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Decision 97-10-057 October 22, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.	R.94-04-031 (Filed April 20, 1994)
Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.	I.94-04-032 (Filed April 20, 1994)

(See Appendix A for appearances)

INTERIM OPINION

This decision addresses several issues relating to "streamlining" electric utility tariffs and regulatory accounts. We initiated this review in Decision (D.) 96-12-077 which approved the utilities' cost recovery plans pursuant to Assembly Bill (AB) 1890. We herein direct the utilities to eliminate certain regulatory accounts which are no longer useful with the ratemaking changes we have implemented pursuant to AB 1890. We find that AB 1890 does not permit the utilities to accumulate costs incurred during the rate freeze period for the purpose of affecting rates during or following the rate freeze period. We also state our intent to embark on an exploration of the type of ratemaking that will be in place following the rate freeze or transition period.

I. Background

The Commission is in the process of implementing far-reaching changes in the electric utility industry. Those changes include the development of competition in generation markets and the simplification of ratemaking for utility distribution services. Apparently in recognition of those changes, on November 27, 1996, San Diego Gas & Electric Company (SDG&E) filed Advice Letter 1005-E, which proposed to eliminate a number of balancing and memorandum accounts, including its Energy Cost Adjustment Clause (ECAC) and Electric Revenue Adjustment Mechanism (ERAM). SDG&E sought approval of its proposal by the end of 1996.

Partly in response to SDG&E's advice letter, D.96-12-077 addressed the purpose of ERAM and ECAC mechanisms during the rate freeze period established by AB 1890. The decision recommended that the Energy Division conduct workshops using SDG&E's advice letter as the basis for discussion. D.96-12-077 recognized that an advice letter is not the appropriate procedural forum for initiating far-reaching changes to ratemaking mechanisms or regulatory programs.

Subsequently, the Energy Division held a workshop in this proceeding on February 20, 1997. Participants filed comments on the workshop on March 6, 1997.

Energy Division published a workshop report on April 30, 1997. On May 20, participants filed comments on the workshop report. Among the parties who filed

comments on the workshop report are Southern California Edison Company (Edison), Pacific Gas and Electric Company (PG&E), SDG&E, Office of Ratepayer Advocates (ORA), California Industrial Users (CIU), Natural Resources Defense Council (NRDC), The Utility Reform Network (TURN), and the Environmental Defense Fund (EDF).

On August 15, 1997, the assigned Administrative Law Judge (ALJ) issued a ruling which scheduled an informational hearing on August 25, 1997. At the hearing, each utility presented an expert witness who described existing and proposed ratemaking mechanisms in more detail and responded to clarifying questions from the ALJ, Commission staff, and outside parties.

II. Existing Utility Ratemaking Mechanisms

PG&E, Edison, and SDG&E have numerous accounts which are designed to facilitate certain ratemaking conventions. In general, all three utilities have or have had an ECAC and an ERAM, balancing accounts which guarantee recovery of past costs under certain conditions. Each serves a somewhat different function and each has numerous subaccounts.

The ECAC is a regulatory account into which the utility enters mainly fuel-related costs. Developed during the 1970s when oil prices were volatile, its original purpose was to limit shareholder risk. It has also served to stabilize rates. Using the ECAC, the Commission sets rates based on a forecast of fuel costs and adjusts rates in a later period to reflect actual fuel costs. The Commission reviews the reasonableness of costs entered into ECACs after the costs are incurred. This reasonableness review process has been the trade-off for the mitigation of shareholder risk.

Edison, PG&E, and SDG&E have ECACs, each of which includes numerous subaccounts for costs associated with such items as qualifying facility (QF) contracts, nuclear incentives, line losses, and interutility power purchases. These accounts are described in more detail for each utility in Appendix B. In general, however, most costs included in ECAC accounts are related to generation, which will be subject to competition beginning January 1, 1998, or public benefits programs, the costs of which will be recovered in surcharge beginning January 1, 1998.

The ERAM tracks customer sales and permits the utility to recover its authorized revenue requirement notwithstanding the variations between sales forecasts and actual sales. The original purpose of the ERAM was to reduce or eliminate the utilities' incentives to market energy and thereby preserve the Commission's objective of promoting energy conservation. Edison no longer has an ERAM since the initiation of its Performance-Based Ratemaking (PBR) mechanism for transmission and distribution costs by D.96-09-092. SDG&E has proposed to suspend its ERAM for 1997 consistent with an agreement it has with ORA. PG&E has an ERAM in place. ERAM accounts reconcile forecasted sales levels with actual sales levels for revenues associated with base rates. Base rates have in the past been set to recover costs related to transmission, distribution, and investment-related generation costs.

Over the years, the Commission has approved the creation of dozens of other types of regulatory accounts for a variety of purposes. Most of them assure the utilities' recovery of costs which we have authorized, such as costs associated with nuclear generation or hazardous waste cleanup. Other accounts track costs to assure that the utilities spend the funds we have allocated to a specific purpose, such as Demand-Side Management (DSM) programs or Research, Development & Demonstration (RD&D).

Some of the costs in these many regulatory accounts were allocated between various utility functions in D.97-08-056, consistent with AB 1890. Notwithstanding the order's findings with regard to the appropriate functional characterization of each, we have not yet determined the ratemaking treatment which should appropriately be applied to various types of costs. For example, we found in D.97-08-056 that costs associated with repairs to the distribution system resulting from natural disasters should be entered into the Catastrophic Events Memorandum Account (CEMA) and that costs associated with repairing generation plant may not be entered into CEMA. We did not, however, determine the appropriate treatment of costs entered into CEMA, finding that the scope of the proceeding did not include consideration of ratemaking mechanisms.

