Application	:	A.05-12-002
Exhibit Number	:	DRA-19
Commissioner	:	Bohn
Admin. Law Judges	:	Kenney, Econome
Witness	:	Tang

DIVISION OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION

Report on the Results of Operations Electric and Gas Distribution Electric Generation for Pacific Gas and Electric Company

General Rate Case

Test Year 2007

Post Test Year Ratemaking

San Francisco, California
April 14, 2006

POST TEST YEAR RATEMAKING

I. INTRODUCTION

This exhibit presents DRA's analysis and recommendations regarding PG&E's Post Test Year Ratemaking (PTYR) request for the electric distribution, gas distribution, and electric generation functional areas.

PG&E is seeking Commission authorization to file advice letters to implement PTYR increases for the 2008 and 2009 attrition years. For electric distribution, PG&E is seeking estimated revenue requirement increases of $87.9 million in 2008 and $108.4 million in 2009. For gas distribution, PG&E is seeking estimated revenue requirement increases of $32.6 million in 2008 and $33.8 million in 2009. For electric generation, PG&E is seeking estimated revenue requirement increases of $65.5 million in 2008 and $100.6 million in 2009.

PG&E also proposes to reduce the total GRC 2008 and 2009 attrition year revenue requirements by $41.1 million and $97.1 million, respectively, to capture estimated net savings from Business Transformation.

II. SUMMARY OF RECOMMENDATIONS

DRA does not oppose a mechanism that provides PG&E the opportunity to earn its authorized rate of return for its GRC-related operations during the years 2008-2009. However, DRA does not agree with all of PG&E's PTYR proposals, as discussed in Section III.

The following summarizes DRA's recommendations regarding PTYR operational expenses:

- DRA does not take issue with PG&E's proposed methodology of determining PTYR increases for electric distribution and gas distribution operational expenses by escalating the 2007 expense levels (except for pension and medical benefits costs) by applying appropriate traditional escalation factors.

- The Commission should adopt DRA's methodology of determining PTYR increases for PG&E's electric generation operational expenses by escalating the 2007 expense levels (except for pension and medical benefits costs) by applying appropriate traditional escalation factors, as opposed to PG&E's proposal of relying on 2008-2009 expense forecasts.
- DRA recommends that the pension costs should not be escalated in 2008 and 2009.
- DRA recommends that the medical benefits costs should be escalated by 3.9% and 3.7% in 2008 and 2009, respectively, as opposed to PG&E's proposal to escalate them by 9.92% and 12.20%, respectively.

The following summarizes DRA's recommendations regarding PTYR plant additions:

- DRA proposes to develop PTYR increases for PG&E's 2008 electric distribution plant by relying on the 2007 level of plant additions escalated for inflation, as opposed to PG&E's proposal of relying only on its 2008 plant additions forecast. DRA does not take issue with PG&E's estimate for 2009 electric distribution plant additions.
- DRA proposes to develop PTYR increases for PG&E's gas distribution plant by relying on the 2007 level of plant additions escalated for inflation, as opposed to PG&E's proposal of relying only on 2008-2009 plant additions forecasts.
- DRA does not take issue with PG&E's estimate for 2008 electric generation plant additions. However, DRA proposes to develop PTYR increases for PG&E's 2009 electric generation plant by relying on the 2007 level of plant additions escalated for inflation, as opposed to PG&E's proposal of relying only on its 2009 plant additions forecast.

The following summarizes DRA's recommendations regarding other PTYR matters:

- DRA does not take issue with PG&E's proposal to file its 2008 and 2009 attrition requests by advice letter in October of the prior year.
- When filing its attrition advice letters for 2008 and 2009, PG&E should be directed to:
    - ➢ incorporate the $138.2 million in committed savings from Business Transformation to the attrition mechanism that is adopted; and
    - ➢ apply the Business Transformation savings to each functional area—electric distribution, gas distribution, and electric generation.

- Since DRA opposes PG&E's proposed front counter closures at local offices (see Exhibit DRA-9), there are no associated cost savings to incorporate into attrition-year estimates.

