo Canyon, none of these facts are true. As a result, even setting aside the question of whether any portion of the original investment was prudent, this is a case where past accounting practices with regard to depreciation expense and reserve calculations must be examined, and where the appropriateness of past capital additions must be checked as they lead directly to sunk costs. TURN recommends a complete audit of Diablo Canyon sunk costs going back to the inception of the plant. Any sunk cost finding in this application should be subject to adjustment based on the results of the audit. This issue is discussed in our section on the audit.

Our discussion of sunk costs will be limited to those issues raised by the parties. To the extent issues are not [*50] raised, we will adopt PG&E's estimate.

A. Out-of-Core Nuclear Fuel Inventory

PG&E has included $78 million in Diablo Canyon sunk costs for out-of-core nuclear fuel inventory. It also includes nuclear fuel in its ICIP proposal. ORA claims that PG&E's proposal will essentially charge ratepayers twice for nuclear fuel that will be used during the next five years. ORA then goes on to propose that out-of-core nuclear fuel balance be excluded from the Diablo Canyon sunk cost. TURN supports ORA.

TURN presented evidence which shows, as an example, that about 79% of the EOY out-of-core fuel in 1993 would have become in-core fuel within two years, and 97% of the fuel would have been transferred to the core within three years. Nearly 66% of the fuel would be burned within three years and 92% would be burned within five years. If this pattern holds true, all of the EOY 1996 out-of-core fuel which PG&E proposes to amortize as a sunk cost would have become in-core fuel at some time during the ICIP period and PG&E would have collected carrying costs in ICIP for the same fuel for which it was amortizing the sunk costs. Furthermore, TURN asserts, there is a market for nuclear fuel before [*51] it is placed in the core, as fuel in intermediate processing stages is relatively fungible and can be sold to other utilities. Therefore, the assumption that 100% of this fuel is a sunk cost is incorrect even in the event of closure of the plant.

PG&E disagrees with the assertion that by including the out-of-core nuclear fuel inventory in Diablo Canyon sunk cost, PG&E charges ratepayers twice for nuclear fuel. It argues that to support operations of Diablo Canyon, PG&E maintains an inventory of nuclear fuel in addition to fuel in the reactor. When this out-of-core fuel is transferred to the reactor core, and is being used to generate electricity, the cost is charged to fuel expense, and the out-of-core inventory is replenished. The cost of nuclear fuel included in the ICIP mechanism is the cost of the fuel in the reactor core. The cost of fuel included in the Diablo Canyon sunk cost amount is the cost of the out-of-core nuclear fuel. PG&E's proposal does not charge ratepayers twice for the same fuel. If the cost of out-of-core nuclear fuel is not included in the Diablo Canyon sunk cost, a balance will remain at the end of the transition period. PG&E's proposal assures that there is [*52] no cost of out-of-core nuclear fuel inventories outstanding at the end of the five-year transition period. PG&E does not see any rationale for treating the cost of the out-of-core nuclear fuel inventory differently from the cost of any other inventories and notes that ORA does not dispute the recovery of Materials and Supplies inventories.

We agree with ORA and TURN. While nuclear plants typically maintain M&S inventories, neither SONGS nor Palo Verde nuclear plants maintain an out-of-core nuclear fuel inventory. As Diablo Canyon has not been subject to traditional ratemaking, PG&E's decision to maintain and out-of-core nuclear fuel inventory has never been subject to reasonableness review. Including PG&E's out-of-core nuclear fuel inventory in sunk costs would allow PG&E either to double collect the cost of fuel it uses during the transition period, or to collect from ratepayers the cost of fuel that will be used after the transition period when PG&E is supposed to be responsible for all of its generation costs. PG&E's proposed ICIP prices reflect the cost of nuclear fuel required to run Diablo Canyon for the five-year transition period. However, PG&E may at its discretion use the [*53] fuel inventory during the five-year period ICIP period rather than purchase additional fuel. Thus, under PG&E's proposal, PG&E will double collect for nuclear fuel. This is patently unreasonable. The out-of-core nuclear fuel inventory should be excluded from sunk costs. We will include the cost of nuclear fuel burn in the ICIP.

B. CWIP

PG&E has included an $8.9 million estimate of the December 31, 1996 CWIP balance in the Diablo Canyon sunk cost. ORA contends that including these costs in the sunk category essentially allows PG&E to double collect these costs since costs of capital additions are reflected in the ICIP prices. PG&E disagrees.

PG&E proposes that costs associated with capital projects expended after December 31, 1996 be recovered as incurred through the ICIP price. Until January 1, 1997, PG&E intends to use traditional accounting rules for capital expenditure, which require capital costs to be included in CWIP prior to operation. PG&E has incurred, and will continue to incur, charges prior to January 1, 1997, for capital projects that will not be operative until after December 31, 1996. PG&E proposes to include the December 31, 1996 CWIP balance for these costs [*54] in the Diablo Canyon sunk cost and amortize them over the five-year period. Since these costs were incurred prior to January 1, 1997, they are not being recovered through the ICIP price, and ratepayers are not being charged twice for these costs.

ORA asserts that CWIP was not included in the SONGS mechanism, and therefore should not be included in the Diablo Canyon sunk cost. PG&E disagrees. It notes that the SONGS mechanism did include some CWIP for marine mitigation costs. This was the only CWIP amount specifically identified in the SONGS settlement. However, nothing in the SONGS settlement agreement precludes other CWIP from being included in sunk costs.

Our analysis of the SONGS decision shows that CWIP was included in SONGS 2&3 sunk costs. Our concern is that PG&E has not double counted Diablo Canyon CWIP as both a sunk and incremental cost. We are persuaded that any costs recorded in CWIP and included in Diablo Canyon sunk costs will not be included in the ICIP. There is no double counting CWIP in both sunk and incremental costs.

C. Prepayments

PG&E has included insurance prepayments of $4.3 million in Diablo Canyon sunk costs. ORA believes that inclusion of these [*55] costs in the sunk category will result in ratepayers being double charged. TURN supports ORA. PG&E disagrees.

TURN argues that insurance prepayments have not been included in sunk costs by Edison either at SONGS or at Palo Verde, and they have not been requested by PG&E or Edison as part of the sunk cost recovery for non-nuclear plants. They should not be included here. TURN contends that insurance payments represent payments for insurance for periods of less than a year in advance. They are, therefore, not sunk costs. If PG&E closed Diablo Canyon, it would within the first year after closure get these costs back by not having to pay for insurance (except to the extent that some of the insurance is required and is included in shutdown Operations and Maintenance (O&M). To give PG&E this money as a sunk cost is to give it approximately a year of free insurance premiums when entering the new competitive market.

PG&E asserts that in the course of operating Diablo Canyon, it is required to pay certain insurance premiums prior to the time the insurance coverage is in effect. PG&E carries these amounts in current assets until such time as the insurance is in effect, then includes the costs [*56] in insurance expense. It then prepays the insurance for the next period, which means that there is always a balance for prepaid insurance. PG&E has estimated the December 31, 1996 prepayment balance and included it in Diablo Canyon sunk costs. PG&E states that inclusion of the prepayment balance in the sunk cost amount does not double charge ratepayers for the insurance. If the prepaid insurance balance is not included in the Diablo Canyon sunk cost, PG&E will have a balance for prepaid insurance at the end of the transition period. PG&E's proposal assures that there is no outstanding balance for prepayments of insurance at the end of the five-year transition period.

We agree with TURN and ORA. Insurance is an ICIP item. To include it in sunk costs would give PG&E a year of free insurance premiums.

D. Post-2001 Tax Benefits

During the course of the hearings, PG&E, ORA, and TURN reached agreement on the allocation of post-2001 tax benefits to customers. Under the agreed upon approach, PG&E will credit customers with revenue requirement reductions due to tax benefits, consistent with the approach adopted for SONGS. This agreement does not require any change in Diablo Canyon [*57] sunk costs, but will result in changes to PG&E's remaining rate base after the sunk cost recovery period.

E. Materials and Supplies (M&S)

PG&E is requesting amortization of 90% of M&S costs, $77,774,000. TURN claims that including M&S in sunk costs gives PG&E free O&M. TURN recommends that M&S amortization not be allowed as a sunk cost. Instead, carrying costs associated with M&S should be recovered in ICIP. TURN argues, first, M&S, when consumed, are booked to O&M expense. If needed, the supplies are then replenished. By writing down the entire M&S inventory when the plant moves into the competitive market in 2002, PG&E is in essence being given not only the plant, but a significant portion of free O&M for the first several years, because it ends up with a warehouse full of ratepayer-funded supplies which it can use at no real cost in the competitive market. Second, M&S costs are not necessarily sunk costs. M&S levels can be changed as conditions warrant. PG&E reduced its M&S inventories by 10% in nominal dollars (15% in real dollars) between 1993 and 1995. TURN proposes: (1) to remove M&S from sunk costs; (2) to include the carrying costs of M&S in ICIP, using PG&E's [*58] full return on rate base (9.49%) and associated taxes; and (3) to amortize the same percentage of actual M&S over five years as is allowed for shutdown O&M (at the sunk cost rate of return) in the event of a premature closure. TURN's computation shows that net ratepayer savings from excluding M&S from sunk costs and including M&S carrying costs in ICIP are $43.7 million (net present value (NPV)).

PG&E argues that TURN's recommendation is inconsistent with the SONGS decision and methodology, as TURN itself concedes. PG&E must maintain M&S inventories to support operations at Diablo Canyon. If the M&S inventories are not included in sunk costs and amortized over the transition period, PG&E will have an unrecovered balance for M&S inventories (less the 10% salvage value) if the plant is shutdown. PG&E says its approach is also consistent with its sunk cost application, in which it has included M&S inventories associated with all its generation-related assets.

We agree with TURN. We need not decide whether or not M&S is a sunk cost. The important issue is whether or not PG&E will collect twice for this item. To adopt PG&E's position we would amortize $77.8 million over five years plus [*59] include in ICIP an estimate of M&S to be consumed during the five-year period. This is a double recovery. We prefer to exclude M&S from sunk costs and include the projected five-year consumption of M&S in ICIP.

F. Computation

Our reading of the pertinent provisions of AB 1890 and D.95-12-063 clearly shows that sunk costs do not equate with uneconomic assets. Much of this decision discusses sunk costs. And PG&E has, in our opinion, equated "sunk costs" with "transition costs." We do not subscribe to that equation. To determine uneconomic costs, also termed "transition costs," our first step is to determine sunk costs. That step, however, does not end the matter; we then must determine which part of those sunk costs is uneconomic. It may be that 100% is uneconomic, but it is more likely that only a portion is.

Sunk costs are costs already incurred that can no longer be avoided or reduced through a curtailment or reduction of output or by providing other means of furnishing the service. Although it is comparatively easy to calculate Diablo Canyon sunk costs, it is difficult to determine the portion of sunk costs that become uneconomic, n10 and impossible to predict five years [*60] in advance that all, or any part, of the sunk costs will become uneconomic. This proceeding determines Diablo Canyon sunk costs. Later proceedings will then have a context within which to determine the uneconomic portion of those costs.

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n10 "The commission shall identify and determine those costs...consisting of generation facilities...that may become uneconomic...." (PU Code Section 367.)

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The sunk costs for Diablo Canyon as of December 31, 1996 are $3,286,706,000. The details of this finding are in Appendix B.

V. Incremental Cost Incentive Pricing

PG&E proposes to replace the performance-based escalating price in the current Diablo Canyon settlement agreement with an incremental cost incentive pricing mechanism similar to the performance-based ICIP adopted in the SONGS 2 & 3 settlement. The Diablo Canyon ICIP would be designed to recover PG&E's incremental costs of operating Diablo Canyon over the five-year period ending December 31, 2001, provided Diablo Canyon operates at an 80% capacity factor.

Like the [*61] existing Diablo Canyon performance-based pricing, the Diablo Canyon ICIP is a preset pricing schedule for Diablo Canyon power output. The Diablo Canyon ICIP, as PG&E proposes it, would apply from January 1, 1997, through December 31, 2001. The Diablo Canyon ICIP is based on a forecast of Diablo Canyon operational performance during the five-year period. The following table summarizes PG&E's and TURN's forecast of Diablo Canyon incremental costs for each year during the five-year period.

	($000) PG&E	TURN
1997	$545,835	$496,000
1998	566,784	500,000
1999	590,996	505,000
2000	621,291	509,000
2001	668,955	514,000
	$2,993,861	$2,524,000

A. Capacity Factor

PG&E forecasts an 80% average capacity factor for Diablo Canyon over the ICIP five-year period. PG&E bases the 80% capacity factor on Diablo Canyon's lifetime capacity factor, taking into account the vintage of plant equipment, the risk of future forced outages, and performance of comparable nuclear units of Diablo Canyon's type, size, and age.

A composite 1993-1995 industry average for comparable nuclear units nationwide shows:

1993-1995 Overall Capacity Factors

	Average 1993-1995 *
Industry	75.6%
NRC Peer Group	78.1%
INPO "1"	83.1%
Westinghouse 4-Loop PWR	71.0%

* Industry Averages exclude DCPP.

[*62]

PG&E believes that Diablo Canyon will operate slightly below its historical capacity factor of 80% over the next five years, given the aging of plant equipment and the risk of forced outage. In the near term, PG&E expects the plant to operate above an 80% capacity factor, but does not expect to sustain performance much above that for the entire period. PG&E believes this is consistent with PG&E's recent 1996 energy cost adjustment clause (ECAC) forecast case, where the Commission adopted a forecast Diablo Canyon capacity factor for 1996 of 86%.

ORA recommends a capacity factor of 83.6% for 1998 through 2001, consistent with Diablo Canyon's performance over the last five years. ORA notes that PG&E forecasts a capacity factor for Diablo Canyon of 89.2% for 1997 in its current ECAC filing, A.96-04-001. Consistent with PG&E's expectations ORA recommends that the 1997 ICIP price reflect PG&E's forecasted Diablo Canyon capacity factor for that year.