III. The Need for and Purpose of Utility Balancing Accounts With the Introduction of Electric Industry Restructuring

The purposes and policy objectives which motivated the creation of various regulatory accounts over the past two decades may conflict with more recently established policy priorities. At the very least, the usefulness of the accounts to accomplish those or other objectives may have changed with changing circumstances.

We begin by considering the passage of AB 1890, which sets forth the framework for major changes in the electric utility industry. Among other things, AB 1890 imposes a rate freeze on electric utility rates until the earlier of March 31, 2002 or the date on which uneconomic generation-related assets and obligations have been recovered. (It does not freeze revenues.) Under the rate freeze, the utilities may not increase or decrease total rates from those that were in place on June 10, 1996. Authorized revenue requirements and associated components of the total rate, such as distribution, may change. The difference between (1) the revenues collected for nongeneration rate elements and for the rates for energy purchased from the Power Exchange (PX) and (2) the revenues from the frozen total rate represents what we have termed "headroom," that is, the amount that is available for utility recovery of uneconomic generation costs. During the rate freeze period, we cannot use regulatory accounts to reconcile costs and revenues if such reconciliation would involve rate changes.

In addition, competition in generation markets will be introduced January 1, 1998 pursuant to AB 1890 and our policies. We have repeatedly stated a commitment to developing regulatory policies and programs which complement competitive generation markets. Balancing accounts and other types of regulatory accounts which provide protections for utility generation costs may conflict with the Commission's objective of fostering competition.

This decision addresses regulatory accounting and ratemaking to the extent they appear to require attention before January 1, 1998. We consider a variety of regulatory accounting mechanisms to assure that those in place on January 1, 1998 are consistent with the rate freeze and facilitate regulatory mechanisms adopted in or pursuant to AB

1890. For example, in a related proceeding, we have authorized each electric utility to establish a Transition Cost Balancing Account (TCBA) to track recovery of authorized costs related to uneconomic generation. The calculation of the revenues entered into the account is affected by the accounting of revenues from other functions, such as distribution and transmission.

Notwithstanding the need for some immediate changes to regulatory accounting, the scope of this decision is narrow because more comprehensive review of utility ratemaking is being considered in other proceedings. Accordingly, this decision does not modify any ratemaking mechanism adopted in any other proceeding if doing so would change the regulatory risks the utility faces. Specifically, we do not adopt changes to PBR mechanisms for Edison or SDG&E or to the existing regulatory regime under which PG&E operates, that is, a general rate case which assures recovery of an authorized revenue requirement through the operation of the ERAM. We retain regulatory mechanisms required to permit the continued promotion of other policy goals where possible. Such goals include the need for conservation, innovation, and the affordability of service to low-income consumers. Related program design issues are left to related proceedings.

Similarly, we defer to other proceedings issues related to cost allocation, interest rates, competition transition charge (CTC) recovery or accounts, or the appropriate ratemaking mechanisms for the period following the rate freeze or transition period.

IV. The Energy Division Workshop Report

Energy Division's workshop notice framed the issues in this phase of this proceeding by posing several questions for the parties' consideration:

1. What tracking and/or balancing accounts are currently included in utilities' ERAM/ECAC applications or proceedings?

2. Please describe the function and purpose of each of the accounts listed in Question 1 above. (a) How are each of these functions impacted by the rate freeze? (b) Will any of these functions continue to be needed during 1997 and/or the transition period 1998 through 2001? Why?

3. For those functions that you believe will be needed, what are the proper proceedings to address them?

4. How do PBR incentives interact with ERAM? (a) Given the rate freeze, what incentives are appropriate?

5. For PG&E and SDG&E, should the ERAM for Transmission and Distribution be eliminated?

6. When tracking ERAM/ECAC costs, are there issues that the Commission should consider for market power abuse?

In response to the written comments of participants and the discussions at the workshops, Energy Division's workshop report recommends the Commission:

- Eliminate several accounts;
- Request that the utilities develop balancing accounts for generation costs in the proceeding addressing transition costs;
- Explore alternatives to the ERAM for distribution services in distribution PBR proceedings;
- Eliminate the forecast phase of ECAC proceedings beginning in 1997;
- Retain the reasonableness review portion of ECAC proceedings.

Appendix B presents Energy Division's recommendations with regard to each account in tabular form. Energy Division recommended eliminating accounts only where the parties agreed that the accounts should be eliminated.

In the workshop report, Energy Division emphasizes that its recommendations are the beginning of a process it believes should be ongoing and should recognize evolving industry characteristics.

V. Utility Proposals and Intervenor Responses

As part of the review process here, each utility presented proposals for treatment of ECAC and ERAM accounts and other regulatory accounts. Their proposals are presented in Appendix B, Energy Division's summary of accounts and parties' proposals for their disposition, and graphically in Appendix C.

A. PG&E

PG&E is currently subject to traditional general rate case reviews with an associated ERAM mechanism which assures recovery of the revenue requirement developed in the general rate case. PG&E proposes to replace its ERAM and ECAC with a Transition Revenue Account (TRA) beginning January 1, 1998. The TRA would be an accounting mechanism designed to facilitate the calculation of the revenues available to offset uneconomic generation costs entered into the TCBA. Specifically, the TRA would be credited with all billed revenues. From that total, PG&E would subtract the authorized revenue requirements for distribution, transmission, public benefits programs, and nuclear decommissioning. PG&E would then subtract any payments to the PX and Independent System Operator (ISO). The remaining balance would determine "headroom," the amount available to offset uneconomic generation costs entered into the TCBA. PG&E proposes that the amounts subtracted for distribution, transmission, public benefits programs, and nuclear decommissioning would be exactly the authorized revenue requirements for each category, rather than the actual revenues it collects. Accordingly, the TRA has the effect of an ERAM. That is, PG&E would not assume any risk for the difference between forecasted sales and actual sales for distribution, transmission, nuclear decommissioning, or public benefits program costs. This proposal is presented graphically in Appendix C.