For the post-test year period, the differences between DRA's recommended and PG&E's proposed methodologies result in the following estimated revenue requirement increases for 2008 and 2009, as shown in Tables 19-1 and 19-2, respectively:

Table 19-1
DRA Recommends a $98 Million
PTYR Estimated Revenue Requirement Increase for 2008
(in Thousands of Dollars)

Description (a)	DRA Recommended (b)	PG&E Proposed (c)	Difference PG&E>DRA (d=c-b)	Percentage PG&E>DRA (e=d/b)
Electric Distribution	$72,188	$87,906	$15,718	21.8%
Gas Distribution	$24,315	$32,581	$8,266	34.0%
Electric Generation	$42,254	$65,507	$23,253	55.0%
Total	$138,757	$185,994	$47,237	34.0%
Less: Net Savings from Business Transformation	-$41,095	-$41,095	$0	0.0%
Net PTYR Increase	$97,662	$144,899	$47,237	48.4%

Table 19-2
DRA Recommends a $51 Million
PTYR Estimated Revenue Requirement Increase for 2009
(in Thousands of Dollars)

Description (a)	DRA Recommended (b)	PG&E Proposed (c)	Difference PG&E>DRA (d=c-b)	Percentage PG&E>DRA (e=d/b)
Electric Distribution	$85,376	$108,419	$23,043	27.0%
Gas Distribution	$25,096	$33,822	$8,726	34.8%
Electric Generation	$37,916	$100,591	$62,675	165.3%
Total	$148,388	$242,832	$94,444	63.6%
Less: Net Savings from Business Transformation	-$97,059	-$97,059	$0	0.0%
Net PTYR Increase	$51,329	$145,773	$94,444	184.0%

III. DISCUSSION

Sections A and B below present PG&E's proposals associated with PTYR. Section C presents a brief historical perspective on attrition increases. Sections D through G present DRA's review and recommendations regarding PTYR issues.

A. Summary of PG&E's Request

PG&E proposes that revenue requirements developed by the PTYR mechanism be based on: (1) forecasts of capital additions in 2008 and 2009 for electric distribution, gas distribution, and electric generation; (2) escalation of 2007 expenses reflecting its estimate of cost increases for the labor, plus goods and services PG&E purchases (including a separate escalation factor for employee health care benefits costs) for electric distribution and gas distribution; and (3) forecasts of 2008-2009 expenses for electric generation.

PG&E is seeking revenue requirement increases of $186.0 million in 2008 and $242.8 million in 2009, for a total of $428.8 million. PG&E also proposes to reduce the 2008 and 2009 attrition year revenue requirements by $41.1 million and $97.1 million, respectively, to capture estimated net savings from Business Transformation.[1] Those savings would reduce PG&E's requested attrition year revenue requirement increase to $144.9 million in 2008 and $145.8 million in 2009, for a total of $290.7 million, as shown in Table 19-3:

[1] Business Transformation was discussed in Exhibit DRA-18.

Table 19-3
PG&E is Seeking Nearly $429 Million in Attrition Revenue Requirement Increases, but Net Savings from Business Transformation Reduces the Request by $138 Million (in Thousands of Dollars)

Year (a)	Electric Distribution Attrition Increase (b)	Gas Distribution Attrition Increase (c)	Electric Generation Attrition Increase (d)	Total Attrition Increase (e=b+c+d)	Net Savings from Business Transformation (f)	Total Attrition Increase Net of Transformation Savings (g=e+f)
2008	$87,906	$32,581	$65,507	$185,994	($41,095)	$144,899
2009[2]	$108,419	$33,822	$100,591	$242,832	($97,059)	$145,773
Total	$196,325	$66,403	$166,098	$428,826	($138,154)	$290,672

PG&E proposes that, if the Commission approves the front counter/local office closures, then the revenue requirement adopted for 2007, 2008 and 2009 should reflect the cost savings resulting from those closures. PG&E did not incorporate those estimated cost savings into its PTYR revenue requirement forecasts. PG&E also requests that the Commission allow PG&E to file its 2008 and 2009 attrition requests by advice letter in October of the prior year.

B. PG&E's Proposed PTYR Mechanism Includes Requested Increases in Capital and Expenses

PG&E's attrition mechanism consists of two primary components—one for capital, the other for expenses. For the capital-related component, PG&E directly forecasted capital additions for 2008-2009 and believes the direct estimates are more realistic than using an average of historical plant additions. For electric distribution, PG&E forecasts $805.0 million of plant additions for 2008 and $747.3 million for 2009.[3] For gas distribution, PG&E forecasts $202.4 million of plant additions for

[2] The attrition calculation for 2009 is developed using the 2008 revenue requirement absent the Business Transformation savings for 2008.

[3] Exhibit PG&E-9, Workpapers Supporting Chapter 3, page 3-4.

