

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**RESOLUTION E-3562
DECEMBER 17, 1998**

RESOLUTION

RESOLUTION E-3562. SAN DIEGO GAS & ELECTRIC COMPANY (SDG&E) REQUESTS APPROVAL OF ITS PERFORMANCE-BASED RATEMAKING BASE RATE MECHANISM FINAL REPORT FOR 1997, WHICH DETAILS REVENUE SHARING CALCULATIONS AND PERFORMANCE REWARDS AND PENALTIES FOR THE SUBJECT YEAR. SDG&E'S ADVICE LETTER 1095-E/1097-G IS APPROVED IN PART. SDG&E SHOULD RECALCULATE THE REVENUE SHARING AMOUNTS.

BY ADVICE LETTER 1095-E/1097-G FILED MAY 15, 1998.

SUMMARY

1. This resolution approves the PBR rewards and penalties reported in San Diego Gas & Electric Company (SDG&E) Advice Letter (AL) 1095-E/1097-G. This AL transmits SDG&E's Performance-Based Ratemaking (PBR) Base Rate Mechanism Final Performance Report for 1997 (Base Rate Report) in compliance with Decision (D.) 94-08-023. The Base Rate Report provides SDG&E's summary of 1997 performance under its base rate PBR mechanism, including SDG&E's revenue sharing calculations and information about SDG&E's rewards and penalties pursuant to the mechanism's safety, reliability, and customer satisfaction components.
2. SDG&E calculated a 1997 rate of return (ROR) subject to sharing of 10.52%. This ROR is 153 basis points above the authorized ROR, which falls within the third band of revenue sharing. Ratepayers would be allocated some of the excess revenues. Ratepayers are allocated 25% of the net operating income which corresponds to an ROR in excess of 100 basis points above the authorized ROR, up to 150 basis points, and are allocated 50% of the net operating income which corresponds to an ROR in excess of 150 basis points above the authorized ROR. Using SDG&E's calculation, ratepayers would be allocated \$4.4 million, while the Energy Division estimates that SDG&E shareholders would receive \$38.9 million.

3. We order SDG&E to recalculate its 1994 through 1997 PBR revenue sharing amounts, to exclude award amounts SDG&E provided to its executives under its Long-Term Incentive Plan and Executive Incentive Compensation Plan. These amounts affected the amount of revenues which are allocated to electric and gas ratepayers under the PBR revenue sharing mechanism. These award amounts should have been paid for by SDG&E's shareholders.
4. We also order SDG&E to recalculate its 1997 PBR revenue sharing amount, to exclude any Energy Incentive Plan rewards it made to employees related to performance under the gas procurement PBR on or after June 1, 1997. These amounts also affected the amount of revenues which are allocated to electric and gas ratepayers under the PBR revenue sharing mechanism. The awards paid to employees for performance under the gas procurement PBR should have been included with brokerage costs recorded in the Purchased Gas Account.
5. In AL 1095-E/1097-G, SDG&E reported that a reward results from its safety and customer satisfaction performance and that a penalty results from its electric reliability performance. SDG&E's 1997 performance results in a net performance penalty of \$333,333.
6. The following performance rewards/(penalties) are approved:

ELECTRIC DEPARTMENT

Performance Rewards/(Penalties)	
Employee Safety	\$2,520,000
Customer Satisfaction	\$ 560,000
<u>System Reliability</u>	<u>(\$4,000,000)</u>
Total Electric Department	(\$ 920,000)

GAS DEPARTMENT

Performance Rewards/(Penalties)	
Employee Safety	\$480,000
<u>Customer Satisfaction</u>	<u>\$106,667</u>
Total Gas Department	\$586,667

7. The gas department allocation of the revenue sharing amount and reward will be recorded in the Gas Fixed Cost Account (GFCA). The electric department allocation of the revenue sharing amount and the penalty will be recorded in the Transition Cost Balancing Account (TCBA).

8. No protests were received.
9. This Resolution also adopts an increase in the authorized 1997 Research, Development, and Demonstration (RD&D) funding, using the Base Rates PBR methodology, of \$16,000 from the 1996 allocation.