PG&E would replace that portion of the existing ECAC proceeding dedicated to forecasting, believing that forecasting efforts will be accomplished in other proceedings. On September 24, the Commission issued D.97-09-102 in Rulemaking (R.) 87-11-012 granting PG&E's request for authority to forgo filing a forecast of its operations in its 1998 ECAC application.

PG&E proposes to retain the ERAM and ECAC through the end of 1997 so that it may include outstanding balances in the TCBA on January 1, 1998.

PG&E would retain the CEMA for distribution and transmission costs.

In its reply comments, PG&E proposes to retain numerous accounts that it had originally proposed eliminating. Its comments do not elaborate on the logic behind PG&E's change of position.

B. Edison

The Commission adopted a PBR mechanism for Edison in D.96-09-092 and, in so doing, eliminated Edison's ERAM. Edison's PBR establishes rates, rather than a revenue requirement. Accordingly, no purpose is served by accounting for differences between forecasted and actual sales and the ERAM is no longer useful.

Edison proposes here to eliminate the ECAC and the forecast phase of the ECAC proceeding on the basis that the PX will accomplish related objectives. In R.87-11-012, Edison has petitioned the Commission to forgo the forecast phase of its 1998 ECAC filing. It would eliminate the reasonableness portion of the ECAC proceeding for operations which begin on January 1, 1998. It would have the Commission review the reasonableness of such matters as QF contract administration in the annual Revenue Adjustment Proceeding (RAP) or TC proceeding.

Edison proposes to calculate revenues available to offset the uneconomic generation costs entered into the TCBA much the way PG&E would, that is, by calculating the residual after all other revenues are accounted for. The difference is how Edison would calculate the distribution and transmission revenues. Consistent with its existing PBR mechanism, Edison would debit total billed revenues with the actual revenues received from those functions, rather than the authorized revenue requirement. Like PG&E, Edison proposes dollar-for-dollar recovery of authorized revenue requirements for public benefits programs and nuclear decommissioning. Pursuant to Resolution E-3478, Edison established a memorandum account to reflect the ratepayer share of PBR-related revenue sharing and shareholder rewards and penalties. It proposes the account be used "so that the service quality incentives and net revenue sharing provision of Edison's nongeneration PBR do not affect CTC headroom during the rate freeze period."

Edison agrees with Energy Division's recommendations for eliminating a variety of accounts, including the DSM Tax Change Memorandum Account, the San Onofre Nuclear Generating Station (SONGS) 1 Memorandum Accounts, and the Women, Minority and Diabled Veterans Business Enterprises (WMDVBE) Memorandum Account, among others. It states two exceptions to Energy Division's

recommendation. It proposes to retain the Palo Verde Phase-In Procedure, which will expire in February 1998 rather than January 1, 1998 as Energy Division assumed. Edison would also retain the income tax component of the Contribution Memorandum Account, which records taxes associated with transfers of QF transmission interties.

As presented graphically in Appendix C, Edison would determine revenues available to offset uneconomic costs by subtracting authorized revenue requirements from total revenues, with the exception that it would subtract actual distribution revenues from the total (as distinguished from PG&E).

C. SDG&E

By D.94-08-023, SDG&E is subject to a PBR mechanism which sets an authorized revenue requirement. A share of the revenues collected above the revenue requirement is refunded to ratepayers in a subsequent period. The revenues subject to sharing is included in the ERAM account. In this proceeding, SDG&E proposes to eliminate the ERAM, observing that it is inconsistent with a rate freeze because overcollections and undercollections may not be reflected in changed rates. SDG&E proposes to replace the ERAM with a balancing account to record rewards, penalties, Incremental Cost Incentive Plan (ICIP) costs, and revenue-sharing dollars related to the PBR mechanism. The amounts in the account would not affect headroom, and would be collected or refunded notwithstanding the rate freeze, consistent with Edison's proposal for PBR revenues subject to sharing. This account, which SDG&E titles the "Revenue Sharing, Penalties and Rewards Balancing Account" (RSPRBA), would accumulate certain costs and revenues over the rate freeze period in order for SDG&E to recover or refund the amounts following the rate freeze period. Unlike Edison, SDG&E proposes to refund overcollections in the account which exceed $10 million during the rate freeze period. SDG&E originally proposed the account in Advice Letter 1005-E.

SDG&E would also eliminate the ECAC balancing account. It observes that the existence of an ECAC could permit a utility to defer collection of costs from one time period to another, which could represent an abuse of market power. It believes

the account serves no purpose during a rate freeze because the balances may not be used to affect rates.

As shown graphically in Appendix C, SDG&E would calculate revenues available to reduce uneconomic generating costs entered into the TCBA much the same way PG&E and Edison would. Like Edison, SDG&E would calculate the transmission component based on actual revenues at authorized rates. For distribution, SDG&E proposes to subtract from total billed revenues those actual revenues received from distribution services with the exception that entries into the RSPRBA would be accounted for in future rates rather than in the calculation of headroom.