2008 and $209.9 million for 2009.[4] For electric generation, PG&E forecasts $139.3 million of plant additions for 2008 and $266.6 million for 2009.[5]

For the expense-related component of electric and gas distribution, PG&E includes the estimated effects of inflation relative to 2007 levels, including increases in wages and salaries, medical benefits costs, and the costs of goods and services. PG&E is seeking a $30.6 million increase in electric distribution operating expenses for 2008 and a $37.0 million increase for 2009.[6] Similarly, PG&E is seeking a $17.8 million increase in gas distribution operating expenses for 2008 and a $20.8 million increase for 2009.[7]

For the expense-related component of electric generation, PG&E relies on a forecast of expenses for 2008-2009, and not on escalation of 2007 levels. PG&E asserts that its proposal "…is intended to account for specific changes in O&M expenses…that PG&E anticipates for 2008 and 2009."[8] As a result, PG&E is seeking a $24.0 million increase in expenses for 2008 and a $58.8 million increase in expenses for 2009 for electric generation.[9]

C. A Brief Historical Perspective: Utilities are not Automatically Entitled to Attrition Rate Increases

Before 1982, the base revenue requirement was generally adjusted only during GRC proceedings. In the period between GRC proceedings, base rates would not change, but the utilities received additional income from customer growth. Attrition rate adjustments were implemented in the early 1980's primarily because of the unprecedented high inflation and lower rates of customer growth and sales in the late

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[4] Exhibit PG&E-9, Workpapers Supporting Chapter 3, page 3-4.

[5] Exhibit PG&E-3, page 13-4, Table 13-2.

[6] Exhibit PG&E-9, Workpapers Supporting Chapter 13, pages 2-7 and 2-8.

[7] Exhibit PG&E-9, Workpapers Supporting Chapter 13, pages 2-20 and 2-21.

[8] Exhibit PG&E-3, page 13-3, lines 23-25.

1970’s and early 1980’s. Since the mid-1980’s, inflation has generally declined to more modest historical levels. The utilities have also had various forms of revenue balancing account protection from sales fluctuation. Additionally, utility fuel-related costs that had high volatility, and over which utilities have limited control, were removed from base rates and are now recovered through separate mechanisms with balancing accounts.

The GRC proceeding is used to periodically review and set reasonable rates for utilities for a specific test year, in this case, 2007. For the period between GRC proceedings, the Commission has, in some cases, granted attrition-type increases and, in other cases, has not provided such increases. In the past, the Commission has stated:

> The attrition mechanism is not an entitlement. Nor is it a method of insulating the company from the economic pressures which all business experience…Neither the Constitution nor case law has ever required automatic rate increases between general rate case applications. (D.93-12-043, 52 CPUC 2d 471, 92.)

For example, in PG&E’s TY1999 GRC decision, the Commission denied attrition for 2000. In D.02-02-043, the Commission granted PG&E a 2001 attrition increase of approximately $151 million. In D.03-03-034, however, the Commission denied PG&E’s attrition increase request for 2002. Hence, it is clear that utilities are not automatically entitled to attrition rate increases between rate cases, even though the Commission has included provisions for post-test year rate relief in recent GRC decisions.

D. DRA Proposes a PTYR Mechanism That is Primarily Based on its Forecast of Expenses and Capital Additions in 2007, Escalated for Inflation

For this GRC, DRA does not oppose a mechanism that provides PG&E the opportunity to earn its authorized rate of return for its GRC-related operations during

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(continued from previous page)

9 Calculated from figures appearing in Exhibit PG&E-3, page 13-4, Table 13-1.

the years 2008-2009. However, DRA does not agree with all of PG&E's PTYR proposed methodologies, in particular those aspects that rely only on 2008-2009 expense and plant addition forecasts. DRA believes that considering test year levels of expenses and plant additions is more reasonable, and consistent with past Commission precedents, than relying solely on budget-based attrition-year forecasts. This is because the farther out in time project-based plans are projected, the greater the likelihood that the projects themselves, and/or the expenditure levels, will change or be eliminated. In addition, DRA and other parties normally do not possess the resources to conduct a detailed analysis of PG&E's budget-based expense estimates and plant additions for years beyond the test year.

Thus, DRA recommends attrition increases based on: (1) increasing the adopted 2007 level of operational expenses for general inflation, except for pension and medical benefits costs; and (2) increasing the adopted 2007 level of plant additions for general inflation, except for the 2008 estimate for electric generation and the 2009 estimate for electric distribution.

1. Post-Test Year Expense Escalation

Test year labor and non-labor escalation rates are discussed and evaluated in Exhibit DRA-4. These rates developed by PG&E were applied to DRA's TY2007 expense estimates to determine DRA's 2008-2009 attrition expense estimates for PG&E. The escalation rates will be updated to reflect the most recent attrition-year escalation figures in the advice letter requesting the attrition increase.