TURN supports ORA. Its witness testified that base performance for the 1991-95 period (assuming 1-1/3 refuelings per year) is 16,153 gWh or an 85.36% capacity factor. He said that performance has been improving dramatically for the entire U.S. [*63] fleet of nuclear units in recent years, as shown in the graph following. The median capacity factor (1993-95 average based on Design Electrical Rating net capacity factor) is 79%, with a median Pressurized Water Reactor capacity factor of 80.49%. Diablo Canyon has consistently performed better than the median. It was above the 25th percentile in performance until 1993-95. The lower ranking in 1993-95 was not from deteriorating Diablo Canyon performance but better performance of other units. At PG&E's proposed 80% capacity factor, however, the Diablo Canyon units would rank only 48th out of 106 operating reactors. The purpose of incentive pricing is not to reward the utility for declining from very good performance to slightly above average.

[SEE Three-Year Rolling Average Nuclear Capacity Factors Ending in Given Year (from Nuclear News, Design Electrical Rating Basis) IN ORIGINAL]

We agree with ORA and TURN. We will adopt a capacity factor of 83.6%. In a world where Diablo Canyon has exceeded an 80% capacity factor in every year since 1991, where we recently adopted a capacity factor forecast for 1996 of 86%, and where PG&E itself predicts an 89% capacity factor for 1997, we give [*64] no weight to PG&E's forecast of an 80% capacity factor.

B. Expenses

ORA argues that PG&E's proposed ICIP prices should be adjusted to reflect historic and reasonably expected costs. Further, ORA argues, PG&E's proposed 3.1% cost escalation factor ignores Diablo Canyon's historically decreasing operating costs. PG&E's approach of basing its forecast of operating costs on a simple average of recorded costs for 1993-1995 (after first escalating them into 1997 dollars), and then applying a yearly 3.1% escalation factor entirely disregards the fact that Diablo Canyon costs have decreased in recent years, not only in real dollars but in nominal dollars as well. In ORA's opinion, PG&E's approach aggravates the problem of inappropriate cost escalation by using the average of 1993-1995 costs. Over this time period, PG&E's O&M and A&G costs substantially decreased. Using the average cost over the three-year period, therefore, sets the 1997 starting point artificially high. There is no basis for either escalating the historic amounts into 1997 dollars, or for escalating the 1997 dollar average to derive the forecast of future costs.

We find, as discussed more fully below, that in regard [*65] to the expenses comprising the ICIP, PG&E's forecasts, other than nuclear fuel, are unpersuasive. PG&E ignores the historical downward trend in costs for the items which comprise the ICIP; PG&E ignores the historical level of plant capacity factor; PG&E ignores its own cost reduction efforts; PG&E ignores its own forecasts of downward trends in costs presented in other proceedings before us; and PG&E ignores the concern this Commission has with reducing costs in the new competitive electric world. PG&E would have us believe that the costs to operate Diablo Canyon will rise substantially each year of the next five. We give no credence to this.

More disturbing is the method by which PG&E determined its forecast. In other places PG&E defines forecasting as "the estimation of events or calculation of information in advance, or the projection into the future of current and past information, adjusted for expected changes." ... Forecasting is of critical importance for regulated utilities such as PG&E. ... [Utilities] must also be able to predict operational needs accurately. ... The development and use of accurate short-term and long-term forecasts can be crucial in these situations to [*66] ensure both that a utility will remain financially sound and that it will continue to be able to provide reliable, reasonably priced service to customers." (Pacific Gas and Electric Company, Resource: An Encyclopedia of Energy Utility Terms 2d Ed. 1992 p. 217.)

PG&E's method of forecasting in this proceeding was to start with an average of 1993-1995 recorded Diablo Canyon expenses, with certain exceptions. The three-year average was then escalated to 1997 prices. Then PG&E escalated the forecast costs by 3.1% per year over the forecast period, using the five-year average of the Consumer Price Index (CPI). The one major exception is capital additions. Here, PG&E's estimate for this cost was based on the Company's most current projection for the next five years, a projection which is 60% less than the 1993-1995 average recorded capital expenses for the plant, escalated by 5%.

This is not forecasting; this is arithmetic. It is the antithesis of PG&E's own forecasting process as set out in its resource encyclopedia. n11

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n11 And it is the antithesis of the testimony of at least one of PG&E's witnesses regarding ICIP prices, who said that PG&E's goal is to produce the most accurate possible estimate of costs. (RT p. 683 and 696.) The witness also said "we're not preparing a forecast at all." (RT p. 682.) However, PG&E's opening brief discusses "PG&E's Forecast of Diablo Canyon...." (PG&E, Opening Brief, p. 10 and passim.) We do not distinguish between an "estimate" and a "forecast." Either should strive for accuracy.

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1. Operations and Maintenance (O&M)

PG&E estimates that Diablo Canyon O&M expenses will be $257.3 million in 1997, based on actual recorded 1993-1995 O&M expenses, each escalated to 1997 dollars and then averaged to arrive at the 1997 estimate. For the five-year period, it then escalated the 1997 estimate by what it considers the rate of inflation, 3.1% each year.

TURN's evidence shows that O&M activities are an area in which PG&E has already achieved significant cost reductions, and expects to achieve further reductions in the upcoming five years. PG&E dramatically reduced the number of workers associated with Diablo Canyon from 1993 through the end of 1995. There were nearly 300 fewer employees at Diablo Canyon at the end of 1995 than there had been at the end of the prior year; the 1995 figure was also 86 below the corresponding figure for 1993. In addition, further reductions in the employee rolls are projected in the ICIP period, with 93 fewer employees forecast for 1997 according to the utility. These reductions are the product of a plan put together at the end of 1994.

TURN maintains that these staffing reductions at Diablo Canyon are not unique; staffing and cost [*68] reductions have been common at nuclear plants since 1991. This is not a one-time occurrence, but rather reflects a change in the staffing levels that can be expected to persist throughout the period of accelerated recovery. PG&E's own witness agreed that the plant's current staffing level is probably the better forecast of the number of workers associated with Diablo Canyon for the next five years, rather than a head count reflecting a period of eight years prior.

We agree with ORA and TURN. PG&E's method of forecasting and its ignoring its own effort to reduce costs, as evidenced by its staffing estimates, among others, are so out of touch with reality that they can be given no weight. TURN's proposal to start with 1995 costs as the basic number for O&M spending is reasonable and will be adopted.

2. Administrative and General (A&G) and Payroll Taxes

PG&E estimates that Diablo Canyon A&G expenses in 1997 will be $114.8 million. If additional A&G or O&M costs are allocated to Diablo Canyon in future rate proceedings, PG&E proposes to increase the Diablo Canyon ICIP to reflect such changes.

ORA's and TURN's recommended A&G expense forecasts follow their O&M forecasts. As we [*69] believe A&G expenses are largely a function of O&M expenses, we will adopt TURN's forecast. We have adopted TURN's estimate of payroll taxes as that too is a function of O&M and A&G. The following table shows the differences between PG&E and TURN.

PG&E and TURN Base Year O&M, A&G, and Payroll Taxes

		O&M	A&G	Payroll Tax	Total
Nominal $	1993	$225,636	$126,366	$11,082	$363,084
	1994	$255,467	$138,073	$11,310	$404,850
	1995	$227,834	$71,456	$9,425	$308,715
1996 $using PG&E Escalation					
	1993	$244,672	$137,027	$12,017	$393,716
	1994	$269,973	$145,913	$11,952	$427,839
	1995	$234,191	$73,450	$9,688	$317,328
1996 $using TURN 1.5% Escalation					
	1993	$235,943	$132,138	$11,588	$379,669
	1994	$263,188	$142,246	$11,652	$417,087
	1995	$231,252	$72,528	$9,566	$313,346
avg. refueling cost 96 $		$52,780			
PG&E in 96 $		$249,612	$118,797	$11,219	$379,628
TURN in 96 $(1995 esc. £ 1.5% + 1/3 refueling)		$248,845	$72,528	$9,566	$330,939
PG&E Exceeds TURN (base year)		$767	$46,269	$1,653	$48,689

The base year data shown above translates into a $351 million (nominal) difference [*70] in ICIP payments between TURN and PG&E over the next five years.

Comparison of PG&E and TURN ICIP for O&M, A&G, and Payroll Taxes ($'000)

	PG&E	TURN	Difference
1997	391,396	335,903	55,493
1998	403,529	340,942	62,588
1999	416,039	346,056	69,983
2000	428,936	351,247	77,689
2001	442,233	356,515	85,718
Total (nominal]	2,082,134	1,730,663	351,471

3. Escalation Factor

TURN contends that its proposed escalation rate of 1.5% is far more reasonable than the general inflation factor of 3.1% proposed by PG&E. It argues that the ICIP mechanism should be derived by applying a 1.5% escalation rate to Diablo Canyon costs over the ICIP period. This approach assumes that PG&E will continue to achieve productivity advances at the plant that keep its costs from rising at the rate of inflation, and is consistent with PG&E's stated plans to achieve further workforce reductions. TURN says that its recommendation is consistent with PG&E's approach to similar spending trends in testimony the utility filed in its most recent general rate case (GRC). TURN illustrates this point by escalating the actual 1995 O&M, A&G, and payroll tax costs by PG&E's 3.1% [*71] inflation rate. The total cost for 1997 would be $345.6 million after adjusting to normalize for refueling. PG&E is seeking $391.4 million for these same costs in 1997 in its ICIP proposal. PG&E's figure is $74 million higher than the actual 1995 costs in these categories, escalated at the utility's chosen inflation rate, and $46 million more than TURN's normalized 1995 spending levels increased at the same inflation rate.

ORA points out that PG&E's use of a 3.1% escalation factor contradicts its pending application for generation PBR, Application (A.) 96-08-001, in which it proposes to use an inflation factor of only 1.5% for its non-fossil generation resources, based on a 2.5% general inflation factor reduced by 1% to reflect expected improvements in its operations. PG&E states in that same application that CPI is an inappropriate measure for forecasting operating costs.

We believe TURN's 1.5% escalation rate is reasonable. In December 1993, we said "inflation rates have been and are expected to be low. Financial markets have been stable for several years." (D.93-12-043, p. 26.) This statement continues to be valid. Even were we to assume that the CPI is at 3.1% (and there is [*72] much debate about this), we see no evidence that PG&E's costs will rise at a 3.1% inflation rate. It is much more reasonable to expect PG&E's past productivity achievements to continue.

4. Nuclear Fuel

PG&E estimates that nuclear fuel expenses for 1997, exclusive of nuclear fuel lease out-of-core carrying costs, will be $66.0 million based on an 80% capacity factor. Fuel costs are forecasted to escalate at 5% annually based on existing long-term contracts with escalator clauses and the recent doubling of uranium spot prices. Neither TURN nor ORA rebutted PG&E's testimony on spot market and contract prices, but instead relied on either the escalation in 1993-1995 trended costs (TURN) or assumed no escalation at all (ORA).

Although we are troubled by the asserted 5% escalation factor, we find that PG&E's evidence on current uranium spot prices and price escalation clauses in its existing fuel contracts is a more reasonable and specific basis for nuclear fuel escalation than ORA's and TURN's recommendation. However, this estimate should be modified to reflect the 83.6% capacity factor adopted herein.

5. Capital Additions

PG&E estimates that the incremental capital additions [*73] to Diablo Canyon will be $37 million in 1997. This estimate is based on 1997 projected capital additions.

TURN recommends modification of PG&E's base spending figure of $37 million per year in capital additions for two reasons. First, PG&E has not reduced the figure to exclude the Allowance for Funds Used During Construction (AFUDC), as was done in the ICIP adopted for SONGS. Second, a 3.1% escalation rate should be used rather than the 5% proposed by the utility. TURN argues there is no basis for PG&E's figure other than the judgment of PG&E's management. No reason was presented for adopting an escalation rate so substantially higher than inflation.

ORA argues that capital additions costs should not be escalated, and should be reduced by 10% to reflect elimination of AFUDC. PG&E's proposed ICIP prices assume that capital additions costs will increase at an annual rate of 5% over the next five years beginning in 1997, rather than 3.1% it assumes for all other costs. As with its other costs, PG&E offers no evidence to support the assumption that capital additions costs will increase at all, much less at higher than the rate of inflation. To the contrary, PG&E's own forecast of 1997 [*74] capital additions costs assumes a significant decrease from historic levels. Historically, capital additions costs have not increased with inflation. ORA recommends that no escalation be assumed for capital additions costs.

In addition, ORA asserts, PG&E failed to remove the costs related to AFUDC from its capital additions forecasts. Since capital additions costs under the ICIP mechanism are to be recovered on an expensed basis, i.e., fully recovered in the year incurred, it is inappropriate to apply AFUDC to those costs. For this reason, the SONGS mechanism reduced capital additions costs by 10% annually to account for the elimination of AFUDC. Consistent with this principle, the forecast of Diablo Canyon capital additions should be reduced by 10% to account for the lack of AFUDC. This results in a proportional decrease in the forecasted amount of income taxes.

PG&E argues that its escalation factor is reasonable in light of "substantial uncertainty" in whether the dramatic reduction in Diablo Canyon capital costs can be sustained, considering the aging of plant equipment, the risks of

Nuclear Regulatory Commission (NRC) regulations, and the specialized nature of the nuclear industry. [*75] It says ORA's and TURN's result-oriented alternative recommendations are unsupported and unreasonable.

Again, we agree with ORA and TURN. There is no reason to include AFUDC in capital additions, since capital additions are recovered on an expensed basis. We will reduce capital additions by 7%. In regard to the 5% inflation rate, we point to our discussion of inflation, above. In the context of this ICIP "substantial uncertainty" has no meaning; we have historic numbers and reasonable projections to guide us. In this instance, we will adopt TURN's 3.1% inflation factor.