SDG&E also proposes to eliminate several other balancing accounts as well in order to effect a "clean break from the past." SDG&E's proposed treatment of its 29 balancing accounts is included as Appendix B. It proposes to eliminate the Arbitration Memorandum Account (AMA), the Electric and Magnetic Fields Memorandum Account (EMFMA), the RD&D Account, the DSM Balancing Account, and the Low-Income Ratepayer Assistance (LIRA) Adjustment Clause. It also proposes eliminating the SONGS I ratemaking proceeding.

SDG&E observes that ECAC forecasting proceedings are no longer useful although it believes reasonableness reviews may still be necessary. It states it has agreed with ORA to eliminate ECAC reasonableness reviews as of year-end 1996.

SDG&E would also retain several balancing or memorandum accounts. It would retain the CEMA account on the basis that it should be permitted to recover the costs of catastrophic events, presumably after the rate freeze, for costs incurred during the rate freeze. It proposes to retain accounts which will "continue to be needed for (a) implementation of restructuring, (b) long-term or extraordinary costs, or (c) customer-specific costs." Among those accounts are the DSM Financing Rate Balancing Account (DSMFR), the Income Tax Component of Contribution and Advances Provision, the SONGS 2&3 ratemaking procedure, and Hazardous Substance Cleanup Cost Account. SDG&E proposes the first two of these be modified to provide that associated costs be allocated only to affected customers.

In general, SDG&E urges the Commission to move forward on these issues quickly. It would not delay or complicate the process by creating new forums.

D. Intervenor Responses

ORA generally agrees with Energy Division's recommendations with regard to eliminating certain accounts. ORA observes, however, that Energy Division in several instances identifies an account for a single utility for elimination and fails to identify the corresponding accounts for the other two. Accordingly, ORA recommends that when the Commission eliminates an account for one utility, it also should order the elimination of the similar accounts for the other two.

ORA recommends eliminating the ECAC beginning January 1, 1998, observing that ECAC components will be recoverable either through the market or the CTC. Consistent with Energy Division's recommendation, ORA would retain the reasonableness review portion of the ECAC proceeding until the Commission is confident that the PX is functioning well. ORA also recommends that the Commission take steps to determine the disposition of the balances in the accounts it would eliminate. It proposes that the Commission should state its policy in this decision that future accounts include a sunset provision to help assure that an account is either eliminated automatically or reviewed to determine the reasonableness of its continuation.

ORA strongly opposes any utility ratemaking mechanisms that would have the effect of deferring rate increases for costs incurred during the rate freeze period. It interprets SDG&E's RSPRBA to be just such a mechanism.

The California Energy Commission supports the Energy Division's proposal to retain accounts for the California Alternative Rates for Energy programs (CARE), DSM programs, and RD&D, believing that the accounts are necessary to "provide the Energy Efficiency and the Low Income Boards with flexibility to administer the transition from utility administration of these programs and funds to the boards themselves in a seamless fashion." The Energy Commission supports exploring alternatives to ERAM because a utility distribution company should not have an incentive to promote increased sales.

NRDC also urges the Commission to retain ERAM or adopt some related mechanism. It observes that Pacific Power and Light Company proposes to accomplish the objective of ERAM by creating a revenue cap mechanism that effectively eliminates the utility's incentive to promote increased electricity use.

CIU comments only that it supports Energy Division's procedural recommendations to continue review of these matters in existing proceedings and to limit action at this time to matters during the transition period.

VI. Treatment of Specific Regulatory Accounts

A. ECACs

ECACs were originally used for fuel and purchased power costs only. They have in recent years included many other types of costs. Those costs were allocated in D.97-08-056 to generation, transmission, or distribution to functions. Because only generation costs would be left in the ECAC and because those costs are now included in the TCBA of each utility or are recoverable through PX or ISO payaments, the ECAC is redundant and serves no regulatory purpose. Following the rate freeze period, utility generation costs will be deregulated to the extent that those costs have received regulatory protections that would not be available to competitors. The Commission has recognized that changes in the industry affect the need for and operation of balancing accounts such as ECACs. In D.96-12-077, we found that ECAC mechanisms may no longer be useful ratemaking tools, observing that "the PX price will set the standard for electric generation and power purchases, the primary components of ECAC costs…" At the same time, D.96-12-088 recognized that associated reasonableness reviews may be required after the introduction of competition in generation markets "to verify the accuracy and fairness of the utilities' recovery of PX costs."

Energy Division's report does not make any recommendations with regard to the ECAC balancing accounts except for elimination of a few subaccounts. The Energy Division does comment that the purpose of the forecast phase of the ECAC proceeding will be substantially changed with the introduction of the PX. It also

suggests that the reasonableness of utility fuel costs and purchases will continue to require Commission oversight until the PX is functioning properly. The utilities unanimously propose eliminating ECACs.

We will direct the utilities to eliminate ECAC mechanisms. Balances in the accounts as of December 31, 1997, should be entered into the interim transition cost balancing accounts pending reasonableness reviews of these costs in final ECAC proceedings. Reasonableness reviews will be conducted in more appropriate proceedings for costs incurred following December 31, 1997. We also find no further need for ECAC forecasts. We will therefore no longer conduct ECAC proceedings for generation costs incurred beginning January 1, 1998. With the elimination of the ECAC proceeding, we will need to develop a forum to determine the energy reliability index. We will seek comments on this matter in this proceeding.