BACKGROUND

1. SDG&E's base rate PBR was adopted by the Commission in D.94-08-023. This PBR establishes the method by which the Company's authorized base rate revenue requirements, i.e. those costs related to operation and maintenance expenses, general and administrative expenses, capital-related costs (e.g., rate base, depreciation, and property tax), and other nonfuel costs, are calculated. It also sets forth performance standards related to SDG&E's quality of service (customer satisfaction, electric reliability, and safety), with associated financial rewards and penalties in the event those standards are exceeded or not met by the utility.
2. SDG&E's base rate PBR also formerly included an electric price performance component, but in D.97-09-052 the Commission suspended the electric price comparison component of the PBR, effective January 1, 1997, while leaving the other components of the PBR in effect.
3. The current base rate PBR became effective on September 1, 1994. It is anticipated to be in effect through 1998. SDG&E has filed an application (A.98-01-014) for a new PBR mechanism to be implemented in 1999, along with a 1999 cost of service study. Hearings in that proceeding have been completed, and a Commission decision is anticipated in early 1999.
4. D.94-08-023 requires SDG&E to file an annual report which provides a summary of the prior calendar year PBR performance on May 15th of each year. AL 1095-E/1097-G was filed on May 15, 1998 to detail the results of SDG&E performance under the base rate PBR for 1997. Previous annual performance reports have been submitted by SDG&E in 1995, 1996, and 1997 for the years 1994, 1995, and 1996, respectively. The first two of those reports were approved by the Commission, and no protests were filed in response to either of those reports, but the Division of Ratepayer Advocates (predecessor to the Office of Ratepayer Advocates (ORA)) filed a report in response to the 1994 performance report. Protests were filed against the 1996 performance report by ORA and the Utility Consumers Action Network (UCAN). The Commission ordered a recalculation of revenue sharing amounts in its resolution on the 1996 report, based on recommendations by the Energy Division.
5. D.94-08-023 ordered that the Commission Advisory and Compliance Division (CACD, the predecessor to the Energy Division) would have the "overall responsibility" for the administration of the monitoring and evaluation of the SDG&E PBR. That

decision also provided that CACD would issue an annual report on SDG&E's PBR results each year. The Energy Division's evaluation report is included within the Discussion section in this resolution.

6. The performance results of the current SDG&E base rates PBR were also extensively discussed in the testimony presented in A.98-01-014.
7. As required by D.95-04-069, SDG&E also reports in AL 1095-E/1097-G the change in available RD&D funding resulting from application of the PBR escalation index.
8. In D.97-10-057, the Commission addressed accounting changes for electric utilities during the transition to a competitive electric market in California. Among other things, the Commission ordered that the Energy Cost Adjustment Clause (ECAC) and Electric Revenue Adjustment Mechanism (ERAM) Balancing Accounts be eliminated as of January 1, 1998, and that 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 was denied. The Commission authorized SDG&E 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 available to offset uneconomic generation costs. SDG&E filed AL 1055-E on November 26, 1997, wherein SDG&E proposed to establish a Rewards and Penalties Balancing Account. The proposed account would allow for the tracking of PBR electric department revenue sharing and various incentive rewards and penalties. The Commission has not yet acted on AL 1055-E.
9. In D.97-12-041, we ordered that "For 1997 and 1998, SDG&E shall record the electric department allocation of any amounts to be shared with ratepayers pursuant to the PBR experiment as a credit in the Transition Cost Balancing Account." (slip op, pg. 14)
10. In D.96-11-060, the Commission authorized a 1997 rate of return for SDG&E of 9.35%.
11. In D.96-04-059, the Commission adopted a modified San Onofre Nuclear Generating Station (SONGS) settlement agreement, including a reduced ROR for SONGS for SDG&E of 7.14%.
12. On April 12, 1996, SDG&E submitted Advice Letter 983-E in order to implement the SONGS ratemaking procedure adopted in D.96-04-059. The advice letter became effective on April 15, 1996.
13. The new ratemaking procedure for SONGS removed "incremental" expenses from base rate PBR treatment, and removed capital amounts and associated expenses from the calculation of the base rate PBR net operating income. However, for the purpose of calculating the ROR subject to sharing, SONGS rate base is still included in the calculation.

NOTICE

1. Public notice of this AL was made by publication in the Commission calendar, and by SDG&E mailing copies of the filing to interested parties, including other utilities, governmental agencies, and the service list to Application 92-10-017.

PROTESTS

1. No protests were received.

DISCUSSION

Revenue Sharing

1. The Base Rate PBR Mechanism includes a revenue sharing component which allocates SDG&E's recorded net operating income (NOI) between the utility's shareholders and ratepayers. Recorded NOI associated with the combined gas and electric department rate of return (ROR) is allocated as follows: up to and including 100 basis points above the authorized ROR, recorded NOI is allocated 100% to shareholders; for the ROR greater than 100 basis points but no greater than 150 basis points above authorized, recorded NOI is allocated 75% to shareholders and 25% to ratepayers; and for the ROR greater than 150 basis points above authorized, recorded NOI is allocated 50% to shareholders and 50% to ratepayers. Shareholders are at risk for all recorded NOI associated with ROR below authorized.

2. For 1997, SDG&E recorded a 10.52% combined ROR (for the electric and gas departments) adjusted to base rates, which is 153 basis points above the weighted authorized ROR of 8.99%.¹

3. SDG&E's recorded ROR is 153 basis points above authorized, which falls into the third sharing tier of the base rate PBR. Ratepayers are allocated 25% of the NOI associated with the ROR more than 100 basis points above authorized, up to 150 basis points, and are allocated 50% of the NOI associated with the ROR more than 150 basis points above authorized. The total NOI associated with ROR more than 100 basis points above authorized is \$14.8 million. Ratepayers are allocated a total of \$4.4 million, after tax effects. Of this amount, electric ratepayers are allocated \$3.7 million, and gas ratepayers are allocated \$0.7 million. Of the recorded NOI above authorized, SDG&E shareholders would be allocated \$38.9 million.