6. ICIP Related Tax Issues

PG&E, ORA, and TURN have agreed that property taxes for both sunk costs and capital additions during the ICIP period will be subject to a balancing account. The amount to be included in setting the ICIP in any given year is the amount that PG&E originally forecast for its sunk costs. The actual property tax costs will be balanced against that figure, so that ratepayers bear only the actual costs. After 2001, any remaining property taxes associated with either sunk costs or ICIP costs will be subject to the 50-50 profit-sharing that will apply to Diablo Canyon.

For insurance associated [*76] with capital additions, the parties have agreed that such costs should be collected from ratepayers during the ICIP period on a pay-as-you-go basis, using PG&E's formula of 0.3% of net plant. The figures included in Exhibit 61 reflect this methodology. While agreement was reached on the methodology, the specific numbers presented by PG&E in Exhibit 61 are subject to revision in the event that we adopt capital additions figures that vary from PG&E's estimate. After 2001, any insurance associated with capital additions made during the ICIP period will be subject to the 50-50 profit sharing.

The parties settled upon a methodology for calculating income taxes for capital additions occurring during the ICIP period. Again, while this methodology is reflected in Exhibit 61, the specific numbers presented by PG&E therein are subject to revision in the event that we adopt capital additions figures that vary from PG&E's estimate.

The parties agreed that post-2001 income tax, property tax, and insurance benefits due to book tax timing differences in the calculation of ICIP costs should be allocated to ratepayers. PG&E's July 1, 2000 application for sharing of post-2001 benefits of the plant [*77] will assure that 100% of these benefits are allocated to ratepayers.

C. Diablo Canyon ICIP Schedule

At an assumed 83.6% capacity factor, Diablo Canyon's projected incremental costs yield the following ICIP price schedule for the period 1997-2001. n12

1997	3.26 cents/kWh
1998	3.31 cents/kWh
1999	3.37 cents/kWh
2000	3.43 cents/kWh
2001	3.49 cents/kWh

-----------------Footnotes-----------------

n12 The detailed computation is set forth in Appendix C.

----------------End Footnotes----------------

D. Exclusions from Diablo Canyon ICIP

Consistent with the SONGS 2 & 3 settlement, PG&E recommends that certain safety-related and other costs should be excluded from the Diablo Canyon ICIP and would be recovered from customers through nonbypassable rates. These exclusions are:

1. Decommissioning Trust Fund Costs and DOE Decontamination and Decommissioning Expenses

PG&E proposes that decommissioning funds for Diablo Canyon continue to be recovered in PG&E's base rates under traditional cost of service ratemaking. Similarly, Diablo Canyon's share of Energy Policy Act of 1992-mandated [*78] contributions to the Department of Energy (DOE) Decommissioning and Decontamination fund for the cleanup of the DOE enrichment facilities would be recovered in PG&E's base rates. PG&E at its option may accelerate the recovery of decommissioning costs over the same depreciation period applicable to Diablo Canyon sunk costs. These proposals are reasonable and will be adopted.

2. Recovery of Specific Assessments, Including Costs Associated With Claims of Exposure to Nuclear Radiation and Electric and Magnetic Fields

PG&E would retain the right to recover costs of certain potential special nuclear assessments, retrospective premiums, or costs for claims associated with Diablo Canyon prior to 2002. These would include costs associated with: (1) NRC Secondary Financial Protection Program; (2) Master Worker Liability coverage with ANI/MAELU associated with incidents or exposures at any locations; (3) Master Worker Liability coverage with ANI/MAELU relating to nuclear plant decommissioning; (4) claims by workers and/or third parties including, but not limited to, allegations of exposure to nuclear radiation and/or electric and magnetic fields (EMF) associated with incidents or exposures [*79] at any location; and (5) claims by workers and/or third parties relating to nuclear plant decommissioning. If Diablo Canyon were permanently shut down during the depreciation period, PG&E would remain liable for any of those costs associated with the shutdown unit(s). Therefore, PG&E believes it should recover those costs from customers through nonbypassable rates. We agree.

3. Shutdown O&M and Unamortized Fuel Expenses

The floor payments and abandonment provisions in the existing Diablo Canyon settlement agreement would be replaced by PG&E's right to recover shutdown O&M expenses and unamortized fuel costs until Diablo Canyon decommissioning commences. Under this approach, if either of the Diablo Canyon units shuts down, PG&E would recover shutdown O&M expenses and unamortized fuel costs. Shutdown O&M expenses are estimated to be approximately 80% of actual recorded Diablo Canyon O&M and A&G expenses (as annualized based on the most recent 24-month operating period) for the first 12 months, 50% in the second 12 months, and 10% during each 12-month period thereafter until decommissioning begins. This is reasonable.

4. Property Taxes

If Diablo Canyon is shut down PG&E [*80] could remain liable for any property taxes assessed on the shutdown unit(s). Therefore, PG&E proposes to recover the property taxes attributable to the shutdown Diablo Canyon unit(s) through base rates. This is approved.

E. Exclusions from Diablo Canyon Market Pricing

PG&E proposes that it continue to recover certain unavoidable costs after 2001. This proposal is reasonable. These costs are:

1. Decommissioning Trust Fund Costs and DOE Decontamination and Decommissioning Expenses

In the event that PG&E chooses not to accelerate recovery of Diablo Canyon decommissioning costs over the same period as Diablo Canyon sunk costs, PG&E will continue to be required to collect such funds subsequent to 2001 to ensure that the Diablo Canyon decommissioning funds are fully funded prior to Diablo Canyon decommissioning.

Similarly, PG&E will be required to collect DOE decontamination and decommissioning expenses after 2001 in accordance with the Energy Policy Act of 1992. Therefore, regardless of whether Diablo Canyon is operated after 2001, PG&E should continue to recover such costs through base rates.

2. Recovery of Specific Assessments, Including Costs Associated With Claims [*81] of Exposure to Nuclear Radiation, and Electric and Magnetic Fields

PG&E would continue to recover in base rates the same specific assessments, retrospective premiums, and costs of claims associated with its ownership of Diablo Canyon after 2001 relating to nuclear facilities in the United States at locations other than Diablo Canyon.

3. Shutdown O&M and Unamortized Fuel

In the event of a permanent closure of Diablo Canyon after 2001, shutdown O&M expenses and unamortized fuel would be recovered from CPUC jurisdictional customers in nonbypassable base rates. After 2001, the CPUC jurisdictional customers' obligation for these costs would be reduced by 10% each year until decommissioning commences. For example, if permanent closure occurs any time in 2003, the CPUC customers' responsibility would be 80% for each year until decommissioning begins, based on a reduction of 10% in 2002 and another 10% in 2003.

F. Cost of Capital

For purposes of this proceeding, PG&E's authorized overall capital structure (common equity, preferred stock, and debt ratios) as of January 1, 1996, will be used to compute the reduced return on Diablo Canyon sunk costs and for other calculations. [*82]

Based on PG&E's 1996 authorized capital structure and the reduced return contained in the SONGS decision and our Policy Decision, the return component of the DCSCRR will be computed as follows:

Debt	46.50%	7.52%	
Preferred	5.50%	7.79%	
Equity	48.00%	6.77%	(90% of Debt)
Total	100.00%	7.17%	

VI. Diablo Canyon Total Revenue Requirement

The adopted estimated CPUC-jurisdictional Diablo Canyon annual revenue requirement is shown in the table below.

Pacific Gas and Electric Company
Diablo Canyon Revenue Requirement
CPUC Jurisdiction
(Million of Dollars)

	1997	1998	1999	2000	2001
Fixed Cost Recovery	1,385	1,322	1,259	1,197	1,135
ICIP Expenses	515	523	532	542	552
Total Revenue Requirement	1,900	1,845	1,791	1,739	1,687

The ICIP revenue requirement is calculated by multiplying the annual ICIP, adopted in this decision, by the net generation of Diablo Canyon. This establishes the revenue requirement for Diablo Canyon fixed costs and the estimated revenues required for ICIP expenses. Calculating the uneconomic portion of these costs, and the associated ratemaking treatment, will be determined in the transition cost recovery [*83] proceeding.

VII. Safety and the Safety Committee

San Luis Obispo Mothers for Peace, Rochelle Becker, and Life on Earth Planet (Mothers for Peace) specifically focused on the safety consequences of the ratemaking proposals for Diablo Canyon. They believe PG&E's current proposal presents a serious conflict between safety and profits. The Mothers for Peace support ORA's proposal that PG&E be allowed to recover its reasonable costs of operating Diablo Canyon; they reject the ICIP concept.

The Mothers for Peace assert that the rush towards economic competition, mandated to begin early in the next century, will likely result in a myriad of safety problems. They contend that the legislature, the Commission, and the utilities have not considered this important issue. They argue that economic pressure will have safety consequences at Diablo Canyon.

They claim that as Diablo Canyon ages there will be an increase in maintenance needs and therefore costs. Age related items will be extremely costly, i.e., steam generators. Many aging issues are already surfacing at nuclear facilities and it is only a matter of time before Diablo Canyon will face the same problems. These aging issues will [*84] increase the costs and economic pressure of operating Diablo Canyon. They claim that PG&E is under enormous economic pressure to cut the costs of operation and maintenance at Diablo Canyon. Its workforce has already been reduced and monitoring has been reduced or eliminated. The utility is also unsure what new and possibly costly requirements the NRC may set for nuclear utilities in the near future.

The Mothers for Peace are concerned that the utility will be unable to maintain safe performance levels while reducing costs. They introduced evidence that the NRC has substantiated this concern in its September 13, 1996, Systematic Assessment of Licensee Performance (SALP) report which downrated Diablo Canyon's safety performance in three areas: operations, maintenance, and engineering.

The SALP Report points out that:

...Maintenance management also was challenged with reorganization activities.... (P. 3, Exhibit 44.)

...the numerous events experienced throughout the assessment period indicated that elements of the maintenance organization were not focused on sustaining superior performance.... (P. 3, Exhibit 44.)

...In March 1995, engineering went through a significant effort [*85] to downsize, reorganize, and consolidate into a single onsite organization with a small portion remaining in the corporate office. This reorganization challenged management. (P. 4, Exhibit 44.)

The Mothers for Peace conclude that the utility's focus on deregulation and preparations for the upcoming competition played a definitive role in its declining safety performance.

In furtherance of their concern over safe operation of Diablo Canyon, the Mothers for Peace have petitioned to set aside submission to take additional evidence on the issue of safety impacts. The evidence involves a report written by a PG&E supervisor at Diablo Canyon and submitted to the Diablo Canyon Independent Safety Committee on February 5, 1997. The report, in essence, claims that PG&E is sacrificing safety in the interest of "financial competitiveness."

PG&E, in response, states that safety is its highest priority at Diablo Canyon and that nothing in its proposal is meant to compromise its commitment to safe operation. PG&E believes that Diablo Canyon will be economic to operate in competitive markets and categorically rejects the assertion that ICIP pricing will compromise safety. Nevertheless, PG&E notes [*86] that the Mothers for Peace provide support for PG&E's position that in setting Diablo Canyon rates, this Commission should take into account the pressures on plant operating costs that PG&E is likely to face over the 5-year transition period.

PG&E opposes the petition to set aside submission. It argues that, contrary to the petition, the concerned employee's statement supports PG&E's commitment to safety and to an open, active process for resolving employee concerns regarding safety. It says the particular employee's concerns have been and are being evaluated and reviewed by PG&E's formal Employee Concerns Program. In addition, the Diablo Canyon Independent Safety Committee has and is reviewing the concerns, and already has made recommendations for improvements to PG&E's programs which PG&E is implementing. Finally, the U.S. Nuclear Regulatory Commission, the agency with primary responsibility for regulating public health and safety at Diablo Canyon, has been and is actively reviewing the employee's concerns.

PG&E asserts that it has publicly stated that it supports the employee in raising the concerns and expects employees to raise such concerns to PG&E and to others in order to [*87] assure an open and timely process for resolution. PG&E declares that its response to the employee indicates that the company continues to be committed to the highest level of safety at Diablo Canyon. Nevertheless, PG&E contends that the Independent Safety Committee should cease to exist at the end of the transition period. It argues that after 2001 Diablo Canyon will no longer be CPUC jurisdictional and the Committee's cost will no longer be necessary. We do not construe our jurisdiction so narrowly. Because PG&E has an interest in Diablo Canyon, and for the reasons stated below, we believe the Committee should remain in existence indefinitely, to be funded by ratepayers.

This Commission is concerned and committed to the highest degree of nuclear safety at Diablo Canyon, and at all nuclear facilities. But it is the Nuclear Regulatory Commission that has nuclear safety jurisdiction over Diablo Canyon. Our participation is to assure adequate funding to operate safely, to assure responsiveness by the Independent Safety Committee, and to make appropriate recommendations when needed. We believe this decision, under the rate freeze, provides more than adequate funding to operate Diablo Canyon [*88] safely. And we are confident that the Independent Safety Committee will discharge its functions responsibly. We have considered the concerns of the Mother for Peace and are of the opinion that they have been adequately met, to the extent of our jurisdiction, in our findings on sunk costs and the ICIP. The petition to set aside submission is denied.

One issue that was not adequately addressed during the hearings was the fate of the Diablo Canyon Independent Safety Committee. PG&E's proposal would have terminated the Committee on December 31, 2001, with the termination of the Settlement Agreement. As we are terminating the Settlement Agreement with this decision, the issue of the viability of the Committee is pertinent.

The Diablo Canyon Independent Safety Committee urges us to continue the Committee indefinitely. It explains that the Safety Committee was established by the parties to the original Diablo Canyon settlement agreement to provide the public with additional assurance that the safety of Diablo Canyon's operation would not be adversely affected by economic considerations. Given the economic incentives provided to PG&E to operate the plant at maximum levels, the Safety Committee [*89] acts as a countervailing force representing the public interest to ensure that important safety issues, including plant operations, are fully reviewed and addressed. Key to this function is the appointment of the three academic or nuclear industry members by the Governor, the Attorney General, and the Chairman of the California Energy Commission from a list nominated jointly by this Commission's president, the Dean of Engineering of the University of California at Berkeley, and the president of PG&E.