B. ERAMs

D.96-12-077 finds that the "introduction of competition for generation will render ineffective our past approach of supporting DSM by using ERAM to counter the utility's economic incentive to increase sales." The ERAM was conceived during a period when the utility was the sole provider of power and a primary provider of conservation technologies and information. The ERAM was designed to reduce the conflict between the Commission's policy objective to promote conservation and the utilities' objective to increase revenues and profits through higher sales. When generation markets are competitive, a distribution utility would not be able to affect the level of power sales. To the extent distribution rates are designed to be insensitive to usage, that is, "flat," the utility would be indifferent to the amount of electricity a customer uses. Where distribution rates are sensitive to the amount of electricity a customer uses, the main purpose the ERAM would serve would be to protect utility shareholders from variations in revenues. Competing electricity providers will promote electricity sales without regard to the distribution utility's ratemaking mechanisms. During the transition period, the utilities may also have an incentive to promote electricity sales notwithstanding the presence of an ERAM because increased

sales will reduce the risk that the utilities will be unable to recover their uneconomic generation costs in the time allotted by AB 1890.

Several parties propose the elimination of the ERAM accounts for the reasons we have addressed here. Energy Division's workshop report also recommends elimination, but proposes to explore alternatives in utilities' distribution PBR application. We appreciate the parties' concern for continued conservation efforts and other types of demand-side management. Their comments in this proceeding, however, do not suggest ways to overcome the inevitable conflict between policy objectives to dampen demand and the compulsion of competitive electric providers to promote more sales. In subsequent proceedings, we will invite the parties to address this matter and possible alternatives to ERAM for the period following the transition period. We will direct PG&E to eliminate its ERAM effective January 1, 1998 and consistent with our subsequent findings regarding PG&E's TRA proposal. SDG&E should eliminate its ERAM since the account no longer serves its original purpose and is used only to track PBR rewards and penalties, and revenues subject to sharing. As we discussed earlier, Edison no longer has an ERAM.

C. PG&E's TRA

The purpose and operation of PG&E's proposed TRA appears to be mostly one of tracking revenues. It does not change PG&E's regulatory regime: to the extent PG&E recovers authorized revenue requirement dollar-for-dollar today using an ERAM, it will continue to do so under the TRA. We do not believe this particular type of ratemaking is useful in a competitive environment for the purpose of protecting conservation goals, as we discussed earlier. It may also provide protections to the utility which are no longer realistic. However, that is a matter for more studied review in PG&E's upcoming PBR proceeding or those future proceedings in which we address specific proposals for regulatory change. In the meantime, the TRA will track revenues by function consistent with existing regulatory mechanisms to calculate the level of credits available for paying off uneconomic generation costs. In this way, PG&E's TRA appears no different from the methods Edison and SDG&E will use to calculate these credits, except in name.

We do not herein adopt PG&E's proposal to include in this ERAM-type mechanism any determinations which would affect the regulation of transmission costs. That is a matter for the Federal Energy Regulatory Commission (FERC). The FERC is currently considering transmission rate proposals by the California electric utilities. After the FERC has issued an order addressing these issues, PG&E should modify its tariffs accordingly. Such an order is expected before the end of 1997. Consistent with D.97-08-056, PG&E may not calculate the transmission revenue requirement residually.

With this exception for transmission revenues, we adopt PG&E's proposal for a TRA account. We will revisit this ratemaking treatment for distribution costs in PG&E's distribution PBR application, which it will file on or after December 15, 1997, pursuant to D.97-04-067.

D. Accounts for Rate Changes or Rate Change Deferrals

The utilities propose retaining certain balancing accounts in order to permit rate changes after the rate freeze for costs incurred during the rate freeze period. Except for collection of certain costs set forth explicitly in AB 1890, we find such a scheme to be unlawful. We believe the legislature intended the utilities' revenues during the rate freeze period to be limited to the amounts collected from the rates that were in effect on June 10, 1996. AB 1890 does not state that utilities may accumulate balances associated with various costs or ratemaking mechanisms through the rate freeze period and then collect them at a later date. Nothing in the bill would lead us to conclude that the rate freeze merely represents a period during which ratepayers and shareholders will lend funds to each other.

Moreover, rate change deferrals would violate the provisions of AB 1890 that set forth the method by which the utilities may collect uneconomic generation costs. Section 368(a) specifies that "the electric corporation shall be at risk for those (generation-related) costs not recovered during (the transition) period." By deferring rate changes to reflect costs (or cost savings) beyond the rate freeze period, the utilities would change the headroom available for the recovery of uneconomic generation investments. AB 1890 specifies the methods by which uneconomic investments may be recoverable and the exceptions to the rule that those costs must be recovered by the end

of the transition period. In so doing, AB 1890 does not anticipate or authorize deferring cost recovery of nongeneration costs until after the rate freeze in ways which would affect headroom.

Some of the costs the utilities propose to include in regulatory accounts for purposes of deferring rate increases are costs for which we have in recent years granted dollar-for-dollar recovery without risk to utility shareholders. Such costs include those incurred to repair utility systems following storms or earthquakes and costs associated with clean-up of hazardous materials. We have not changed our view that these costs are legitimate (although we have stated our concern that balancing account treatment of them may create incentives for the utilities to defer maintenance). Notwithstanding our views, however, AB 1890 does not permit the utilities to recover such costs by way of rate increases--either during the rate freeze period or after it—to reflect costs incurred during the rate freeze period. We cannot fashion an exception to the law on the basis that the law conflicts with our policy preferences. The Legislature has narrowly circumscribed our ratemaking authority during the transition period. Exceptions that AB 1890 does not specify to the rate freeze provisions are unlawful. We therefore reject proposals that would authorize the utilities to accumulate costs or revenues in balancing accounts during the rate freeze in order to incorporate them into rate changes after the end of the rate freeze period, except as expressly identified in AB 1890 for certain transition costs.