¹ The authorized 1997 ROR for SDG&E adopted in D.96-11-060 was 9.35%. In D.96-04-059 the Commission adopted a modified SONGS settlement agreement which included a 7.14% ROR for SONGS, effective April 15, 1996. The effective rate base-weighted SDG&E authorized ROR for 1997 is 8.99%.

4. The Energy Division has reviewed SDG&E's revenue sharing calculations, and recommends that the revenue sharing should be recalculated, as discussed below.
5. SDG&E's 1997 Base Rate Report indicates that the main reasons SDG&E exceeded its authorized ROR in 1997 were: 1) lower O&M expense than authorized, 2) "miscellaneous revenue", 3) depreciation, 4) lower rate base than authorized, and 5) off-system sales. SDG&E's previous Base Rate Reports indicated that lower O&M, depreciation, lower rate base, and miscellaneous revenue also were among the leading reasons for SDG&E's higher ROR in earlier years.
6. The Energy Division found that actual rate base additions for past years have been far lower than the PBR-authorized rate base additions. PBR-authorized net plant additions are calculated using a regression formula. For example, in 1997, the PBR regression formulas authorized rate base additions of \$312.1 million, while SDG&E's actual net additions were only \$203.6 million, a difference of over \$100 million. A comparable difference occurred in 1996 as well. This difference affects both rate base and depreciation expense. SDG&E's weighted average rate base was lower in 1997 than in 1994.
7. The Energy Division found that SDG&E initiated a large reduction in the number of its "base" and "peakload" employees in the year the PBR experiment began, and continued this reduction through 1997. SDG&E's total workforce in 1997 was 17% lower than in 1993. This has likely made a significant contribution to the reduction in actual O&M expense compared to the PBR-authorized O&M expense.
8. The pension cost incurred by SDG&E also appears to have been a factor in reducing SDG&E's operating expenses. SDG&E has basically incurred no net pension cost since 1993. The Energy Division could not determine the exact amount assumed in the 1993 GRC "starting point" operating expenses, because the adopted 1993 GRC revenue requirement was based on a settlement. Nevertheless, it appears that this must have been a factor in SDG&E's lower O&M expenses.
9. In the course of its review of the 1997 Base Rate Report, the Energy Division found that SDG&E has established numerous incentive plans for its employees, managers, and executives. These include the Corporate Incentive Plan, the Pay-for-Performance Plan, Corporate Incentive Rewards, the Executive Incentive Compensation Plan (EICP), the Long-Term Incentive Plan (LTIP), the Energy Incentive Plan, and others. Some of these plans, such as the LTIP, were supposed to be paid out of shareholder funds. Generally, incentive awards appear to be part of an executive's, employee's, or manager's overall compensation "package" and are tied to corporate performance goals in some fashion.
10. In the past, the Commission has required that some of these programs be funded by shareholders. For example, as authorized in D.86-08-046, and modified by D.95-11-064, LTIP expenses are to be paid for by shareholders.

11. In D.92-12-019, the 1993 SDG&E GRC decision, the Commission adopted a settlement between SDG&E, DRA, UCAN, and the City of San Diego. The Commission specifically noted that the settlement excluded SDG&E's proposed expenses for a long-term incentive plan, and an executive incentive compensation plan, and reduced SDG&E's requested expense for a senior management incentive compensation plan. (46 CPUC 2d 570)

12. The Settlement itself (attached to D.92-12-019) notes that "...the Settling Parties have specifically excluded the dollars requested by SDG&E related to bonuses payable to SDG&E's officers pursuant to the Long-Term Incentive Plan and the Short-Term Incentive Plan. In addition, the Settling Parties have specifically excluded the dollars requested by SDG&E related to the costs of directors' pensions." (46 CPUC 2d 747) The Short-Term Incentive Plan is the same as the Executive Incentive Compensation Plan.

13. The SDG&E base rate PBR used the revenue requirement adopted in the 1993 GRC, in D.92-12-019, as the "starting point" revenue requirement to be escalated to 1994 using the PBR mechanism.

14. Despite the settlement's exclusion of the expenses for the LTIP, the EICP, and directors' pensions, and the Commission's adoption of that settlement, SDG&E has included the expenses for the rewards granted under the LTIP and EICP as actual operating expenses in calculating its annual NOI and ROR for 1994 through 1997.

15. Thus, SDG&E has included operating expenses which were explicitly excluded from the starting point. Furthermore, there is nothing in the PBR mechanism that authorizes SDG&E to now include these previously excluded expenses.

16. By including these expenses as actual operating expenses, the NOI and ROR are reduced, thereby reducing the amount of revenue sharing which SDG&E ratepayers receive.

17. We believe that, based on the GRC settlement, the GRC decision which adopted the settlement, and D.86-08-046, ratepayers should not have been expected to bear any expense for these executive award programs.