DRA does not take issue with PG&E's proposed methodology of determining PTYR increases for electric and gas distribution operational expenses by escalating the 2007 expense levels for those areas, except for pensions and medical benefits. DRA determined PTYR increases for PG&E's electric generation operational expenses by escalating the 2007 expense levels (except pensions and medical benefits) with appropriate traditional escalation factors, as opposed to PG&E's proposed methodology which relies on 2008-2009 expense forecasts.

The pension costs should not be escalated because the 2008-2009 funding levels have already been agreed upon by DRA, PG&E, and CCUE in the proposed pension settlement, as discussed in Exhibit DRA-10, Chapter 10-N. The medical benefits costs should not be increased by 9.92% and 12.20% for 2008 and 2009, respectively, as PG&E proposes. Instead, DRA recommends that the medical benefits costs should be increased by 3.9% and 3.7% for 2008 and 2009, respectively,[10] pursuant to the forecasted group health insurance escalation rates appearing in the Global Insight Cost Planner First-Quarter 2006. This is the same source which DRA relies on for the 2005-2007 medical benefits escalation rates used in Exhibit DRA-10, Chapter 10-L.

Global Insight is also the same source that both PG&E and DRA rely upon for the escalation rates used to develop test year and attrition-year expense estimates.[11]

2. Post-Test Year Capital-Related Costs

PG&E seeks a form of the attrition ratemaking mechanism using budget-based plant addition estimates for 2008 and 2009, rather than based on historical levels of plant additions consistent with traditional attrition relief.

In reviewing post-test year plant additions, DRA evaluated 5-year (2003-2007) averages, 3-year (2005-2007) averages, and escalation of 2007 figures. DRA decided to generally rely on escalating its forecasted 2007 plant additions to develop the 2008 and 2009 figures, except if DRA's figure exceeded PG&E's request. DRA's approach of determining attrition-year plant additions estimates is reasonable because it: (1) relies on the 2007 level of plant additions stemming from the recommended capital expenditures discussed and forecasted in other DRA exhibits, and (2) does not rely solely on PG&E's forecasts of 2008-2009 plant additions that DRA and other parties could not thoroughly review and analyze.

[10] Global Insight Cost Planner First-Quarter 2006, Additional Forecast Tables, Table A1, for Group Health Insurance (ECIHI).

[11] See Exhibit DRA-4.

For electric distribution, DRA's attrition-year plant addition estimate for 2008 is based on its forecasted level of 2007 plant additions, escalated to 2008 dollars. A similar approach for 2009 would yield an estimate which is higher than PG&E's forecast for that year. DRA accepts PG&E's electric distribution plant additions estimate for 2009, since it is comparable to the 5-year average of plant additions and there is no rationale for DRA to recommend a figure above PG&E's estimate.

For gas distribution, DRA's attrition-year plant addition estimates are based on its forecasted level of 2007 plant additions, escalated to 2008 and 2009 dollars.

DRA accepts PG&E's electric generation plant additions estimate for 2008, given that it is lower than DRA's TY2007 forecast. For the 2009 electric generation plant additions estimate, DRA takes its recommended level of 2007 plant additions and escalates it to 2009 dollars. DRA's forecast of 2009 electric generation plant additions is also reasonable in light of the testimony in Exhibit DRA-7, where DRA recommends that capital costs for: (1) the Diablo Canyon Unit 2 Reactor Vessel Head replacement be removed from this GRC and evaluated in the ensuing GRC or through a separate application; and (2) some Humboldt Bay fossil plant modifications be removed entirely, under the assumption that the plant will be retired in 2010.

Tables 19-4 and 19-5 compare DRA's recommended with PG&E's proposed gross plant additions estimates for 2008 and 2009, respectively:

Table 19-4
PTYR Estimated Gross Plant Additions for 2008
(in Thousands of Dollars)

Description (a)	DRA Recommended (b)	PG&E Proposed (c)	Difference PG&E>DRA (d=c-b)	Percentage PG&E>DRA (e=d/b)
Electric Distribution	$774,940	$805,032	$30,092	3.9%
Gas Distribution	$190,875	$202,427	$11,552	6.1%
Electric Generation	$139,321	$139,321	$0	0.0%
Total	$1,105,136	$1,146,780	$41,644	3.8%

Table 19-5
PTYR Estimated Gross Plant Additions for 2009
(in Thousands of Dollars)

Description (a)	DRA Recommended (b)	PG&E Proposed (c)	Difference PG&E>DRA (d=c-b)	Percentage PG&E>DRA (e=d/b)
Electric Distribution	$747,271	$747,271	$0	0.0%
Gas Distribution	$195,189	$209,924	$14,735	7.5%
Electric Generation	$189,883	$266,571	$76,688	40.4%
Total	$1,132,343	$1,223,766	$91,423	8.1%

E. Since DRA Opposes the Front Counter Closures at Local Offices, There Are No Associated Cost Savings to Incorporate into Attrition-Year Estimates

PG&E identified but did not incorporate estimated cost savings resulting from the front counter closures at local offices into its attrition year request. Since DRA opposes those proposed front counter closures at this time (see Exhibit DRA-9), its attrition estimates do not incorporate any associated cost savings.