The Safety Committee, which conducts three public meetings annually in San Luis Obispo County, provides public visibility of and a forum for plant safety issues. In addition, the Safety Committee processes inquiries from a wide range of citizen groups and individuals, including Diablo Canyon operators and other key employees. As recently as March 1997, the Safety Committee replied to concerned residents who live in the vicinity of Diablo Canyon and to a request by the Attorney General's office to respond to alleged safety problems.

It states that throughout its operation, the Safety Committee has taken its responsibilities seriously and executed its duties conscientiously. It has conducted [*90] fact-finding investigations of appropriate areas of operation and also general inspections of Diablo Canyon's operations. The Safety Committee has spent its allocated funds hiring expert engineering and related consultants to ensure that all important safety issues are fully addressed. The Safety Committee's numerous recommendations to PG&E regarding plant operations have been responded to in a positive and cooperative fashion. The Safety Committee's activities and recommendations have contributed significantly to the safe operation of Diablo Canyon. Moreover, to its knowledge, there have been no objections to the performance of the Safety Committee.

The California Energy Commission (CEC) strongly opposes the abolition of the Committee now, or five years hence. The CEC reminds us that the responsibilities of the Committee include preparing annual reports containing an assessment of the safety of Diablo Canyon operations and making suggested changes in order to enhance safety at Diablo Canyon. When considering the establishment of the Committee in 1988, this Commission found that "the Safety Committee will be a useful monitor of safe operation of Diablo Canyon. With competent members [*91] dedicated to achieving safety at Diablo Canyon, the committee will confer a benefit on the public and is in the public interest." (Finding of Fact 20, D.88-12-83, p. 188.) In fact, the opposition expressed during that proceeding to the creation of the Committee was based on concerns that the Committee would not be strong enough to assist in ensuring safe operation. The CEC believes that the Commission's original conclusions about the value of the Committee are correct. It sees no reason to abolish a Committee which has helped ensure safe operation of the Diablo facility absent a thorough examination of its value to the public and without consideration of the alternative mechanisms the Commission could use to achieve the objectives the Commission had in mind when it originally established the Committee.

We are in complete agreement with the Committee and the CEC. We will continue to maintain and fund the Committee at its current level of $673,077 in 1996 dollars adjusted upward at 1.5% annually until a showing is made that the Committee no longer performs a useful function.

VIII. County of San Luis Obispo - Property Tax Relief

The County of San Luis Obispo and the San Luis [*92] Coastal Unified School District (County) seek protection against the risk that Diablo Canyon-related property taxes will decrease precipitously and jeopardize the ability of the County to provide basic public and educational services. If the threat actually materializes, the County wants to be made whole. By its recommendation, the County seeks adoption by the Commission of a mechanism that insures that the County has the opportunity to recover the property tax revenues they had a reasonable expectation of receiving but for electric restructuring.

The County recommendation is that this Commission should:

. Find that $158 million (NPV in 1999 dollars) represents a reasonable estimate of the potential difference between property tax revenues that the County would have received from PG&E in the absence of accelerated recovery of Diablo Canyon depreciation and what the County could actually receive given restructuring.

. Find that $158 million in property tax revenues potentially denied to the County as a consequence of electric restructuring is eligible under both our Policy Decision and AB 1890 for recovery by PG&E as part of CTC.

. Order that $158 million in potentially [*93] forgone property tax revenues be included in the total amount of CTC which PG&E is authorized to recover between 1/1/98 and 12/31/2001.

. Order that the $158 million in potentially forgone property taxes be collected by PG&E as CTC at a rate of $39.5 million per year during the CTC recovery period and held in a separate, segregated interest-bearing account until 2026.

. Order PG&E, starting in 1999 and continuing thereafter on an annual basis, to withdraw funds from the segregated CTC account and to remit to the County the difference between the estimated tax payments based upon straight-line depreciation of Diablo Canyon through the year 2026 (as set forth in Exhibit 24; Attachment 1, p. 2, Column III) and any amount of property taxes actually determinated to be due and payable by PG&E to the County in each year, to the extent such actual taxes are less than the estimated straight-line depreciation based property taxes set forth in Exhibit 24; Attachment 1, p. 2, Column III.

. Order that payments by PG&E to the County from the segregated CTC fund continue on an annual basis either until the end of 2026 or until the fund is exhausted.

. Order that PG&E determine on an annual [*94] basis whether the remaining amount in the segregated CTC fund exceeds the total amount of remaining estimated property taxes through the year 2026 as set forth in Exhibit 24; Attachment 1, p. 2, Column III and, if so, order that any such excess be returned to PG&E's ratepayers.

. Order that any funds remaining in the segregated CTC fund following expiration of PG&E's obligation to remit payments to the County after 2026 be returned to PG&E's ratepayers.

The County asserts that adoption of its recommendation will provide protection against the possibility that the County will experience drastic reductions in property tax revenues as a direct result of electric restructuring. If the risk of property tax reductions does not materialize or produces lower tax revenue losses than predicted, any excess amounts otherwise reserved for payment to the County will be returned to ratepayers.

The County contends that the evidence produced by it shows:

. that the County enjoys unique status by reason of long-standing, mutual commitments with PG&E relating to the location and operation of Diablo Canyon within the County;

. that electric restructuring, and PG&E's related pricing proposal [*95] for Diablo Canyon in particular, create the real possibility that the County will suffer far greater negative consequences from restructuring than any other similarly situated stakeholder, primarily in the form of dramatic reductions in the level of otherwise expected property tax revenues to be received from PG&E;

. that the consequence for the County of any property tax revenue reductions resulting from PG&E's Diablo Canyon pricing proposal includes severe reductions in essential public services available to the residents and schoolchildren of San Luis Obispo County;

. that the mutual commitments between the County and PG&E and, in particular, the County's reliance on PG&E's promises to provide identifiable economic benefits in exchange for siting and operating a nuclear generation facility within San Luis Obispo County, create an enforceable entitlement to a stable and predictable level of property tax revenues for the County throughout the projected operating life of Diablo Canyon; and

. that the difference between property tax revenues that the County would have received from PG&E in the absence of accelerated recovery of Diablo Canyon depreciation and what the County actually [*96] receives given implementation of electric restructuring is properly recoverable (by PG&E and payable to the County) as part of CTC, as defined both by the Commission's Policy Decision and by AB 1890.

This evidence, in the opinion of the County, leads to only one conclusion of law: It is consistent with law, policy, and the public interest for the Commission to adopt a mechanism that will provide a safety net for the County by ensuring that the County's property tax receipts are unaffected by any accelerated depreciation of Diablo Canyon authorized by the Commission in conjunction with its initiative to restructure the state's electric industry.

PG&E and ORA oppose the County. PG&E argues that the County had mischaracterized potential property tax impacts by including an assumption that Diablo Canyon would close after 2001 (a proposal which is not before the Commission in this proceeding) and that current property tax assessment methodology would continue unchanged after the 2000 expiration of the current agreement among the State Board of Equalization, California utilities, and California counties. Moreover, it appears that, due to the lag time in property tax assessment, the County [*97] will not experience any adverse impacts from AB 1890 until 1999 and 2000, leaving time for the impacts to be addressed by the state legislature or the Commission in proceedings other than this one.

In addition to the problems in predicting the actual impacts of restructuring on the County, PG&E asserts that the County's proposal to recover lost property tax revenues is legally suspect. AB 1890 contains no explicit provision to allow utilities to recover costs or lost governmental revenues that they are not liable for but which are incurred by third parties, such as counties, under restructuring. In addition, as a general principle of ratemaking, utilities are not permitted to include in their cost of service payments which in fact they have not incurred or accrued, or forecast to incur, and which they have not become legally obligated to incur or accrue.

ORA states that the County has not cited any statute or rule that would support its position. ORA notes that there has never been any guarantee that Diablo Canyon property tax revenues would not decrease, even in the absence of electric restructuring and PG&E's accelerated depreciation proposal. For example, if Diablo Canyon continued [*98] to perform at current levels in the future such that PG&E recovered more in revenues than intended under the original ratemaking settlement, the Commission could require a reduction in prices as was done in 1995, or the early termination of the ratemaking treatment. This would impact San Luis Obispo tax revenues, even in the absence of electric restructuring. In addition, nothing in the existing Diablo Canyon ratemaking treatment precludes the facility from shutting down, not just for catastrophic failure, but for economic reasons as well. Under such circumstances, regardless of electric restructuring, there would likely be no tax revenues for San Luis Obispo. ORA maintains that accelerated recovery of Diablo Canyon sunk costs increases the likelihood that Diablo Canyon will not be shut down. Recovering all of its uneconomic investment before entering competition in the electric market improves PG&E's ability to succeed in that market.

ORA submits that San Luis Obispo is not the only county that will experience reduced property taxes as a result of utilities accelerating the depreciation of their generation assets. Notwithstanding the fact that San Luis Obispo is likely to experience [*99] a greater tax impact than other California counties, the accelerated depreciation of SONGS, as well as non-nuclear generation, will impact the property tax revenues of the counties in which they are located.

Most telling is ORA's argument that San Luis Obispo would have the Commission impose on ratepayers what is essentially a tax that is entirely unrelated to utility service. The County's proposal that ratepayers pay for property taxes that PG&E does not incur is not permitted under either general ratemaking principles or public utility law. Section 451 of the PU Code requires:

"All charges demanded or received by any public utility ... for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful."

A utility cannot charge ratepayers costs that are unrelated to the provision of any product or commodity or service, and the Commission cannot lawfully order such charges. n13

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n13 Thus, for example, absent specific enabling legislation, the Commission could not permit ratepayers to be charged for compensating financially deserving consumer representatives for intervening in regulatory proceedings. (Consumers Lobby Against Monopolies v. Public Utilities Com. (1979) 25 Cal.3d 891, 160 Cal.Rptr. 124; PU Code §§ 1801 et seq.).

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However, ORA supports San Luis Obispo's efforts to seek relief in a more appropriate forum. It is within the state's powers, not the Commission's, to levy taxes and to disburse tax revenues. The state will receive a windfall of approximately $200 million in increased income tax revenues over the next five years as a result of accelerating the recovery of Diablo Canyon costs. ORA believes it is equitable for the state to allocate some portion of this windfall to provide relief to San Luis Obispo.

The arguments of PG&E and ORA are persuasive. There is no legal basis for this Commission to authorize PG&E to include in its rates and cost of service estimated property taxes which it is not lawfully obligated or forecasted to pay. Taxes which are included in rates are those in effect at the time the rates are approved, unless the existing law provides for a change at a future date. (Re Pac. Tel. & Tel. (1954) 53 CPUC 276, 295.) Absent legislative change, or

Board of Equalization change, PG&E's taxes are what they are under existing law and the County's proposal will not change that fact. The County must direct its request for relief to the Legislature and the Board, not this Commission. [*101]

IX. The 1988 Diablo Canyon Settlement

In our original decision approving the Diablo Canyon settlement we were careful to point out that in approving the settlement we could not bind future Commissions nor could we bind the Legislature. (30 CPUC 2d 189, 223.) The question before us now is whether any portion of the settlement, as modified, remains in effect given the strictures of AB 1890, our Policy Decision, and this decision. We conclude that the entire Diablo Canyon settlement, as modified, is of no force and effect, having been supplanted by AB 1890, our Policy Decision, and this decision.

By the terms of the original and modified Diablo Canyon settlements, there is no longer a valid nuclear settlement covering PG&E's operation of the Diablo Canyon plant. The settlement adopted in D.88-12-083 provides: "This Agreement sets forth PG&E's exclusive method for recovering any CPUC jurisdictional costs of owning or operating Diablo Canyon for the term of this Agreement." (Appendix C, p. 1.) Later in that same document, the settling parties agreed that "any material change in this Agreement shall render the Agreement null and void." (Id., Paragraph 17.) With the adoption [*102] of AB 1890, the Legislature abrogated the terms of the settlement agreement and substantially modified the Commission decision adopting that agreement. Rather than recovering its costs of operating the plant over the next 28 years through the provisions of the settlement, PG&E will recover the portion of the plant costs that appear to be uneconomic in the next five years or not all.

Further, according to the terms of the Restructuring Rate Settlement (RRS) Diablo Canyon ratemaking issues are proposed to be modified. The RRS covers a broad range of issues, including Diablo Canyon pricing and ratemaking for the period of accelerated cost recovery and beyond. (Ex. 13, Att. 1, pp. 5, 7-8.) Under the RRS, incremental costs are recovered through an ICIP mechanism, and sunk costs associated with the plant are part of the generation-related assets that must be collected by the end of 2001. Thus, the RRS is evidence that the original and modified Diablo Canyon settlements have been abrogated by PG&E and are therefore null and void. Neither ORA (as the successor in interest to DRA) nor the Attorney General has agreed to the terms of those portions of the RRS that would modify the terms of the [*103] existing settlement.

X. Audit

TURN urges the Commission to order a thorough, independent audit of Diablo Canyon sunk costs. Because this plant has not heretofore been subject to cost-of-service ratemaking, TURN believes it is imperative that the underlying data be correctly stated on a ratemaking basis. It urges the Commission to direct PG&E to retain, at shareholder expense, an appropriate accounting firm with experience in regulatory matters and experience in depreciation to review PG&E's calculations of its sunk costs and verify that the numbers are correct and that the depreciation practices since inception of the plant are reasonable. TURN states that its request for an audit is consistent with the RRS. The audit would not be a management audit; it would not review the reasonableness of PG&E's construction decisions. The audit would be a financial verification audit, to examine the Diablo Canyon accounts and express an opinion on the propriety of the financial statements. n14

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n14 In its "Restructuring Rate Settlement," PG&E agreed that "Diablo Canyon plant costs would be no higher than those shown in PG&E's 1995 annual report, ... and all of the above costs will be subject to a verification audit, the results of which must be satisfactory to the parties. If a party is not satisfied with the verification audit, the party has absolute discretion to withdraw from this agreement."