18. We will require SDG&E to exclude the LTIP and EICP expenses from its calculation of its actual NOI and ROR for the years 1994 through 1997, and to recalculate the revenue sharing amounts for those years. SDG&E should also exclude the LTIP and EICP expenses from its calculation of its actual NOI and ROR in 1998.

19. SDG&E recorded the following reward amounts as base rate PBR operating expenses under its EICP: \$704,000 in 1994, \$1.538 million in 1995, \$1.999 million in 1996, and \$1.704 million in 1997. These EICP rewards total \$5.945 million.

20. SDG&E recorded the following reward amounts as base rate PBR operating expenses under its LTIP: \$201,000 in 1994, \$1.506 million in 1995, \$915,000 in 1996, and \$1.137 million in 1997. These LTIP rewards total \$3.759 million.

21. Revenue sharing amounts for 1994 through 1997 should be recalculated, excluding the above expenses, and any additional ratepayer revenue sharing amount should be allocated to ratepayers.

22. The conclusion we reach here appears consistent with SDG&E's own views as to who should bear the costs of the LTIP and EICP. SDG&E acknowledges that expenses under the LTIP should be borne by shareholders not ratepayers. In its testimony submitted in its application for a new base rate PBR and its 1999 cost of service, A.98-01-014, SDG&E states that its officers' LTIP expenses were excluded from the 1999 cost of service estimate, and that "As authorized in Decision 86-08-046, and modified by Decision 95-11-064, LTIP expenses are to be paid for by shareholders and SDG&E shall not seek recovery in rates for these costs." (SDG&E Testimony in A.98-01-014, 1999 Cost of Service Study, Chapter 5, Administrative and General Expenses, pg. 5A-6)

23. SDG&E also acknowledged in its response to an Energy Division data request that LTIP expenses were to be borne by shareholders, not ratepayers, and that exclusion of the Short-Term Incentive Plan (i.e. the EICP) from the GRC settlement was consistent with D.86-08-046. SDG&E stated "In Paragraph 9 of the Settlement Agreement (Appendix N to D.92-12-019) SDG&E and DRA specifically agreed to exclude the dollars related to bonuses payable to officers pursuant to the Long-Term Incentive Plan and the Short-Term Incentive Plan. However, this was consistent with earlier Commission approval (in D.86-08-046) of the LTIP - that is, the Commission allowed SDG&E to issue the stock necessary to implement the incentive plan, but agreed with SDG&E's recommendation that the LTIP was a shareholder expense."

24. In 1996 and 1997, SDG&E also recorded the rewards it made to SDG&E employees under its Energy Incentive Plan as base rate PBR operating expenses. These rewards are made to employees in the Fuels and Power Supply Department, and are based on the department's performance under the SDG&E gas procurement and generation and dispatch (G&D) PBRs.

25. In SDG&E's last BCAP decision, D.97-04-082, we established a brokerage fee for SDG&E, and required that brokerage-related costs should be removed from core transportation rates and included in core procurement rates instead. We also required that this brokerage fee revenue requirement be subject to balancing account treatment.

26. We stated in D.94-12-052, when adopting a brokerage fee for the Southern California Gas Company, "The basic concept behind the brokerage fee is that the utility incurs certain costs in performing its gas procurement function, which costs have traditionally been included in transportation rates rather than procurement rates. Since transport-only customers do not cause the utility to incur procurement costs, it is inequitable and

inconsistent with cost causation principles to include procurement-related brokerage costs in the transport rate.” (58 CPUC 2d 338)

27. We believe that SDG&E should have recorded any Energy Incentive Plan rewards it made to employees related to gas procurement as a brokerage-related cost, in its purchased gas account, not as a base rate PBR operating expense. SDG&E's BCAP rates and the brokerage fee became effective June 1, 1997, so any rewards made on or after that date under the Energy Incentive Plan related to gas procurement should be recorded as brokerage-related costs.

28. By recording the Energy Incentive Plan rewards as an operating expense, potential revenue sharing amounts for ratepayers are reduced. In addition, SDG&E's total gas procurement price is not accurately represented as a price against which core aggregators must compete.

29. SDG&E's generation and dispatch PBR was terminated December 31, 1997, so no additional incentive rewards related to the G&D PBR should be recorded after that date. Prior to January 1, 1998, electric utilities did not offer direct access, and no electric brokerage fee existed, so we do not object to the employee rewards related to G&D PBR performance being included as base rate operating expenses.

Employee Safety

30. The employee safety performance component is based upon the utility's performance in the frequency of certain lost-time accidents reported to the Federal Occupational Safety and Health Administration (OSHA). The employee safety benchmark is set at an OSHA Lost Time Accident (LTA) frequency of 1.20. For each hundredth of a point above and below this benchmark down to 1.17 and up to 1.23, rewards and penalties vary. The maximum reward is \$3 million (at 1.17 and lower), and the maximum penalty is \$5 million (at 1.23 and higher). Rewards or penalties received for employee safety performance were allocated 84% to the electric department and 16% to the gas department in 1997.