In addition to the accounts they propose for certain operational costs, both Edison and SDG&E propose to use regulatory accounts for the purpose of affecting rate changes to reflect a variety of PBR costs incurred during the rate freeze period. Edison's memorandum account for PBR rewards and penalties and SDG&E's RSPRBA would permit the utilities to accumulate entries for recovery at the end of the rate freeze period. SDG&E's proposal goes further by ignoring the rate freeze altogether if revenue-sharing balances exceed $10 million during the rate freeze period. As we have stated, AB 1890 does not permit such ratemaking mechanisms. We add that we cannot circumvent the intent of AB 1890 to impose a rate freeze by calling rate changes any other name. We interpret AB 1890 to require that the tariffed rates in effect on June 10,

1996 are those which must be in place during the rate freeze period. We clarify that Resolution E-3478 did not authorize Edison to use a memorandum account for such a purpose and an advice letter would not be the proper forum for reviewing the lawfulness or wisdom of such a matter. We reject the proposals of Edison and SDG&E to create new balancing accounts to track PBR rewards, penalties, and revenue sharing for the purpose of affecting rates during or after the rate freeze period. Any such rewards or penalties would be reflected in the portion of total rates allocated to distribution and thereby affect the calculation of headroom. However, balancing accounts should be created for the sole purpose of crediting the TCBA.

E. Accounts for Public Purpose Programs

Some electric utility accounts are designed to track program costs for the purpose of assuring that either authorized funding is spent on the program or is returned to ratepayers. Such accounts include those relating to the CARE program, DSM programs, and RD&D. In some cases, they are "one-way" balancing accounts because ratepayers may receive refunds for unspent funds but would not be required to pay for cost overruns. These types of accounts may be useful, even necessary, for program administration notwithstanding the rate freeze. In fact, Section 381 and Section 382 require the utilities to fund a variety of public policy programs at specified levels.

This proceeding does not rule on the wisdom of funding levels for public purpose programs. Those are matters which are appropriately subjects of proceedings relating to program design and administration. We will, however, direct the utilities to retain these accounts for the purpose of tracking related costs and revenues with that understanding and as a method of assuring that the funds dedicated to related programs are actually used for their intended purposes.

We also adopt the proposals of the electric utilities to create balancing accounts for authorized nuclear decommissioning costs and authorized public benefits programs costs. We agree that their proposals are consistent with AB 1890 which authorizes recovery of associated costs. Consistent with our earlier discussion, the

balances in these accounts would affect only headroom during the transition period except to the extent we have determined otherwise in the transition cost proceedings.

F. Other Accounts

Several other accounts have been created pursuant to AB 1890 and Commission decisions which are designed to accomplish certain objectives through the transition period. These accounts have been established in transition cost proceedings and will not be changed in any way by this decision.

The utilities and other parties propose to eliminate various accounts as being unnecessary due to industry changes. With the exceptions of those accounts required to track DSM, RD&D, and CARE programs, discussed above, and those required for transition matters which have been addressed in relevant transition cost decisions, we encourage the utilities to eliminate regulatory accounts beginning January 1, 1998. We will require each utility in its first RAP to identify those regulatory accounts that have been eliminated and those that have been retained.

G. Cost Allocations

SDG&E's proposal to modify the allocation of costs in certain accounts is denied because cost allocations are outside the scope of this proceeding. We adopted cost allocation methods for SDG&E in D.97-08-058.

H. Edison's Comments on the Proposed Decision

In its comments on the proposed decision, Edison proposes for the first time a "modified TRA." It argues that it should be permitted the same opportunity as PG&E to recover its costs and payments to the ISO and PX. Like PG&E, it observes that a TRA will perform the function of a number of balancing accounts and simplify accounting.

We understand Edison's concern and, in light of the complexity of our ratemaking programs and the overlays which are required to implement AB 1890, the difficulty in interpreting the intent of the proposed decision. Edison observes correctly that "The PD finds no difference, except in name, between the TRA mechanism adopted for PG&E and Edison's method of determining the revenues available for

paying off transition costs." In fact, the intent of the proposed decision and our order today is that Edison would subtract various revenue requirements, or actual revenues depending on the mechanism already adopted for a category of costs, from billed revenues. For Edison, the calculation would operate just as it would for PG&E, applying the TRA, with the exception that the deduction for Edison's distribution operations would be based on actual revenues rather than an adopted revenue requirement, consistent with Edison's PBR mechanism.

We do not herein specifically adopt a TRA mechanism for Edison because, prior to the filing of its comments on the proposed decision, Edison did not propose a TRA. Nevertheless, our intent is that the calculation of Edison's "headroom" would be made as if Edison had a TRA. If Edison believes it requires a specific account to effect this calculation, it may propose one in the tariff modifications it submits in compliance with this order.

VII. Concluding Principles and Policies

This decision makes several changes to utility regulatory accounting mechanisms, either eliminating them or replacing them. It does not, however, change any regulatory accounts in a way that would affect utility risk, and we do not herein make any changes which would affect the operation of existing utility ratemaking programs. Thus, although we eliminate the utilities' ECAC accounts, their fuel costs remain in a balancing account (the TCBA) except to the extent they will be recovered by revenues from sales made through the PX. Although we eliminate PG&E's ERAM, its distribution revenue requirement is still recovered on a dollar-for-dollar basis notwithstanding sales levels. SDG&E's and Edison's PBR ratemaking schemes are similarly unchanged. As we have stated, other proceedings are more appropriate forums for considering major changes to ratemaking programs.

Based on the foregoing discussion, we list the following principles and policies resolved in this decision:

- Except as expressly set forth in AB 1890, the electric utilities may not change rates during or after the rate freeze period to reflect costs incurred or revenues received during the rate period.

- The utilities shall eliminate ECAC and ERAM effective January 1, 1998.