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We will order the audit. We have never scrutinized PG&E's depreciation practices associated with Diablo Canyon. Such scrutiny, which normally would occur in a GRC, serves at least two important functions: It provides auditable figures of gross plant and depreciation reserve in a recorded year, and it establishes depreciation parameters within which the utility must operate between rate cases. For every other element of utility-owned generation plant or related assets for which CTC recovery is sought under the Commission's restructuring order and AB 1890, the Commission has performed such audits as part of traditional cost-of-service ratemaking. Under the Diablo Canyon settlement, such review has never occurred. We note that we have ordered an audit for the sunk cost applications filed by PG&E, Edison, and SDG&E in A.96-08-001 et al. (D.96-09-032). Those applications covered assets and other costs that had largely, if not entirely, been subjected to review in previous GRCs. Even with the comfort of that past review, we determined that allowing accelerated sunk cost recovery as part of the industry restructuring effort warranted a further, full-fledged audit of the accounting practices [*105] applied to those non-nuclear generation assets. Given the lack of past review for Diablo Canyon, the argument for such an audit is even stronger.

The audit is limited to sunk costs. It will ensure that the net book value amounts for Diablo Canyon sunk costs are independently established with all parties having an opportunity to respond to the audit report. The Energy Division shall oversee the management of the audit, and the selection of auditor, if necessary. As we did in D.96-09-052, we will order PG&E to pay for the audit.

Because we have limited time available and because the independent auditors selected to do the PG&E non-nuclear generation audit are familiar with PG&E's system, we direct the Executive Director to seek to negotiate to expand the current PG&E independent auditor's contract to include the audit ordered by this decision. We expect the final audit report to be completed within six months. Costs of the audit will be part of PG&E's revenue requirement.

As we desire to close this docket with this decision, PG&E shall, upon receipt of the final audit report, file an application seeking approval of the report.

Findings of Fact

1. Rather than waiting an additional [*106] 15 years to recover sunk costs under present pricing, and being at risk all those years, PG&E has been given the opportunity to recover its uneconomic generation costs in five years.

2. The "SONGS comparability" called for in D.95-12-063, as modified by D.96-01-009, should be construed as the use of an ICIP mechanism for recovery of incremental operating costs during the period of accelerated sunk cost recovery. Because of the material differences between the Diablo Canyon and SONGS plants, the specifics of the ICIP mechanism and sunk cost recovery vary.

3. The lack of reasonableness review for Diablo Canyon's original construction costs and subsequent capital investment is a critical difference between that plant and SONGS.

4. The balance of risk and reward for Diablo Canyon was very different under the Diablo Canyon Settlement Agreement than it would have been under traditional ratemaking. The adoption of an ICIP and accelerated sunk cost recovery will reduce PG&E's risk in operating Diablo Canyon.

5. Ratepayers should be responsible only for reasonable costs and Diablo Canyon has never undergone a reasonableness review.

6. In the Diablo Canyon settlement decision PG&E admitted [*107] to error of no more than $100,000,000 (30 CPUC2d at 281, Finding of Fact 5.) There was no dispute that an error was made by PG&E and its contractors (30 CPUC2d at 269, 271.) There should be disallowed from current sunk costs the depreciated value of $100,000,000, under the formula:

$100,000,000 x depreciated value of original plant * / undepreciated value of original plant

* The depreciated value of original plant equals the current depreciated value of the entire plant less the depreciated value of all capital additions to December 31, 1996.

7. By the terms of the original and modified Diablo Canyon settlements, there is no longer a valid nuclear settlement covering PG&E's operation of the Diablo Canyon plant upon adoption of the new Diablo Canyon ratemaking effective January 1, 1997 under this decision.

8. PG&E has included $78 million in Diablo Canyon sunk costs for out-of-core nuclear fuel inventory. It also includes nuclear fuel in its ICIP proposal. PG&E's proposal will charge ratepayers twice for nuclear fuel that will be used during the next five years.

9. Including PG&E's out-of-core nuclear fuel inventory in sunk costs would allow PG&E either to double collect the cost [*108] of fuel it uses during the transition period, or to collect from ratepayers the cost of fuel that will be used after the transition period when PG&E is responsible for all of its generation costs. Including out-of-core nuclear fuel inventory as a sunk cost would inappropriately provide the utility with a fuel inventory at its current level on January 1, 2002, and fails to reflect the fungibility of the fuel at most stages of its processing. The out-of-core nuclear fuel inventory should be excluded from Diablo Canyon sunk cost recovery.

10. PG&E has included an $8.9 million estimate of the December 31, 1996 CWIP balance in Diablo Canyon sunk costs. Our analysis of the SONGS decision shows that CWIP was included in SONGS 2&3 sunk costs. Any costs recorded in CWIP and included in Diablo Canyon sunk costs will not be included in the ICIP. There is no double counting CWIP in both sunk and incremental costs.

11. PG&E has included insurance prepayments of $4.3 million in Diablo Canyon sunk costs. Inclusion of these costs in the sunk category will result in ratepayers being double charged. Insurance prepayments should not be included as sunk costs because doing so would prefund a portion [*109] of the plant's insurance coverage from January 1, 2002, forward.

12. PG&E requests amortization of 90% of M&S costs, $77,774,000. Including M&S in sunk costs gives PG&E free O&M. Amortizing $77.8 million over five years plus including in ICIP an estimate of M&S to be consumed during the five-year period causes a double recovery. We prefer to exclude M&S from sunk costs and include the projected five-year consumption of M&S in ICIP.

13. The sunk costs for Diablo Canyon as of December 31, 1996 are $3,286,706,000.

14. The ICIP should reflect the most accurate estimate of the reasonable incremental costs PG&E may be expected to incur over the next five years.

15. PG&E bases its forecast of operating costs on the average of recorded costs for 1993 through 1995 after first escalating them into 1997 dollars, and then applying a yearly 3.1% escalation factor. This method of forecasting is not credible.

16. Diablo Canyon costs have decreased in recent years, in real dollars as well as in nominal dollars.

17. PG&E's O&M and A&G costs substantially decreased from 1993 through 1995.

18. Forecasting future costs based on the average cost over the three-year period from 1993 to 1995 sets the [*110] 1997 starting point artificially high.

19. Given the reduction in the number of Diablo Canyon employees, wages increases under PG&E's labor agreement with IBEW are not indicative of future cost increases.

20. PG&E has reduced the number of Diablo Canyon O&M-related employees by at least 10% between 1993 and 1995.

21. Assuming 1996 O&M costs based on the average of escalated 1993 and 1995 costs fails to reflect the savings from these headcount reductions and overstates the level of O&M costs in 1996.

22. PG&E has indicated a target of further Diablo Canyon employee reductions between 1996 and 1998.

23. PG&E estimates that Diablo Canyon O&M expenses will be $257.3 million in 1997. PG&E's method of forecasting and its ignoring its own effort to reduce costs, as evidenced by its staffing estimates, among others, are so out of touch with reality that they can be given no weight. TURN's proposal to start with 1995 costs as the basic number for O&M spending is reasonable and will be adopted.

24. The O&M costs used to derive the ICIP should reflect a realistic forecast of the plant's costs rather than simply escalating historical costs by the rate of inflation.

25. The O&M costs used to [*111] derive the ICIP should reflect employee head counts that are consistent with current staffing, rather than average staffing levels during 1993-1995 when significant downsizing was undertaken.

26. Employee severance costs should be removed from the O&M forecast to reflect the fact that such costs will not be reincurred for work force reductions that have already occurred.

27. Except as provided in other findings, the escalation rate used to develop ICIP prices should be 1.5% to reflect improved productivity at Diablo Canyon and PG&E's stated plans to achieve further work force reductions. We see no evidence that PG&E's costs will rise at a 3.1% inflation rate. TURN's 1.5% escalation rate is reasonable.

28. The escalation rate applied to fuel prices for use in developing the ICIP prices should be 5%, consistent with PG&E's long-term contracts and recent uranium spot price increases.

29. Performance incentive payments should be included in the ICIP mechanism; they are a reasonable cost of doing business.

30. Because A&G expenses are largely a function of O&M expenses, we will adopt TURN's forecast. .TURN's estimate of payroll taxes will also be adopted as that too is a function of O&M [*112] and A&G.

31. PG&E's proposed ICIP prices assume a capacity factor based on the historic average over the entire life of Diablo Canyon, including the period of start-up problems.

32. PG&E forecasts a capacity factor for Diablo Canyon of 89.2% for 1997 in its current ECAC filing, A.96-04-001.

33. Diablo Canyon's average capacity factor of 83.6% in recent years during the period of mature operation is fairly representative of what can be expected of Diablo Canyon over the next five years. A capacity factor of 83.6% is reasonable and will be adopted. In a world where Diablo Canyon has exceeded an 80% capacity factor in every year since 1990, where we recently adopted a capacity factor forecast for 1996 of 86%, and where PG&E itself predicts an 89% capacity factor for 1997, we give no weight to PG&E's forecast of an 80% capacity factor.

34. PG&E's proposed ICIP prices assume that capital additions costs will increase at an annual rate of 5% over the next five years. Historically, capital additions costs for Diablo Canyon have increased at less that the rate of inflation.

35. PG&E estimates that nuclear fuel expenses for 1997, exclusive of nuclear fuel lease out-of-core carrying costs, [*113] will be $66.0 million based on an 80% capacity factor. This estimate should be modified to reflect the 83.6% capacity factor adopted herein and, as modified, adopted.

36. AFUDC should not be included in capital additions, as capital additions are recovered on an expensed basis. We will reduce capital additions by 7%. For capital additions, we will adopt TURN's 3.1% inflation factor.

37. At an assumed 83.6% capacity factor, Diablo Canyon's projected incremental costs yield the following ICIP price schedule for the period 1997-2001.

1997	3.26 cents/kWh
1998	3.31 cents/kWh
1999	3.37 cents/kWh
2000	3.43 cents/kWh
2001	3.49 cents/kWh

38. The safety of Diablo Canyon continues to be critical and the Diablo Canyon Independent Safety Committee is a key element of monitoring the safe operation of Diablo Canyon. Therefore, the Committee shall remain in effect under the terms and conditions of Appendix C, Attachment A to the Diablo Canyon settlements, until further order of the Commission. Funding for the Committee shall established at its current level under the terms of Appendix C for 1996 at $673,077 and adjusted upward at 1.5% annually.

39. Exclusions from Diablo Canyon ICIP [*114] should be recovered through PG&E's base rates and should include:

a. Decommissioning trust fund costs and DOE decontamination and decommissioning and safety-related expenses, including the Diablo Canyon Independent Safety Committee.

b. Recovery of specific assessments, including costs associated with claims of exposure to nuclear radiation and electric and magnetic fields.

c. If either of the Diablo Canyon units shuts down, PG&E would recover shutdown O&M expenses and unamortized fuel costs. Shutdown O&M expenses are estimated to be approximately 80% of actual recorded Diablo Canyon O&M and A&G expenses (as annualized based on the most recent 24-month operating period) for the first 12 months, 50% in the second 12 months, and 10% during each 12-month period thereafter until decommissioning begins. This is reasonable.

d. Property taxes attributable to the shutdown Diablo Canyon unit(s) shall be recovered through base rates.

40. Exclusions from Diablo Canyon market pricing after 2001 should be recovered through PG&E's base rates and should include:

a. Decommissioning trust fund costs and DOE decontamination and decommissioning and safety-related expenses, including the [*115] Diablo Canyon Independent Safety Committee.

b. Recovery of specific assessments, including costs associated with claims of exposure to nuclear radiation, and electric and magnetic fields.

c. In the event of a permanent closure of Diablo Canyon after 2001, shutdown O&M expenses and unamortized fuel would be recovered from CPUC jurisdictional customers in nonbypassable base rates. After 2001, the CPUC jurisdictional customers' obligation for these costs would be reduced by 10% each year until decommissioning commences. For example, if permanent closure occurs any time in 2003, the CPUC customers' responsibility would be 80% for each year until decommissioning begins, based on a reduction of 10% in 2002 and another 10% in 2003.

41. Cost of Capital should be calculated as follows:

Debt	46.50%	7.52%	
Preferred	5.50%	7.79%	
Equity	48.00%	6.77%	(90% of Debt)
Total	100.00%	7.17%	

42. The Diablo Canyon Total Estimated Revenue Requirement is as follows:

CPUC Jurisdiction
(Million of Dollars)

	1997	1998	1999	2000	2001
Fixed Cost Recovery	1,385	1,322	1,259	1,197	1,135
ICIP Expenses	515	523	532	542	552
Total Revenue Requirement	1,900	1,845	1,791	1,739	1,687

[*116]

43. ORA, PG&E, TURN stipulated to two-way balancing account treatment of Diablo Canyon property taxes.

44. The Commission required, under the SONGS ratemaking methodology, that ratepayers receive 50% of the post-2001 operating profits.

45. After 2001, any remaining property taxes associated with either sunk costs or ICIP costs will be subject to the 50-50 profit-sharing that will apply to Diablo Canyon.

46. For insurance associated with capital additions, such costs should be collected from ratepayers during the ICIP period on a pay-as-you-go basis, using PG&E's formula of 0.3% of net plant.

47. After 2001, any insurance associated with capital additions made during the ICIP period will be subject to the 50-50 profit sharing.

48. Post-2001 income tax, property tax, and insurance benefits due to book tax timing differences in the calculation of ICIP costs should be allocated 100% to ratepayers. PG&E's July 1, 2000 application for sharing of post-2001 benefits of the plant will assure that 100% of these benefits are allocated to ratepayers.