31. For 1997, SDG&E reports that it experienced 45 lost-time accidents, resulting in an LTA frequency of 1.17, and the maximum reward of \$3 million. SDG&E has reported the maximum reward for four years in a row now, and reported an actual LTA well below the benchmark LTA in the first three years.

32. For 1996, SDG&E reported 37 lost-time accidents, resulting in an LTA of 0.98. For 1995, SDG&E reported 35 lost-time accidents, resulting in an LTA of 0.90. For 1994, SDG&E reported 42 lost-time accidents, resulting in an LTA of 1.04.

33. According to the March 31, 1997 midterm evaluation report conducted by Vantage Consulting for SDG&E, SDG&E's internal corporate goal is an LTA of 1.10.

34. SDG&E reports that it did not include two LTAs in its 1997 PBR safety calculations "due to a non-preventable and extraordinary vehicle accident." This accident involved two SDG&E employees who were injured when an earthmover, owned by another company, slipped off its flatbed trailer, rolled downhill and crushed the vehicle being driven by the SDG&E employees. Although this accident resulted in two OSHA-reportable LTAs, SDG&E has requested that these LTAs be excluded from the PBR safety calculation. SDG&E states that "this accident was completely non-preventable and unrelated to SDG&E work..." SDG&E contends that this accident should not influence the company's employee safety performance in 1997.

35. The Energy Division requested and received a detailed explanation of the accident's circumstances from SDG&E, and is satisfied that the accident was not the responsibility of SDG&E.

36. However, SDG&E's PBR mechanism does not specifically provide for any LTA exclusions from the safety performance calculations. In addition, it is not clear whether the LTA benchmark of 1.20 was based on an historical record which included any such accidents. If that historical record included any such accidents, the LTA benchmark itself may be inflated.

37. The Energy Division asked SDG&E in a data request whether the historical accident record prior to implementation of the PBR included any accidents which were not the fault of SDG&E. SDG&E's response was that "No attempt to has been made to go back and identify whether SDG&E employees have been involved in past accidents which were not their fault. There is no reason to do so since 'fault' has no bearing on OSHA recordability." SDG&E also indicated that it had no way to determine if any "no fault" accidents occurred in the 1988-92 timeframe.

38. This accident helps to illustrate the extreme sensitivity of the SDG&E safety performance benchmark. While SDG&E reports the maximum reward results when these two LTAs are excluded from the PBR safety calculations, if these two LTAs had been included in the calculations, the maximum penalty of \$5 million would result.

39. The Energy Division has reviewed SDG&E's employee safety performance reward calculations and concurs that they were made correctly, after the exclusion noted above.

40. There is no clear allowance in the PBR decision or in the joint settlement which proposed the safety performance indicator to exclude accidents which were not the fault of SDG&E.

41. As with the exclusion of the executive compensation awards discussed above, we must rely on our interpretation of the intent of our previous decisions. The intent of the safety performance indicator is to provide SDG&E management with a financial incentive to maintain and improve a high safety standard for its employees. It was not

our intent in D.94-08-023 that SDG&E management and shareholders should be penalized for accidents which are the fault of other parties.

42. We believe that SDG&E's exclusion of the discussed accident from the LTA calculation should be allowed, and the calculated reward of \$3 million should be adopted.

Customer Satisfaction

43. The customer satisfaction performance component is based on the utility's year-to-date performance as reported in the Customer Service Monitoring System (CSMS) Results. CSMS is an internally-generated survey of over 10,000 SDG&E customers which SDG&E has conducted since the 1970's. It assesses customer satisfaction in seven service areas based on interviews with a sample of customers receiving the particular service over the subject year. The customer satisfaction benchmark is set at 92% of the surveyed customers indicating a "very satisfied" response. The reward or penalty varies with each half of a percentage point in these responses, down to a maximum penalty of \$2 million at 89% or lower, and a maximum reward of \$2 million at 95% or higher. Rewards or penalties are allocated 84% to the electric department and 16% to the gas department.

44. For 1997, SDG&E reported that 93% of the SDG&E customers which were surveyed are "very satisfied" with the utility's service, resulting in a reward of \$666,667.

45. The survey was audited by an independent accountant, Armando Martinez & Company, which found that the 1997 SDG&E CSMS Results were unbiased and valid.

46. This is the fourth year in a row in which SDG&E has reported a reward for customer satisfaction. In 1994 through 1996, SDG&E reported a 95% "very satisfied" customer response, resulting in the maximum reward of \$2 million for each of those years.

47. The Energy Division has reviewed SDG&E's 1997 customer satisfaction performance, and concurs that a \$666,667 reward results.

Electric System Reliability

48. SDG&E's electric system reliability performance is based on its System Average Interruption Duration Index (SAIDI) as reported in the annual Electric Distribution System Performance Report. SAIDI measures the average electric service interruption duration per customer served per year, excluding "major events". The benchmark SAIDI in the SDG&E base rates PBR is 70 minutes. Rewards or penalties vary with each half a minute change from the benchmark, with a maximum reward at 50 minutes or less, and a maximum penalty at 90 minutes or more.