F. DRA Does Not Oppose PG&E's Request to File for Attrition Rate Relief via Advice Letter

PG&E requests that the Commission allow the utility to file its 2008 and 2009 attrition requests by advice letter in October of the prior year. DRA does not take issue with this request.

G. When PG&E Files for 2008-2009 Attrition Rate Relief, the Advice Letters Should Incorporate and Clearly Identify the Business Transformation Savings

PG&E proposes to reduce the 2008 and 2009 attrition-year revenue requirements by $41.1 million and $97.1 million, respectively, to capture estimated net savings from Business Transformation. As discussed in Exhibit DRA-18, DRA does not take issue with PG&E's net savings estimates from Business Transformation for this GRC cycle.

Thus, taking DRA's estimated attrition increases in conjunction with the Business Transformation savings yields the following estimated 2008-2009 PTYR revenue requirement increases:

Table 19-6
DRA Recommends Nearly $149 Million in Attrition Revenue Requirement Increases, Net of Savings from Business Transformation
(in Thousands of Dollars)

Year (a)	Electric Distribution Attrition Increase (b)	Gas Distribution Attrition Increase (c)	Electric Generation Attrition Increase (d)	Total Attrition Increase (e=b+c+d)	Net Savings from Business Transformation (f)	Total Attrition Increase Net of Transformation Savings (g=e+f)
2008	$72,188	$24,315	$42,254	$138,757	($41,095)	$97,662
2009[12]	$85,376	$25,096	$37,916	$148,388	($97,059)	$51,329
Total	$157,564	$49,411	$80,170	$287,145	($138,154)	$148,991

When filing its attrition advice letters for 2008 and 2009, PG&E should be directed to:

- incorporate the $138.2 million in committed savings from Business Transformation to the attrition mechanism that is adopted; and
- apply the Business Transformation savings to each functional area—electric distribution, gas distribution, and electric generation.

In Exhibit DRA-18, Table 18-4 provides a functional area breakdown of the Transformation savings. That information is reproduced here, as Table 19-7:

Table 19-7
Net Savings from Business Transformation Will Reduce 2008-2009 PTYR Increases for Electric Distribution by $69 Million, for Gas Distribution by $40 Million, and for Electric Generation by $29 Million
(in Thousands of Dollars)

Description (a)	2008 (b)	2009 (c)	Cumulative (d=b+c)
Electric Distribution	$15,014	$54,061	$69,075
Gas Distribution	$12,561	$27,623	$40,184
Electric Generation	$13,521	$15,374	$28,895
Total	$41,095	$97,059	$138,154

12 Again, the attrition calculation for 2009 is developed using the 2008 revenue requirement absent the Business Transformation savings for 2008.

Given the breakdown shown above, DRA calculates that PG&E's requested attrition revenue requirement increases for each of the three functional areas will be as follows:

Table 19-8
Net of Savings from Business Transformation, PG&E's Requested
2008-2009 Attrition Revenue Requirement Increases Total $291 Million
(in Thousands of Dollars)

Year (a)	Electric Distribution Attrition Increase (b)	Gas Distribution Attrition Increase (c)	Electric Generation Attrition Increase (d)	Total Attrition Increase (e=b+c+d)
2008	$72,892	$20,020	$51,986	$144,899
2009	$54,358	$6,199	$85,217	$145,774
Total	$127,250	$26,219	$137,203	$290,672

For comparison purposes, taking DRA's estimated attrition increases in conjunction with the savings breakdowns from Table 19-7 yields the following estimated 2008-2009 PTYR revenue requirement increases for each of the three functional areas:

Table 19-9
Net of Savings from Business Transformation, DRA's Estimated
2008-2009 Attrition Revenue Requirement Increases Total $149 Million
(in Thousands of Dollars)

Year (a)	Electric Distribution Attrition Increase (b)	Gas Distribution Attrition Increase (c)	Electric Generation Attrition Increase (d)	Total Attrition Increase (e=b+c+d)
2008	$57,174	$11,754	$28,733	$97,661
2009	$31,315	-$2,527	$22,542	$51,330
Total	$88,489	$9,227	$51,275	$148,991