49. Nothing in the existing Diablo Canyon ratemaking treatment precludes the facility from shutting down, not just for catastrophic failure, but [*117] for economic reasons as well.

50. Accelerated recovery of Diablo Canyon sunk costs increases the likelihood that Diablo Canyon will not be shut down.

Conclusions of Law

1. The SONGS decision stands for the proposition that an ICIP mechanism can be an appropriate means of recovering a price representing the incremental costs of operating a plant during the period of accelerated sunk cost recovery. However, the details of both the plant-specific ICIP mechanism and the terms of the sunk recovery should be determined based on plant-specific facts.

2. This Commission and the Legislature have made the policy decision to permit utilities the opportunity to recover their uneconomic costs as they compete in the restructured electricity market. Removing $2 billion from the sum potentially available for CTC substantially impedes achieving this policy goal. To accede to ORA's request for a 10% rate reduction in addition to the 10% rate reduction required by AB 1890 would be discriminatory, benefiting one class of customers at the expense of all other classes.

3. The Legislature has provided that costs must be recovered from all customers in substantially the same proportion as similar [*118] costs are recovered as of June 10, 1996. ORA's proposal would delay CTC recovery, thereby burdening large utility customers with the obligation to pay CTC for a longer period of time because smaller customers will be paying less than their full share of CTC. This cost shifting is prohibited by statute (PU Code § 367(e)(1)) and by our Policy Decision (D.95-12-063 at 142).

4. The 1988 Diablo Canyon ratemaking settlement was a compromise that allowed PG&E to forgo a reasonableness review of its $5.5 billion construction costs, in exchange for which PG&E took the operating risks of the plant, with the opportunity, if the plant ran well, to recover all of its investment by the year 2016.

5. A financial verification audit of PG&E's Diablo Canyon plant accounts should be ordered, to be performed by an independent accounting firm paid for by PG&E. Costs of the audit shall be included in PG&E's revenue requirement. Because of time constraints, the Executive Director shall seek to negotiate to expand the current PG&E independent auditor's contract to include the audit ordered by this decision.

6. Ratepayers should receive 100% of post-sunk cost recovery period tax benefits.

7. ICIP prices [*119] are intended to reflect expected operating costs based on historic performance and reasonable expectations of future costs. Setting the ICIP to reflect forecast costs will result in reasonable prices for customers and a reasonable incentive for good plant performance for the utility.

8. PG&E's proposed ICIP prices overstate its reasonably expected costs and performance.

9. Diablo Canyon property taxes should be subject to two-way balancing account treatment.

10. Except as modified by specific findings of fact and conclusions of law, beginning January 1, 2002, customers will be entitled to 50% of the post-2001 net benefits associated with the operation of Diablo Canyon in an electricity market. The post-2001 net benefits can be valued by either:

a. The audited profits from continued operations; or

b. Commission determination of any gain-on-sale or loss-on-sale associated with the sale of Diablo Canyon;

c. Acceptance by PG&E of a third-party appraisal consistent with the Commission's restructuring policy decision (Decision (D.) 95-12-063, p. 139), or then-existing state or Commission policy on third-party appraisals of nuclear plants; or

d. Another valuation method adopted [*120] by the Commission.

PG&E will notify the Commission by application, filed no later than July 1, 2000, as to its preferred approach to the valuation of the plant for the period beginning January 1, 2002. PG&E's application shall include the ratemaking and accounting methods to be used in the valuation of the post-2001 benefits associated with the operation of Diablo Canyon.

11. Customer responsibility for post-2001 shutdown O&M costs should be reduced by 10% annually.

12. Under AB 1890, a rate reduction of no less than 10% for residential and small commercial customers from 1998 continuing through 2002 is mandatory.

13. Under AB 1890, utilities have the discretion to seek rate reduction financing related to the 10% rate reduction for residential and small commercial customers through rate reduction bonds.

14. The request of the County of San Luis Obispo and San Luis Coastal Unified School District for property tax relief is denied. There is no legal basis for this Commission to authorize PG&E to include in its rates and cost of service estimated property taxes which it is not lawfully obligated or forecasted to pay. Taxes which are included in rates are those in effect at the time [*121] the rates are approved, unless the existing law provides for a change at a future date. (Re Pac. Tel. & Tel. (1954) 53 CPUC 276, 295.) Absent legislative change, or Board of Equalization change, PG&E's taxes are what they are under existing law and the County's proposal will not change that fact. The County must direct its request for relief to the Legislature and the Board, not this Commission.

15. Treating San Luis Obispo's forgone property tax revenues associated with Diablo Canyon as a transition cost recoverable from ratepayers would amount to a tax on a ratepayers that is unrelated to utility service.

16. Utilities may not receive in rates or charges costs that are unrelated to any product or commodity furnished or service rendered by a public utility.

17. This decision balances equally the interests of shareholders and ratepayers.

18. The entire Diablo Canyon settlement adopted in D.88-12-083, and modified by D.95-05-043, is of no force and effect as of the date this decision becomes final. However, the Diablo Canyon Independent Safety Committee shall remain in effect under the terms and conditions of Appendix C, Attachment A to the Diablo Canyon settlements, until further [*122] order of the Commission. Funding for the Committee shall be established at its current level under the terms of Appendix C, Attachment A for 1996 at $673,077 and adjusted upward at 1.5% annually.

19. Consistent with the Commission's Preferred Policy Decision and AB 1890 the new Diablo Canyon rates adopted in this decision are effective as of January 1, 1997.

ORDER

IT IS ORDERED that:

1. The sunk costs for the Diablo Canyon Nuclear Power Plant (Diablo Canyon) as of December 31, 1996 are $3,286,706,000.

2. The Diablo Canyon Total Estimated Revenue Requirement is as follows:

CPUC Jurisdiction
(Million of Dollars)

	1997	1998	1999	2000	2001
Fixed Cost Recovery	1,385	1,322	1,259	1,197	1,135
ICIP Expenses	515	523	532	542	552
Total Revenue Requirement	1,900	1,845	1,791	1,739	1,687

3. At an assumed 83.6% capacity factor, Diablo Canyon's projected incremental costs yield the following ICIP price schedule for the period 1997-2001.

1997	3.26 cents/kWh
1998	3.31 cents/kWh
1999	3.37 cents/kWh
2000	3.43 cents/kWh
2001	3.49 cents/kWh

4. a. A financial verification audit of Pacific Gas and Electric Company's (PG&E) Diablo Canyon accounts [*123] shall be performed by an independent accounting firm paid for by PG&E. Costs of the audit shall be included in PG&E's revenue requirement.

b. Upon completion of the audit, PG&E shall file a new application seeking Commission approval of the audit. The application shall be served upon all appearances in Application 96-03-054.

5. Diablo Canyon property taxes shall be subject to two-way balancing account treatment.

6. Ratepayers should receive 100% of post-sunk cost recovery period tax benefits.

7. Except as modified by specific findings of fact and conclusions of law, beginning January 1, 2002, customers will be entitled to 50% of the post-2001 net benefits associated with the operation of Diablo Canyon in an electricity market. The post-2001 net benefits can be valued by either:

a. The audited profits from continued operations; or

b. Commission determination of any gain-on-sale or loss-on-sale associated with the sale of Diablo Canyon;

c. Acceptance by PG&E of a third-party appraisal consistent with the Commission's restructuring policy decision (D.95-12-063, p. 139), or then-existing state or Commission policy on third-party appraisals of nuclear plants; or

d. Another valuation [*124] method adopted by the Commission.

PG&E will notify the Commission by application, filed no later than July 1, 2000, as to its preferred approach to the valuation of the plant for the period beginning January 1, 2002. PG&E's application shall include the ratemaking and accounting methods to be used in the valuation of the post-2001 benefits associated with the operation of Diablo Canyon.

8. Customer responsibility for post-2001 shutdown operations and maintenance costs shall be reduced by 10% annually.

9. The request of the County of San Luis Obispo and San Luis Coastal Unified School District for property tax relief is denied.

10. The entire Diablo Canyon settlement adopted in D.88-12-083 and modified by D.95-05-043 is of no force and effect as of the date this decision becomes final. However, the Diablo Canyon Independent Safety Committee shall remain in effect under the terms and conditions of Appendix C, Attachment A to the Diablo Canyon settlement decision D.88-12-083, until further order of the Commission. Funding for the Committee shall be established at its current level under the terms of Appendix C for 1996 at $673,077 and adjusted upward at 1.5% annually until further [*125] order of the Commission.

11. PG&E shall file within 20 days an advice letter, in compliance with General Order 96-A, establishing balancing accounts and tariff language to reflect the modified ratemaking treatment adopted in this decision, as well as memorandum accounts to track the invoiced auditor costs of the audit ordered by this decision. This advice letter shall not go into effect until approved by the Commission.

12. The Executive Director is directed to negotiate to expand the current PG&E's independent auditor's contract to include the audit ordered by this decision. Failing to expand the contract, the Executive Director shall negotiate for other independent auditors.

13. The new Diablo Canyon rates adopted in this decision are effective as of January 1, 1997.

14. a. The petition of the Mothers for Peace to set aside submission is denied.

b. The motion of San Luis Obispo for oral argument is denied.

15. All motions to appear, to file comments, and to file late are granted.

16. This proceeding is closed.

This order is effective today.

Dated May 21, 1997, at Sacramento, California.

I will file a dissent.

/s/ P. GREGORY CONLON

President

I will file a dissent.

/s/ JESSIE [*126] J. KNIGHT, JR.

Commissioner

APPENDIX A

List of Appearances

Applicant: Christopher J. Warner, Attorney at Law, for Pacific Gas and Electric Company.

Interested Parties: Edson & Modisette, by Carolyn A. Baker, Attorney at Law, for various clients, including Chevron U.S.A.; Barbara R. Barkovich, for Barkovich & Yap; Rochelle Becker, for San Luis Obispo Mothers for Peace; Brady & Berliner, by Roger Berliner, Attorney at Law, and Sheldon Reid, for Norcen Energy Resources Limited; Morrison & Foerster, by Jerry Bloom, Attorney at Law, for California Cogeneration Council; Greg Blue, for Destec Power Services; Michael Boccadoro, and Graham and James, LLP, by Peter W. Hanschen and Robert Monti, Attorneys at Law, for Agricultural Energy Consumers Association; Jackson, Tufts, Cole & Black, LLP, by William M. Booth, Attorney at Law, for California Large Energy Consumers Association; Brady & Berliner, by Jonathan A. Bromson, Attorney at Law, for himself; McCracken, Byers & Bergeron, by David J. Byers, Attorney at Law, for California City-County Streetlight Association; De Cuir & Somach, by Dennis W. De Cuir, Attorney at Law, for [*127] De Cuir & Somach; Sam De Frawi, for the Department of the Navy; Robert Finkelstein, Attorney at Law, for Toward Utility Rate Normalization; Norman J. Furuta and John M. Cummins, Attorneys at Law, for the Department of Defense; Steven A. Geringer, Attorney at Law, for himself; Dian M. Grueneich, Attorney at Laaw, for the Department of General Services; Richard L. Hamilton, Attorney at Law, for Western Mobilehome Park Owners Association; Ellison & Schneider, by Lynn Haug and Douglas K. Kerner, Attorneys at Law, for Independent Energy Producers Association; Aldyn Hoekstra, for Cambridge Energy Research Associates; Adams & Broadwell, by Marc D. Joseph, Attorney at Law, for IBEW Local 1245 and Coalition of California Utility Employees; Ron Knecht, for himself; Elizabeth T. Lowe, for Barakat & Chamberlin, Inc.; David Marcus, for IBEW 1245 and CUE; William Marcus, for JBS Energy, Inc.; Sutherland, Asbill & Brennan, by Keith R. McCrea, Attorney at Law, for California Manufacturers Association; Karen Mills, Attorney at Law, for California Farm Bureau Federation; Sara Steck Myers, Attorney at Law, for Center for Energy Efficiency and [*128] Renewable Technologies; Steve Patrick, Attorney at Law, by Claudine Schwartz, for Southern California Gas Company; Paul Premo, by Wendy Illingworth, for Foster Associates, Inc.; Carol A. Schmid-Frazee, Attorney at Law, for Southern California Edison Company; Reed V. Schmidt, for Bartle Wells Associates; Andrew J. Skaff and Karen L. Peterson, for Knox Ricksen; James Squeri and Diane Fellman, Attorneys at Law, for County of San Luis Obispo and San Luis Obispo County Unified School District; James Squeri, Attorney at Law, for California Retailers Association; Downey, Brand, Seymour & Rohwer, by Philip A. Stohr and Dan L. Carroll, for California Industrial Users; Mark J. Urban, for Daniel E. Lungren, Attorney General of the State of California; Morse, Richard, Weisenmiller & Associates, by Robert B. Weisenmiller, for various clients; and Bruce J. Williams and Keith W. Melville, Attorney at Law, for San Diego Gas & Electric Company.

Office of Ratepayer Advocates: Hallie Yacknin, Attorney at Law.