49. "Major events" are excluded from the SAIDI calculation when the following conditions a., b., and c. are met or condition d. is met:
- a. customer outages attributed to highly unusual events (e.g. severe storms or earthquakes);
 - b. 10,000 customers out of service simultaneously in any single district;
 - c. more than five simultaneous outages in any single district;
 - d. customer outages beyond the control of the district.

50. For 1997, SDG&E reported a SAIDI of 91.4 minutes which resulted in the maximum \$4 million penalty. For 1996, SDG&E reported a SAIDI of 77.5 minutes which resulted in a \$1.5 million penalty. For 1995, SDG&E reported a SAIDI of 67.4 minutes, resulting in a reward of \$500,000. For 1994, SDG&E reported a SAIDI of 70.1 minutes, resulting in no reward or penalty.

51. SDG&E excluded 15 "major events" from its SAIDI calculation. However, the exclusion of these "major events" had no impact on the SAIDI penalty results since the maximum penalty was incurred.

52. The Energy Division has reviewed SDG&E's 1997 electric reliability performance and concurs that a \$4 million penalty results.

Overall PBR Evaluation

53. As discussed above, SDG&E has taken measures to reduce its operating costs. But SDG&E shareholders have obtained far more of the benefits of such measures than ratepayers. The Energy Division has reviewed the revenue sharing calculations and rewards and penalties through 1997, and found that the following revenue sharing benefits and rewards and penalties occurred:

Ratepayer/Shareholder Allocation of SDG&E PBR Revenue Sharing (\$millions)

	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>Total</u>
Ratepayer share	0	\$2.4	\$4.4	\$4.4	\$11.2
Shareholder share	\$32.3	\$25.2	\$30.6	\$38.9	\$127.0

Quality of Service Rewards/(Penalties) Paid to SDG&E by Shareholders (\$millions)

	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>Total</u>
Reward/(Penalty)	\$7.0	\$5.5	\$6.5	(\$0.3)	\$18.7

Therefore, for the first three years of the mechanism (1994 - 1996), SDG&E shareholders have received a benefit of over \$85 million, while ratepayers have been allocated a

revenue benefit of only \$6.8 million. The SDG&E Base Rates PBR revenue sharing mechanism has clearly benefited SDG&E's shareholders far more than it has benefited ratepayers.

54. In 1997, SDG&E initially calculated that ratepayers would be allocated \$4.4 million under the revenue sharing mechanism. The Energy Division estimates that shareholders would receive about \$38.9 million.² Thus, for the first four years of the PBR operation, ratepayers would have been allocated only \$11.2 million under the revenue sharing mechanism, while SDG&E's shareholders would have received about a \$127 million benefit.

55. As shown above, the Energy Division also found that, when the PBR performance rewards are taken into account, ratepayers will actually have paid more in total performance rewards than they received in PBR revenue sharing benefits. As noted above, ratepayers would only receive \$11.2 million in shared revenues (through 1997), which serves to reduce rates. However, ratepayers have also paid over \$18 million in PBR performance rewards.³ Thus, ratepayers would have made net payments of over \$7 million to SDG&E shareholders, while SDG&E shareholders would be allocated more than \$145 million.

56. Employee safety has been enhanced under PBR operation, although safety performance was improving prior to PBR implementation. In addition, in 1997, an unusual accident occurred which was removed from the SDG&E safety performance results. Inclusion of that accident would significantly change the safety performance results. Customer satisfaction with the measured SDG&E services has been maintained at historically high levels, but it also was significantly and steadily improving prior to PBR implementation. On the other hand, average electric reliability has slightly declined. In fact in 1997, the SDG&E SAIDI turned out to be at its highest level in many years. In the last two years, SDG&E has incurred a performance penalty for electric reliability. Its average SAIDI for the first four years of the PBR is higher than the average SAIDI for the five-year period 1989-1993.

57. The PBR escalation mechanism has resulted in higher electric and gas authorized revenue requirements each year it has been in operation. The Energy Division found that it is difficult to compare the above PBR performance with what would have occurred under traditional GRC regulation. This is generally because: 1) one would have to speculate about whether SDG&E would have made the same efforts to reduce costs under traditional regulation, and 2) one would have to speculate about the revenue requirement the Commission might have adopted in 1994 and 1995 attrition years and in a 1996 test

² However, these amounts do not yet reflect the recalculation of ratepayer benefits we have ordered in this resolution.

³ Of the \$18 million in performance rewards, \$5 million were related to the electric price performance indicator, which has been eliminated from the PBR mechanism starting in 1997.

year GRC. Nevertheless, the above data raises questions about whether ratepayers would have fared better under traditional GRC regulation than the adopted base rate PBR.