- The utilities shall retain the regulatory accounts relating to DSM, CARE, and RD&D programs for the purpose of assuring that costs allocated to a specific program or function are spent on that program or function, consistent with relevant Commission orders.

- Nothing in this decision authorizes any change to the PBR mechanisms of SDG&E or Edison, or the method applied to PG&E for recovering distribution revenue requirement by way of a general rate case and associated reconciliation of forecasted revenues with actual revenues. Changes to PBR mechanisms or PG&E's regulatory regime are the topics of other proceedings.

- The utilities may retain any existing memorandum or tracking account for the purpose of identifying costs incurred and revenues collected during the rate freeze period but not for the purpose of affecting regulated rates at any time except as expressly provided in AB 1890 and authorized by the Commission. They may eliminate any regulatory account beginning January 1, 1998 which is not required for the funding or administration of DSM, RD&D, or CARE programs or which has not been the subject of a Commission order addressing transition cost recovery. In their first RAP applications, the utilities shall submit a listing of the regulatory accounts they eliminate and those they propose to retain and justify the purpose of each.

- Nothing in this proceeding directs or implies any changes in cost allocations that were established or continued by D.97-08-056 or subsequent Commission orders.

- During the rate freeze period, all other regulatory accounts that are retained may be used for the limited purpose of tracking costs and revenues and, if subsequently so ordered by the Commission, for the purpose of facilitating ratemaking for costs incurred and revenues collected following the rate freeze period.

VIII. Procedural Guidelines

In order to effectuate the foregoing principles and policies, we set forth the following procedural guidelines:

- ECAC reasonableness reviews will be conducted for balances in ECACs as of December 31, 1997.

- ECAC forecasts are eliminated.
- Future reasonableness reviews of issues relating to QF contract administration, market power issues and administration of public purpose programs will be conducted in each utility's annual transition cost proceeding or RAP proceeding pursuant to Commission orders or rulings .
- By June 1, 1998, each utility shall file proposals for ratemaking mechanisms that they believe should be in place after the end of the rate freeze period. Such proposals may include alternatives to ERAM.
- Tariff changes to effect the elimination of ECAC and ERAM accounts shall be filed as part of advice letters no later than November 3, 1997.

Findings of Fact

1. The Commission initiated this review of utility regulatory accounts in D.96-12-077, held workshops and received comments from parties on relevant issues.

2. PG&E, Edison, and SDG&E have ECACs which reconcile revenues and costs associated with fuel for generation operations. The original purpose of the accounts was to reduce utility risk during a period when fuel prices were volatile.

3. PG&E has an ERAM which assures recovery of authorized revenue requirement for distribution and transmission, notwithstanding sales volumes.

4. SDG&E has an ERAM which tracks revenues for the purpose of determining revenues it must refund to ratepayers in a subsequent period pursuant to the sharing rules in its PBR.

5. The original purpose of the ERAM accounts was to reduce or eliminate the incentive for utilities to market power contrary to the Commission's goal to promote conservation.

6. PG&E, SDG&E, and Edison have a variety of regulatory accounts established for a variety of costs and purposes.

7. D.97-08-056 determined the appropriate allocation of costs between utility functions but did not address the appropriate ratemaking treatment for those costs.

8. Electric industry restructuring and the rate freeze enacted by AB 1890 may conflict with the original purposes and efficacy of various regulatory accounts.

9. The Commission has stated its commitment to ratemaking policies which complement competition in generation markets.

10. The Energy Division published a workshop report summarizing the workshops held on related issues and recommending certain Commission action.

11. Issues with regard to PBR program design, cost allocation, interest rates on certain accounts, matters relating to TC recovery or accounts, and ratemaking mechanisms for the period following December 31, 2001 are outside the scope of this proceeding.

12. AB 1890 does not permit the utilities to change total rates in effect either during or after the rate freeze period to reflect the revenues received or costs incurred during the rate freeze period with specified exceptions.

13. The Commission has determined the methods for calculating the amounts available to offset uneconomic generation costs in D. 97-06-060 and D.97-08-056.

14. Some regulatory accounts have been established for the purpose of assuring that ratepayer funding of certain programs is used exclusively for those programs.

15. The Commission has determined that the efficacy of ECACs may be affected by the introduction of competition in generation markets.

16. The Commission has determined that the efficacy of ERAMs may be affected by the introduction of competition in generation markets.

17. PG&E's proposed TRA would track the revenues available to offset costs associated with uneconomic generation entered into the TCBA and would effectively permit dollar-for-dollar recovery of authorized revenue requirements consistent with its existing regulatory regime.

18. Edison proposes to account for the revenues available to offset costs associated with uneconomic generation in a way that is generally consistent with its existing regulatory regime.

19. SDG&E proposes to account for the revenues available to offset costs associated with uneconomic generation in a way that is generally consistent with its existing regulatory regime.

20. Regulatory accounts for CARE, DSM, and RD&D are required for the Commission to determine the extent to which funds expended for related programs are actually spent implementing those programs.

Conclusions of Law

1. The Commission should direct PG&E, Edison, and SDG&E to eliminate their ECAC mechanisms.

2. The Commission should direct PG&E and SDG&E to eliminate their ERAMs.

3. Consistent with AB 1890, the Commission should prohibit the use of any regulatory account to accrue costs incurred or revenues collected during the rate freeze period for the purpose of affecting rates either during the rate freeze period or after it.

4. The Commission should require PG&E, Edison, and SDG&E to retain accounts related to DSM, RD&D, and CARE programs.

5. The Commission should permit the utilities to retain regulatory accounts with the exception of ERAM and ECAC and subject to the condition that they justify their maintenance in their first revenue adjustment proceedings. The Commission should permit the utilities to eliminate any accounts which are believed to be unnecessary during the transition period.