APPENDIX B

Diablo Canyon Revenue Requirements Estimation Model
Results of Operations Calculations ($000)

Ln.No.		1996	1997	1998
	Weighted Cost of Capital			
1	Debt		3.50%	3.50%
2	Preferred Stock		0.43%	0.43%
3	Common Equity		3.25%	3.25%
4	Total %		7.17%	7.17%
5	Debt		103,675	81,225
6	Preferred Stock		12,703	9,952
7	Common Equity		96,318	75,461
8	Total $212,696 166,638			
	Sunk Cost			
9	Plant	6,460,825	6,460,825	6,460,825
	Working Capital			
10	Nuclear Fuel Lease	0	0	0
11	Materials and Supplies	0	0	0
12	Prepayments	0	0	0
13	Subtotal	0	0	0
14	Total Plant	6,460,825	6,460,825	6,460,825
	Less:			
15	Accumulated Deferred Taxes	832,292	742,743	561,335
16	Deferred Investment Tax Credit	159,373	143,436	111,561
17	Vacation Pay Deferral	(6,245)	(5,621)	(4,372)
18	Capitalized interest	(4,296)	(3,866)	(3,007)
19	Subtotal	981,124	876,692	665,517
20	Accumulated Depreciation	2,192,995	2,619,274	3,472,462
21	Sunk Cost	3,286,706	2,964,859	2,322,846

[*129]

Diablo Canyon Revenue Requirements Estimation Model
Results of Operations Calculations ($000)

Ln.No.		1999	2000	2001
	Weighted Cost of Capital			
1	Debt	3.50%	3.50%	3.50%
2	Preferred Stock	0.43%	0.43%	0.43%
3	Common Equity	3.25%	3.25%	3.25%
4	Total %	7.17%	7.17%	7.17%
5	Debt	58,879	36,606	14,372
6	Preferred Stock	7,214	4,485	1,761
7	Common Equity	54,701	34,008	13,352
8	Total $120,794 75,099 29,486			
	Sunk Cost			
9	Plant	6,460,825	6,460,825	6,460,825
	Working Capital			
10	Nuclear Fuel Lease	0	0	0
11	Materials and Supplies	0	0	0
12	Prepayments	0	0	0
13	Subtotal	0	0	0
14	Total Plant	6,460,825	6,460,825	6,460,825
	Less:			
15	Accumulated Deferred Taxes	376,325	189,246	1,014
16	Deferred Investment Tax Credit	79,687	47,812	15,937
17	Vacation Pay Deferral	(3,123)	(1,874)	(625)
18	Capitalized interest	(2,148)	(1,289)	(430)
19	Subtotal	450,741	233,896	15,897

20	Accumulated Depreciation	4,326,280	5,180,098	6,033,916
21	Sunk Cost	1,683,804	1,046,831	411,012

Diablo Canyon Revenue Requirements Estimation Model
Plant and Depreciation ($000)

Ln.No.		1996	1997	1998
	Cumulative Plant (End-of-Year)			
1	Electric Plant	6,148,261	6,148,261	6,148,261
2	Common Plant	144,930	144,930	144,930
4	Regulatory Asset II	167,634	167,634	167,634
5	Total	6,460,825	6,460,825	6,460,825
6	Weighted Average Plant		6,460,825	6,460,825
	Book Depreciation			
7	Electric Plant		801,154	801,154
8	Common Plant		18,885	18,885
9	Regulatory Asset II		32,519	33,779
10	Total		852,558	853,818
11	Accumulated <1>	2,192,995	2,619,274	3,472,462
	Amortizations			
12	100% Nuclear Fuel Lease		0	0
13	90% Materials & Supplies		0	0
14	100% Prepayments		0	0
15	Total Amortizations		0	0
16	Total Depreciation		852,558	853,818
	Straight Line Income Tax Depreciation			
17	Electric Plant	2,419,487	483,897	483,897
18	Allocated Common Plant	16,140	3,228	3,228
19	Total		487,125	487,125
	Federal Income Tax Depreciation			
20	Electric Plant		59,863	49,290
21	Allocated Common - ACRS/MACRS		1,749	1,342
22	Total		61,612	50,632
23	Allocated Common - Non-ACRS/MACRS		56	54
	State Income Tax Depreciation			
24	Electric Plant		161,183	157,705
25	Allocated Common Plant		2,268	1,556
26	Total		163,451	159,261
	Deferred Taxes - Depreciation			
27	Difference in Depreciation	1,977,419	425,513	436,494
28	Tax Rate Needed to Amortize	42.0898%		
29	Current Period		(179,098)	(183,719)
30	Accumulated	832,292	742,743	561,335
	Deferred Investment Tax Credit			
31	Current Period		31,875	31,875
32	Accumulated	159,373	143,436	111,561
	Vacation Pay Deferral			
33	Current Period		1,249	1,249
34	Accumulated	6,245	5,621	4,372
	Capitalized Interest Deferral			
35	Current Period		859	859
36	Accumulated	4,296	3,866	3,007

[*130]

Footnotes:

1) 1996 accumulated depreciation amount includes the $65.6 million in disallowance adopted in the decision.

Diablo Canyon Revenue Requirements Estimation Model
Plant and Depreciation ($000)

Ln.No.		1999	2000	2001
	Cumulative Plant (End-of-Year)			
1	Electric Plant	6,148,261	6,148,261	6,148,261
2	Common Plant	144,930	144,930	144,930
4	Regulatory Asset II	167,634	167,634	167,634
5	Total	6,460,825	6,460,825	6,460,825
6	Weighted Average Plant	6,460,825	6,460,825	6,460,825
	Book Depreciation			
7	Electric Plant	801,154	801,154	801,154
8	Common Plant	18,885	18,885	18,885
9	Regulatory Asset II	33,779	33,779	33,779
10	Total	853,818	853,818	853,818
11	Accumulated <1>	4,326,280	5,180,098	6,033,916
	Amortizations			
12	100% Nuclear Fuel Lease	0	0	0
13	90% Materials & Supplies	0	0	0
14	100% Prepayments	0	0	0
15	Total Amortizations	0	0	0
16	Total Depreciation	853,818	853,818	853,818
	Straight Line Income Tax Depreciation			
17	Electric Plant	483,897	483,897	483,897
18	Allocated Common Plant	3,228	3,228	3,228
19	Total	487,125	487,125	487,125
	Federal Income Tax Depreciation			
20	Electric Plant	43,350	39,758	38,157
21	Allocated Common - ACRS/MACRS	1,150	1,044	859
22	Total	44,500	40,802	39,016
23	Allocated Common - Non-ACRS/MACRS	37	41	40
	State Income Tax Depreciation			
24	Electric Plant	154,100	151,474	149,255
25	Allocated Common Plant	1,189	1,088	1,040
26	Total	155,289	152,562	150,295
	Deferred Taxes - Depreciation			
27	Difference in Depreciation	442,626	446,324	448,109
28	Tax Rate Needed to Amortize			
29	Current Period	(186,300)	(187,857)	(188,608)
30	Accumulated	376,325	189,246	1,014
	Deferred Investment Tax Credit			
31	Current Period	31,875	31,875	31,875
32	Accumulated	79,687	47,812	15,937
	Vacation Pay Deferral			
33	Current Period	1,249	1,249	1,249
34	Accumulated	3,123	1,874	625
	Capitalized Interest Deferral			
35	Current Period	859	859	859
36	Accumulated	2,148	1,289	430

[*131]
Footnotes:

1) 1996 accumulated depreciation amount includes the $65.6 million in disallowance adopted in the decision.

Diablo Canyon Revenue Requirements Estimation Model
Results of Operations Calculations ($000)

Ln.No.		1996	1997	1998
1	Operating Revenue:		1,905,090	1,849,831
	Operating Expenses:			
2	Production Expenses/ICIP		515,092	523,458
3	Nuclear Fuel (Excl. CC)		0	0
4	In-Core Fuel Carrying Costs		0	0
5	Administrative and General		0	0
6	Uncollectibles		3,336	3,183
7	Franchise Requirements		10,026	9,567
8	Capital Additions Rev.Req.		0	0
9	Subtotal Expenses		528,454	536,208
	Taxes:			
10	Superfund		1,126	1,080
11	Property		0	0
12	Payroll		0	0
13	Other Taxes			
14	State Corporation Franchise		98,406	95,195
15	Fedreal Income		211,851	196,891
13	Subtotal Taxes		311,383	293,167
17	Depreciation		852,558	853,818
18	Total Operating Expenses		1,692,395	1,683,193
19	Net for Return		212,696	166,638
20	Weighted Average Rate Base		2,964,859	2,322,846
21	Rate of Return: On Rate Base		7.17%	7.17%
22	On Equity		6.77%	6.77%
	Jurisdictional Allocations			
	Fixed Costs			
23	CPUC 99.6830%		1,385,592	1,322,169
24	FERC 00.3170%		4,406	4,204
25	Total		1,389,998	1,326,373
	ICIP Costs			
26	CPUC 99.9509%		514,839	523,201
27	FERC 00.0491%		253	257
28	Total		515,092	523,458
29	Total CPUC Jurisdictional Revenue Requirement		1,900,432	1,845,370

[*132]

Diablo Canyon Revenue Requirements Estimation Model
Results of Operations Calculations ($000)

Ln.No.		1999	2000	2001
1	Operating Revenue:	1,795,850	1,742,874	1,691,076
	Operating Expenses:			
2	Production Expenses/ICIP	532,449	542,154	552,689
3	Nuclear Fuel (Excl. CC)	0	0	0
4	In-Core Fuel Carrying Costs	0	0	0
5	Administrative and General	0	0	0
6	Uncollectibles	3,032	2,882	2,732
7	Franchise Requirements	9,112	8,660	8,211
8	Capital Additions Rev.Req.	0	0	0

9	Subtotal Expenses	544,593	553,697	563,632
	Taxes:			
10	Superfund	1,038	995	953
11	Property	0	0	0
12	Payroll	0	0	0
13	Other Taxes			
14	State Corporation Franchise	92,012	88,738	85,450
15	Fedreal Income	183,594	170,528	157,737
13	Subtotal Taxes	276,644	260,261	244,140
17	Depreciation	853,818	853,818	853,818
18	Total Operating Expenses	1,675,056	1,667,776	1,661,590
19	Net for Return	120,794	75,099	29,486
20	Weighted Average Rate Base	1,683,804	1,046,831	411,012
21	Rate of Return: On Rate Base	7.17%	7.17%	7.17%
22	On Equity	6.77%	6.77%	6.77%
	Jurisdictional Allocations			
	Fixed Costs			
23	CPUC 99.6830%	1,259,397	1,196,914	1,134,778
24	FERC 00.3170%	4,005	3,806	3,608
25	Total	1,263,401	1,200,720	1,138,387
	ICIP Costs			
26	CPUC 99.9509%	532,187	541,888	552,418
27	FERC 00.0491%	261	266	271
28	Total	532,449	542,154	552,689
29	Total CPUC Jurisdictional Revenue Requirement	1,791,584	1,738,803	1,687,196

[*133]

Diablo Canyon Revenue Requirements Estimation Model

Results of Operations Calculations ($000)

Ln.No.		1996	1997	1998
	Taxable Income:			
1	Operating Revenue		1,905,090	1,849,831
2	Less: O&M Expenses		528,454	536,208
3	Superfund Tax		1,126	1,080
4	Taxes Other Than Income		0	0
5	Interest Charges		103,675	81,225
6	Fiscal/Calendar Adjustment			
7	Operating Expense Adjustment			
8	Capitalized Interest Adjustment			
9	Capitalized Inventory Adjustment			
10	Vacation Accrual Reduction			
11	Subtotal Deductions		633,255	618,514
12	Taxable Income before Depreciation		1,271,836	1,231,317
	California Corporation Franchise Tax (CCFT)			
13	State Depreciation		163,451	159,261
14	Removal Costs			
15	Repair Allowance			
16	State Taxable Income		1,108,385	1,072,056
17	CCFT		97,981	94,770
18	Deferred Taxes - Interest		173	173
19	Deferred Taxes - Vacation		252	252
20	Deferred Taxes- Other			
21	Total CCFT		98,406	95,195
	Federal Income Tax			

22	Prior Year CCFT		97,981	97,981
23	Federal Depreciation		61,668	50,686
24	Removal Costs			
25	Repair Allowance			
26	Preferred Dividend Credit			
27	Federal Taxable Income		1,112,186	1,082,650
28	Federal Income Tax		389,265	378,928
29	Deferred Taxes - Depreciation		(179,098)	(183,719)
30	Deferred Taxes - Interest		686	686
31	Deferred Taxes - Vacation		997	997
32	Deferred Taxes - Other			
33	Total Federal Income Tax		211,851	196,891

[*134]

Diablo Canyon Revenue Requirements Estimation Model

Results of Operations Calculations ($000)

Ln.No.		1999	2000	2001
	Taxable Income:			
1	Operating Revenue	1,795,850	1,742,874	1,691,076
2	Less: O&M Expenses	544,593	553,697	563,632
3	Superfund Tax	1,038	995	953
4	Taxes Other Than Income	0	0	0
5	Interest Charges	58,879	36,606	14,372
6	Fiscal/Calendar Adjustment			
7	Operating Expense Adjustment			
8	Capitalized Interest Adjustment			
9	Capitalized Inventory Adjustment			
10	Vacation Accrual Reduction			
11	Subtotal Deductions	604,511	591,298	578,957
12	Taxable Income before Depreciation	1,191,339	1,151,577	1,112,119
	California Corporation Franchise Tax (CCFT)			
13	State Depreciation	155,289	152,562	150,295
14	Removal Costs			
15	Repair Allowance			
16	State Taxable Income	1,036,050	999,015	961,824
17	CCFT	91,587	88,313	85,025
18	Deferred Taxes - Interest	173	173	173
19	Deferred Taxes - Vacation	252	252	252
20	Deferred Taxes- Other			
21	Total CCFT	92,012	88,738	85,450
	Federal Income Tax			
22	Prior Year CCFT	94,770	91,587	88,313
23	Federal Depreciation	44,537	40,842	39,056
24	Removal Costs			
25	Repair Allowance			
26	Preferred Dividend Credit			
27	Federal Taxable Income	1,052,033	1,019,148	984,750
28	Federal Income Tax	368,211	356,702	344,663
29	Deferred Taxes - Depreciation	(186,300)	(187,857)	(188,608)
30	Deferred Taxes - Interest	686	686	686
31	Deferred Taxes - Vacation	997	997	997
32	Deferred Taxes - Other			
33	Total Federal Income Tax	183,594	170,528	157,737

[*135]