58. The revenue sharing tiers which the Commission adopted for Southern California Edison Company and Southern California Gas Company both provide potentially greater revenue sharing benefits to ratepayers than the SDG&E PBR, particularly within the initial sharing tiers. For example, SCE's first year performance under its PBR in 1997 resulted in a rate of return of 10.46%, or 97 basis points above its authorized ROR of 9.49%. Under the SDG&E revenue sharing mechanism, shareholders would have received all of the benefits of the revenues associated with the excess ROR, but under the SCE PBR revenue sharing mechanism the customer share of the PBR revenues was \$42.6 million.⁴

59. One of the initial intentions of the SDG&E PBR was to provide an incentive to reduce SDG&E's high electric rates. The PBR originally included a price performance component which compared SDG&E's system average electric price to the national average. The benchmark was set at about 137% of the national average in 1994, and declined in subsequent years to 132% in 1998. If SDG&E could bring its rates under the benchmark, it would receive a reward. If SDG&E's electric rates exceeded the benchmark, it would be penalized. This component was eliminated at the end of 1996 due to the electric price freeze established in California. Through the end of 1996, SDG&E had achieved some success in reducing its electric rates below the benchmark. In 1996, SDG&E's rates were 133.6% of the national average, while the 1996 benchmark was 135%. However, based on preliminary information, in 1997, its electric rates were 137.5% of the national average. Had the electric price incentive remained in effect, the 1997 benchmark would have been 133.5%.⁵

60. In 1991, 1992, and 1993, SDG&E's electric rates were 132%, 131%, and 130% of the national electric price average. Thus, while the electric price performance component was in effect, SDG&E's electric rates fell in relation to the national average, but remained relatively high compared to its rates prior to PBR operation. In 1997, SDG&E's electric rates were higher than the benchmark, relatively higher than prior to PBR operation, and relatively higher than in 1994, the first year of PBR operation.

⁴ The SCE revenue sharing mechanism actually compares authorized return on equity to actual return on equity. The above ROR comparison is necessary in order to show what SCE results would be under an SDG&E-type of revenue sharing mechanism.

⁵ SDG&E's electric rates were not strictly frozen in 1997. SDG&E was allowed to increase its rates due to Section 397 of the Public Utilities Code. Section 397 allowed SDG&E to increase rates up to a certain level if gas prices increased. SDG&E did in fact increase its electric rates in 1997 according to the mechanism allowed by Section 397.

Research, Development, and Demonstration

61. In compliance with D.95-04-069, SDG&E also submits with its advice letter filing its report of the change in available RD&D funds resulting from the application of the performance-based O&M escalation index.

62. SDG&E's authorized RD&D revenue increased \$16,000 in 1997 from 1996 for a total RD&D budget of \$7,712,000.⁶

63. The Energy Division has reviewed the increase in RD&D funds, and concurs with the increase in the RD&D budget of \$16,000 in 1997.

Implications of D.97-10-057

64. AL 1095-E/1097-G indicates that SDG&E intends to record any 1997 electric rewards or penalties in its proposed Revenue Sharing, Penalties and Rewards Balancing Account (RSPRBA) as described in its AL 1055-E.

65. In D.97-10-057, the Commission addressed accounting changes for electric utilities during the transition period to a competitive electric market in California. In that decision, the Commission eliminated the ERAM balancing account during the transition period, effective January 1, 1998. The Commission also rejected the proposal of SDG&E to establish a memorandum account or balancing account to defer ratemaking treatment of PBR rewards, penalties, sharing or other costs for the purpose of affecting rates during or after the rate freeze period.

66. However, D.97-10-057 also indicates that "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." (D.97-10-057, slip op, pg. 27) SDG&E filed AL 1055-E on November 26, 1997 for the purpose of establishing such an account, but the Commission has not yet acted on that AL.

67. In D.97-12-041, we ordered that, for 1997 and 1998, SDG&E shall record the electric department allocation of the ratepayer revenue sharing amount in the TCBA.

68. In Resolution E-3527, we allowed credits to be transferred to the TCBA from other utilities' Transition Revenue Accounts (TRA), but we required that debits may be carried over from month-to-month, and may not be transferred from the TRA to the TCBA.

⁶ SDG&E AL 1095-E/1097-G inadvertently stated an increase in the RD&D budget for 1997 of \$113,000. However, the Energy Division reviewed the calculation of the 1997 RD&D budget and found that the actual increase for 1997 from 1996 was only \$16,000. SDG&E's Table B with the AL also inadvertently reported the 1998 increase of \$113,000, rather than the 1997 increase of \$16,000.

69. Both the electric department allocation of SDG&E's ratepayer revenue sharing amount and the net electric department performance penalty would be a credit to the TCBA. Since these amounts would be TCBA credits, we believe that, based on the ordering paragraph of D.97-12-041 and our orders in Resolution E-3527, it would be acceptable for SDG&E to record the 1997 electric department allocation of the ratepayer revenue sharing amount and the electric department penalty as credits in the TCBA.