6. FERC has primary jurisdiction over transmission rates and the Commission may not adjust transmission rates to account for variations between forecasted sales and actual sales.

7. The Commission should adopt PG&E's proposal to create a TRA with the exception that the determination of transmission rates is subject to the jurisdiction of the FERC.

8. The Commission should adopt Edison's proposal to use the BRPMA to track PBR rewards, penalties, and revenue sharing.

9. The Commission should adopt SDG&E's proposal to create an account to track PBR rewards, penalties, and revenue sharing.

INTERIM ORDER

IT IS ORDERED that:

1. No electric utility account used for the purpose of electric regulation or ratemaking shall include costs incurred or revenues collected during the rate freeze period for recovery at any time either during or after the rate freeze period except as expressly authorized in Assembly Bill (AB) 1890 and implemented by Commission order.

2. Pacific Gas and Electric Company (PG&E), Southern California Edison Company (Edison), and San Diego Gas & Electric Company (SDG&E) shall modify their tariffs by filing advice letters no later than November 3, 1997 to eliminate Energy Cost Adjustment Clause (ECAC) mechanisms effective January 1, 1998. Balances remaining in the ECAC and ERAM accounts as of December 31, 1997 shall be transferred to the interim Transition Cost Balancing Accounts and treated according to subsequent Commission orders.

3. PG&E and SDG&E shall modify their tariffs by filing advice letters no later than November 3, 1997 which eliminate their Electric Revenue Adjustment Mechanisms (ERAM) effective January 1, 1998.

4. PG&E shall retain the regulatory accounts relating to DSM, CARE, and RD&D programs. Nothing in this order changes the operation of those programs or accounts, or amounts to be included in the accounts authorized by Commission orders.

5. Edison shall retain the regulatory accounts relating to DSM, CARE, and RD&D programs. Nothing in this order changes the operation of those programs or accounts, or amounts to be included in the accounts authorized by Commission orders.

6. SDG&E shall retain the regulatory accounts relating to DSM, CARE, and RD&D programs. Nothing in this order changes the operation of those programs or accounts, or amounts to be included in the accounts authorized by Commission orders.

7. PG&E, Edison, and SDG&E may retain any existing memorandum or tracking accounts for the purpose of identifying costs incurred and revenues collected during the rate freeze period but not for the purpose of affecting regulated rates at any time

except as expressly provided in AB 1890 and authorized by Commission order. The utilities shall submit a listing of those accounts in their first Revenue Adjustment Proceeding (RAP) applications and provide a justification for retaining each at that time.

8. Nothing in this decision authorizes or implies any changes in cost allocations established or continued by D.97-08-056 or subsequent Commission orders. Utility tariff filings due November 3, 1997 shall propose no cost allocation changes.

9. Nothing in this decision authorizes or implies any changes to the performance-based ratemaking (PBR) mechanisms of SDG&E or Edison.

10. Nothing in this decision authorizes or implies any changes in the method of establishing distribution revenue requirement or rates for PG&E.

11. During the rate freeze period, Edison, PG&E, and SDG&E may retain regulatory accounts for the limited purpose of tracking costs and revenues and, if subsequently so ordered by the Commission, for the purpose of facilitating the reinstitution of ratemaking following the rate freeze period subject to the conditions set forth herein.

12. ECAC forecasts for PG&E, Edison, and SDG&E are eliminated.

13. Future review of the reasonableness of utility activities relating to qualifying facility contract administration, fuel purchases, market power issues and administration of public purpose programs will be conducted in each utility's annual transition cost proceeding or RAP proceeding pursuant to Commission orders or rulings. This decision does not, however, order new or different forms of reasonableness reviews for utility operations or expenses subject to PBR mechanisms.

14. PG&E, Edison, and SDG&E shall each file an application on January 15, 1999 which proposes ratemaking mechanisms which they believe should be in place after the end of the rate freeze period. Such proposals may include alternatives to ERAM. Nothing in this decision shall be construed to represent an approval of cost recovery or ratemaking mechanisms for the period beginning after the rate freeze period.

15. PG&E's request to establish a Transition Revenue Account is adopted with the exceptions set forth herein regarding transmission rates. PG&E shall file related tariff modifications by November 3, 1997 from the effective date of this decision. PG&E shall file further tariff modifications consistent with the determinations of the Federal Energy Regulatory Commission's (FERC) order with regard to transmission rates and transmission ratemaking. If the FERC defers to this Commission for establishing ratemaking mechanisms for the transmission revenue requirement, PG&E shall modify its tariffs consistent with its proposal herein which provides that PG&E will subtract from total billed revenues the total authorized revenue requirement for transmission.

16. Edison's request to use the Base Rate Performance Memorandum Account to track PBR rewards, penalties, sharing or other costs or revenues is granted. Balances in the account may not be carried over to affect rate following the transition period and, during the transition period, shall be added to or subtracted from total billed revenues in calculating revenues available to offset uneconomic generation costs.

17. SDG&E's request to establish a memorandum account or balancing account to defer ratemaking treatment of PBR rewards, penalties, sharing or other costs or revenues is denied. SDG&E is authorized to create such an account for the purpose of tracking PBR sharing, rewards and penalties which would be added to or subtracted from total billed revenues in calculating revenues available to offset uneconomic generation costs.

18. Parties may file comments no later than November 17, 1997, addressing the appropriate forum in which to consider all matters relating to the Energy Reliability Index.

This order is effective today.

Dated October 22, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners

See Formal File for App. A-C.

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