APPENDIX C

PG&E, ORA and TURN Agreement
Diablo Canyon ICIP Prices

		1996	Esc./Fac.	1997	1998
1	O&M	248.9	1.5%	252.6	256.4
2	A&G	65.0	1.5%	66.1	67.2
3	Uncoll. & Fran.		0.9734%	5.0	5.0
4	Nuclear Fuel (excl. cc.)		5.0%	69.0	72.4
5	In-Core Fuel Carrying Cost			4.3	4.3
7	Out of Core Carrying Costs		5.50%	4.3	4.3
8	M&S Carrying Costs		13.56%	10.6	10.7
9	Capital Additions		3.1%	34.4	35.5
10	Income Taxes			16.0	17.7
11	Property Taxes			43.2	40.0
12	Payroll & Other Taxes	9.6	1.5%	9.7	9.9
13	Total			515.1	523.5
14	Generation		83.6%	15,818	15,818
15	ICIP (cents/kwhr)			3.26	3.31

PG&E, ORA and TURN Agreement
Diablo Canyon ICIP Prices

		1999	2000	2001
1	O&M	260.2	264.2	268.1
2	A&G	68.3	69.4	70.5
3	Uncoll. & Fran.	5.1	5.2	5.3
4	Nuclear Fuel (excl. cc.)	76.0	79.8	83.8
5	In-Core Fuel Carrying Cost	4.3	4.3	4.3
7	Out of Core Carrying Costs	4.3	4.3	4.3
8	M&S Carrying Costs	10.9	11.1	11.2
9	Capital Additions	36.6	37.7	38.9
10	Income Taxes	19.8	22.4	25.4
11	Property Taxes	36.9	33.7	30.5
12	Payroll & Other Taxes	10.0	10.2	10.3
13	Total	532.4	542.2	552.7
14	Generation	15,818	15,818	15,818
15	ICIP (cents/kwhr)	3.37	3.43	3.49

[*136]

Comments

Includes cap adds insurance expense - pay as you go

Out of core fuel carrying cost at the commercial paper rate

7% capitalized int. reduction, rather than 10% AFUDC reduction

Includes cap adds property taxes - pay as you go

June 3, 1997

TO: ALL PARTIES OF RECORD IN APPLICATION 96-03-054

Decision 97-05-088, which modified the pricing of power from Pacific Gas and Electric Company's Diablo Canyon Nuclear Power Plant, determined Diablo Canyon's sunk costs, and adopted an incremental cost incentive price (ICIP), among other things, was mailed on May 29, 1997, without the Dissenting Opinion of President Gregory Conlon.

Attached herewith is President Conlon's Dissenting Opinion.

Lynn T. Carew, Chief
Administrative Law Judge

Attachment

DISSENTBY: Conlon; Knight

DISSENT:

PRESIDENT P. GREGORY CONLON, DISSENTING:

Although supportive of the approach used by the majority to address the cost recovery and incremental pricing of Pacific Gas & Electric's (PG&E's) Diablo Canyon plant, I would have preferred the alternate decision of Commissioner Knight. Both the majority decision and Commissioner Knight's alternate would have allowed PG&E to amortize the sunk costs of its remaining [*137] investment in Diablo Canyon by the year 2002. Both decisions would have established a pricing formula that would have paid PG&E a fixed price (adjusted each year) for each kilowatt hour of power generated by the plant.

The majority decision and Commissioner Knight's alternate differ on the start-up revenue requirement and the assumed capacity factor that Diablo Canyon is predicted to run. I believe Commissioner Knight's alternate better reflects Diablo Canyon's costs and operating conditions.

In determining the incremental pricing methodology for Diablo Canyon, I am sympathetic to the steps that PG&E had already taken to address the effect that Diablo Canyon was having on PG&E's high electric rates. I applaud PG&E's willingness to propose accelerated cost recovery for its Diablo Canyon plant, both in its restructuring rate settlement in June, 1996 and in the legislative debates in August, 1996 that led to the passage of AB1890.

Although supportive of Commissioner Knight's alternate, I differ from him, and the majority decision, over the issue of disallowances. The majority decision disallows $100 million (prior to adjustment for depreciation) from PG&E's fixed costs of the Diablo [*138] Canyon plant. This disallowance is due to PG&E's admission of design errors in the construction of the plant, the so-called "mirror image" problem. Commissioner Knight's alternate does not contain any disallowance.

I believe PG&E should be held responsible for the mirror-image problem, but would have preferred a disallowance in the range of $50 million (prior to depreciation). The $100 million was not fully developed in the record of this proceeding and the lower amount would have been more conservative.

/s/ P. Gregory Conlon
P. GREGORY CONLON,
President

San Francisco, California
June 2, 1997

Commissioner Jessie J. Knight, Jr., Dissenting:

In the preferred policy decision (D. 95-12-063) n1 this Commission asked PG&E to replace its agreements with a new ratemaking plan for its Diablo Canyon nuclear power plant that more closely resembled the ratemaking treatment afforded Southern California Edison's San Onofre Nuclear Generating Station (SONGS). Prior to that decision, PG&E had a recently approved modification to its 1988 agreement. That settlement resulted in a significant reduction in the price paid by consumers for power generated by Diablo Canyon. This was a modification [*139] that PG&E, the Attorney General and the Division of Ratepayer Advocates (DRA, newly named Office of Ratepayer Advocates), all supported. This settlement was found to be in the public interest and was found to result in $2.1 billion in incremental benefits going to ratepayers during the first four years alone, when compared to the original 1988 settlement.

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n1 As modified by D. 96-01-009.

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Of its own volition, PG&E stepped forward and sought to mitigate stranded costs associated with Diablo Canyon at a time when the Commission was in its first stages to deregulate the electric industry. This Commission had adopted a settlement in 1988 that, in hindsight, proved to be beneficial to PG&E due to its managerial prowess. The company's results proved to outstrip the conservative forecasts promulgated by the Commission and other stakeholders. Although their performance translated into a unfortunate economic hit to ratepayers, it still was within the terms of the agreement that DRA negotiated with PG&E and the deal that the Commission [*140] endorsed, approved and sanctioned. As a direct result of this Commission's efforts to restructure the electric services industry, PG&E boldly agreed with the other signatories to modify the deal they already had in hand. This modification resulted in significant lower revenues to PG&E. It resulted in no additional guarantees for recovery of stranded cost. It called for no acceleration of recovery of its investment in Diablo Canyon. It simply was a cooperative attempt by PG&E to mitigate its stranded costs and move the electric restructuring debate along at the behest of the Commission to move toward realizing direct access in a competitive marketplace. I supported that modification. This Commission once again approved the modification to the settlement, finding that it provided $2.1 billion in benefits within four years and total benefits projected to be between $4 and $7.2 billion over the life of the settlement. This is the deal this Commission has with PG&E on this May 21st, 1997.

In December of 1995, in the preferred policy decision, this Commission asked PG&E to file a change in the ratemaking treatment of Diablo Canyon to make it similar to the treatment [*141] adopted for SONGS. In March of 1996, PG&E cooperatively filed the proposal that is the focus of today's decision.

On June 10th 1996, a broad coalition of California energy consumers, labor, agricultural, governmental and independent power organizations supported a plan to freeze PG&E rates and accelerate the transition to greater competition and customer choice in California's electric industry. This proposal called for the accelerated recovery of Diablo Canyon's January 1, 1997 book value. It called for the power to be priced at market rates by January 1st, 2002. It called for Diablo Canyon's incremental costs to be recovered through an Incremental Cost Incentive Price (ICIP) mechanism. Also, it called for this ICIP to be set at levels using a methodology comparable to that adopted by the Commission in 1996 for SONGS.

In September 1996, the legislature passed AB 1890, which required each electric utility to propose a cost recovery plan for the recovery of the uneconomic costs of an electrical generations-related assets. Governor Pete Wilson signed the bill enthusiastically. The legislature laid out specific criteria that these plans had to meet. It said that an example of a plan [*142] authorized by AB 1890 was the Restructured Rate Settlement, which called for accelerated recovery of Diablo Canyon sunk costs and the development of an ICIP for recovery of going forward costs.

The majority's decision is overly harsh to PG&E. It does not strike an appropriate balance between the interests of consumer and shareholders. I sought to craft an alternative decision that struck a more appropriate balance.

The alternate was based upon the Proposed Decision of the administrative law judge, but differed significantly in several important ways.

First, the alternate did not call for a further $100 million reduction in the sunk costs of Diablo Canyon. There is no rational basis to reduce the sunk costs associated with Diablo Canyon by an arbitrary $100 million as the majority did. PG&E was directed to seek SONGS-like treatment for Diablo Canyon. The proposal the utility put forward results in approximately $4 billion in benefit to consumers. In my view, this disallowance is unwarranted in light of the benefits that PG&E has already conferred upon consumers. Moreover, to exact these monies on the basis of review of utility performance, tied to issues that pre-date settlements, [*143] pierces the veil into a reasonableness review and is unfair to the utility. It is the second bite at the proverbial apple by this regulatory body.

Also, I differ with the majority on the applicability of Section 463 of the Public Utilities code, that reaches an erroneous conclusion that the current regulatory framework for recovery under AB1890 is still traditional cost-of-service regulation. This conclusion is not consistent with the regulatory and market changes that have occurred in the electric industry. Also, this conclusion is inconsistent with the very nature of the stranded cost recovery envisioned by AB1890, which is fundamentally an incentive based regulatory framework. The ratemaking treatment for Diablo Canyon is inherently incentive ratemaking, not traditional cost of service ratemaking, therefore, Section 463 does not apply.

Second, I differ with the majority in the means used to prevent double recovery of the materials and supply inventories and the out-of-core nuclear fuel inventory. To avoid double recovery, I prefer to allow amortization only of the uneconomic portion, if any, of the nuclear fuel inventory and only the unused portion of the materials and [*144] supplies inventory. The majority allows PG&E to only recover the economic portion of these inventories. The majority misses the point that the very purpose of the whole stranded cost recovery debate is the recovery of the uneconomic portion of PG&E's investments. I prefer a mechanism that allows PG&E to recover the economic portion of these inventories in the ICIP and the uneconomic portion is amortized over the next five years.

Third, I prefer an escalation factor set at CPI minus 0.5% rather than the 1.5% adopted by the majority. It seems to me that allowing ICIP prices to escalate at only 1.5% is unfair to PG&E, especially when this is compared to the 3.7% escalation factor adopted for SONGS. Rather than attempting to determine an ethereal "fair estimate" of future inflation, which is almost an impossible task, my proposal allowed prices to increase at the actual CPI minus 0.5%. This would have insured that the ICIP would fall in real terms, but would set an escalation factor that would increase relative to general inflation in the economy. I would suggest that this approach is far more defensible and less subject to future vagaries in the economy.

Fourth, the alternate [*145] adopted Administrative and General (A&G) expenses based on the average of 1994 and 1995 expenditures, rather than just based upon the 1995 average used by the majority. Rather than simply adopting TURN's proposal as the majority's decision did, or adopting PG&E's proposal, I preferred a middle ground. The A&G expenses upon which the ICIP is based is a full $16 million below that proposed by PG&E. The majority adopted A&G expenses that are based on 1995 numbers that are approximately 50% of the A&G expenses of the previous year. In my mind, the use of the average of the 1994 and 1995 A&G expenses is a more reasonable way to determine the A&G costs associated with the ICIP. The incorporation of more data points in a reasonable time frame is a more fair assessment in light of such disparate annual results using discrete years.

Fifth, I proposed a capacity factor of 82%. The majority decision adopted a capacity factor of 83.6%. PG&E proposed a capacity factor of 80%. The capacity factor adopted in the SONGS decision is 78%. ORA proposed a capacity factor of 83.6%. The median historical capacity factor for pressurized water reactors is 80.5%. I sought to strike a middle ground that sets [*146] the rate at the median capacity factor for the pressurized water reactor units plus a "ratepayer adder" of 1.5%. This establishes a break-even capacity that is 4 percentage points above that adopted for SONGS, 2 percentage points above that requested by PG&E and 1.6 percentage points below that proposed by ORA. In my mind, an 82% capacity factor would have allowed PG&E to gain from successful operation of the facility, but would have also ensured that PG&E bear the risk for poor performance.

In preparing an alternate to the order accepted by the majority, I attempted to strike a fair balance between the interests of customers and the interests of PG&E shareholders. In my view, the majority proposal falls short of striking this balance. Their decision results in harsh treatment of PG&E, particularly after the company has worked diligently with the Commission to remove the huge hurdle of Diablo Canyon in arriving at a competitive electric industry. Diablo Canyon is a tragic regulatory story that has stood between the old world's rigid regulatory regime and a new regime where direct access would lead to a truly competitive marketplace.

It must be said that PG&E's Chief [*147] Executive Officer, Mr. Stanley Skinner, made tough economic decisions and sacrifices that allowed this Commission to get to where we are today. Moreover, his former counterpart, Mr. Ed Texiera, former Director of the Division of Ratepayer Advocates, equally made tough economic decisions in protracted negotiations that equally allowed the Commission to get to where we are now. The fruits of their laborious negotiations stand as an important backdrop to any decision accepted by this Commission in regard to the future of Diablo Canyon. In my mind, the majority has minimized the tremendous contributions and economic gains made by these two men who sought and achieved the goal to lessen the economic burdens to ratepayers that were created by an unsustainable regulatory regime. Both men had to balance the interests of shareholders and ratepayers alike in the aftermath of the sad regulatory saga of Diablo Canyon Nuclear Power Plant.

I believe that the alternate I sponsored would have allowed the Commission to not only move Diablo Canyon to a SONGS-like incentive regulatory framework that, like the majority, would have yielded significant benefits to ratepayers. But more importantly, it also [*148] would have maintained fidelity to the agreements and the spirit of decisions that were deemed fair in the past.

Dated May 21, 1997 in Sacramento, California.

/s/ Jessie J. Knight, Jr.

Jessie J. Knight, Jr.

Commissioner