FINDINGS

1. SDG&E filed AL 1095-E/1097-G on May 15, 1998, requesting approval of its PBR Base Rate Mechanism Final Performance Report for 1997. This report transmits the Company's revenue sharing calculations and performance component rewards and penalties under the mechanism for 1997.
2. No parties filed a protest of AL 1095-E/1097-G.
3. In 1994 through 1997, SDG&E recorded as base rate PBR operating expenses the awards it made to company executives and senior management, under the Company's EICP and LTIP.
4. Ratepayers should not be required to bear any expense for those incentive compensation plans.
5. The expenses for the LTIP and EICP plans should be removed from base rate PBR operating expenses for the purpose of calculating revenue sharing amounts for 1994 through 1997. SDG&E should recalculate the revenue sharing amounts for 1994 through 1997. SDG&E should not include these expenses as base rate PBR operating expenses in the future, for as long as the current PBR is in operation.
6. In 1996 and 1997, SDG&E also recorded the expenses it paid as employee rewards under the Energy Incentive Plan as base rate operating expenses. A gas procurement brokerage fee was established by SDG&E pursuant to D.97-04-082 on June 1, 1997. The 1997 Energy Incentive Plan rewards related to gas procurement made on or after June 1, 1997 should be recorded as brokerage-related costs in SDG&E's purchased gas account.
7. The following performance rewards and penalties should be approved:

ELECTRIC DEPARTMENT

Performance Rewards/(Penalties)	
Employee Safety	\$2,520,000
Customer Satisfaction	\$ 560,000
<u>System Reliability</u>	<u>(\$4,000,000)</u>
Total Electric Department	(\$ 920,000)

GAS DEPARTMENT

Performance Rewards/(Penalties)	
Employee Safety	\$480,000
<u>Customer Satisfaction</u>	<u>\$106,667</u>
Total Gas Department	\$586,667
Combined 1997 Performance Reward/(Penalty)	(\$333,333)

8. For the years 1994 through 1997, SDG&E achieved PBR rewards of \$7 million, \$5.5 million, \$6.5 million, and a penalty of \$0.3 million, respectively. Part of the reason for the rewards was due to the former electric price comparison performance indicator.

9. In addition, due to its achievement of a higher ROR than authorized by the PBR, SDG&E shareholders have gained over a \$125 million benefit, while ratepayers have benefited by only \$11 million. (After SDG&E recalculates the revenue sharing amounts for 1994 through 1997, the amount received by ratepayers will slightly increase.) When payments made by ratepayers for performance rewards are also considered, shareholders have achieved a net benefit of over \$140 million, while ratepayers have made net payments of \$7 million.

10. These results have occurred despite a slight decline in average electric reliability. Good performance has been achieved in customer satisfaction and safety performance during the operation of the PBR, but performance in these areas was improving before the PBR was implemented.

11. SDG&E's electric rates were higher in 1997 than when the PBR experiment began, and are relatively higher, compared to the national average electric price, than prior to PBR operation.

12. SDG&E's electric penalty and electric revenue sharing amount should be recorded in the TCBA.

13. SDG&E's gas reward and gas revenue sharing amount should be recorded in their Gas Fixed Cost Account (GFCA).

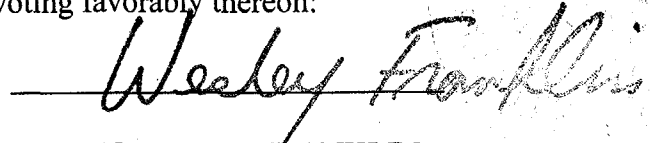
14. The RD&D authorized revenue increase for 1997 should be \$16,000.

THEREFORE, IT IS ORDERED THAT:

1. SDG&E's Base Rate Report for 1997, is partially approved, subject to a recalculation of the revenue sharing amounts.
2. SDG&E shall recalculate the revenue sharing amounts for 1994 through 1997, excluding the expenses for the EICP and LTIP. SDG&E shall also exclude these expenses from base rate PBR operating expenses in 1998.
3. SDG&E shall also recalculate the revenue sharing amount for 1997, excluding the Energy Incentive Plan rewards it made to employees for gas procurement performance on or after June 1, 1997. SDG&E shall also exclude these expenses from base rate PBR operating expenses in 1998.
4. SDG&E's electric and gas department rewards and penalties, as indicated above, are approved.
5. The electric department revenue sharing amount and penalty shall be booked to the TCBA.
6. The gas department revenue sharing amount and reward shall be booked to the GFCA.
7. The RD&D budget increase for 1997 shall be \$16,000.
8. SDG&E shall file a supplemental advice letter to reflect the above ordered revenue sharing recalculation. To avoid future confusion, the supplemental advice letter shall also report the proper RD&D budget increase for 1997. The supplemental advice letter shall be effective after it has been reviewed by the Energy Division for compliance with this Resolution, and the Energy Division informs SDG&E in writing that the supplemental advice letter is in compliance.
9. This resolution is effective today.

December 17, 1998

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on December 17, 1998, the following Commissioners voting favorably thereon:



WESLEY M. FRANKLIN
Executive Director

RICHARD A. BILAS
President

P. GREGORY CONLON

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

Commissioners