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October 22, 1992

EX PARTE

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
Stop Code 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: CC Docket No. 92-101

Dear Ms. Searcy:

On October 5, 1992, the California Public Utilities Commission (CPUC) released the Proposed Decision of ALJ Galvin in I.90-07-037 in which the CPUC is investigating the matter of post-retirement benefits other than pensions. In the proposed decision, ALJ Galvin recommends the following treatment regarding the adoption of SFAS 106 for ratemaking and the exogenous treatment under Price Caps of related costs:

- o Adoption of SFAS 106 for regulatory accounting and ratemaking purposes.
- o Authorized an exogenous adjustment for tax deductible funding effective 1/1/93.
- o Economic studies presented by NERA and Godwin's demonstrated that the GNP-PI would not be impacted to any significant degree by adoption of SFAS 106.

Earlier in this proceeding, the Ad Hoc Telecommunications Users Committee (Ad Hoc) submitted an ex parte presentation to include in the record a report prepared by the CPUC's Division of Ratepayer Advocates (DRA) regarding their position on the treatment of post-retirement benefits other than pensions. On August 3, 1992, Pacific Telesis Group followed with its own ex parte filing of the rebuttal testimony of Pacific Bell, and pointed out that the DRA's views were not necessarily those of the CPUC.

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List A B C D E

To complete the record, we would now like to include this Proposed Decision of ALJ Galvin in I.90-07-037. We believe that it is important for the FCC to have all available information in making its decision in this proceeding.

In accordance with Section 1.1206(a)(1) of the Commission's rules, enclosed is an additional copy of this letter with the appropriate attachment. Please include the attached material in the above referenced proceeding.

Acknowledgement and date of receipt of this transmittal are requested. A duplicate letter is attached for this purpose.

Please contact me if you have any questions concerning this matter.

Respectfully submitted,

Sherry Herauf

Attachment
cc: Chris Frentrup
Mike Mandigo

STATE OF CALIFORNIA PETE WILSON, Governor

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

October 5, 1992 File No.: I.90-07-037 et al.

TO: PARTIES OF RECORD IN I.90-07-037 ET AL.

This is the proposed decision of the administrative law judge. It will be on the Commission's agenda at the next regular meeting 30 days after the above date. The Commission may act then, or it may postpone action until later.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in the attached Rules of Practice. Please read them carefully and note the filing dates, the limitations on content of comments, and the requirement of service on all other parties.

/s/ LYNN T. CARCEW

Lynn T. Carew, Chief
Administrative Law Judge

LTC:rmn

Rules for comments added to the Commission's Rules of Practice and Procedure by Decision 86-12-056 on December 17, 1986

77.1 (Rule 77.1) <u>Filing Administrative Law Judge Proposed Decision.</u> The Administrative Law Judge shall prepare a proposed decision, whether interim or final, setting forth recommendations, findings and conclusions. After discussion with the assigned commissioner, the proposed decision of the administrative law judge shall be filed with the Commission and served on all parties without undue delay, not later than 90 days after submission.

This procedure will apply to all matters which have been heard, except those initiated by customer or subscriber complaint unless the Commission finds that such procedure is required in the public interest in a particular case.

Applicants in matters involving passenger buses, sewer utilities or vessels may make an oral or written motion to waive the filing of and comment on the proposed decision. Any party objecting to such waiver will have the burden of demonstrating that such filing and comment is in the public interest.

77.2 (Rule 77.2) <u>Time for Filing Comments.</u> Parties may file comments on the proposed decision within 20 days of its date of mailing. An original and 12 copies of the comments with a certificate of service shall be filed with the Docket Office and copies shall be served on all parties. The administrative law judge shall be served separately.

An applicant may file a motion for an extension of the comment period if it accepts the burden of any resulting delay. Any other party requesting an extension of time to comment must show that the benefits of the extension outweigh the burdens of the delay.

77.3 (Rule 77.3) <u>Scope of Comments.</u> Except in general rate cases, major plant addition proceedings, and major generic investigations, comments shall be limited to 15 pages in length plus a subject index listing the recommended changes to the proposed decision, a table of authorities and an appendix setting forth proposed findings of fact and conclusions of law. Comments in general rate cases, major plant addition proceedings, and major generic investigations shall not exceed 25 pages.

Comments shall focus on factual, legal or technical errors in the proposed decision and in citing such errors shall make specific references to the record. Comments which merely reargue positions taken in briefs will be accorded no weight and are not to be filed.

New factual information, untested by cross-examination, shall not be included in comments and shall not be relied on as the basis for assertions made in post publication comments.

77.4 (Rule 77.4) Specific Changes Proposed in Comments. Comments proposing specific changes to the proposed decision shall include supporting findings of fact and conclusions of law.

77.5 (Rule 77.5) Late-Filed Comments and Replies to Comments. Late-filed comments will ordinarily be rejected. However, in extraordinary circumstances a motion for leave to file late may be filed. An accompanying declaration under penalty of perjury shall be submitted setting forth all the reasons for the late filing.

Replies to comments may be filed five days after comments are filed and shall be limited to identifying misrepresentations of law, fact or condition of the record contained in the comments of other parties. Replies shall not exceed five pages in length, and shall be filed and served as set forth in Rule 77.2.

The following Rules are repealed.

78. (Rule 78) Petition for Proposed Report.

79. (Rule 79) Proposed Reports.

80. (Rule 80) Exceptions.

81. (Rule 81) Replies to Exceptions.

Decision PROPOSED DECISION OF ALJ GALVIN (Mailed 10/5/92)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the matter of post-retirement benefits other than pensions.	I.90-07-037 (Filed July 18, 1990)
And Related Matters.	Application 88-12-005 (Filed December 5, 1988) I.89-03-033 (Filed March 20, 1989)

(See Appendix A for Appearances.)

I N D E X

I N D E X

O P I N I O N

I. Summary

By this order energy, water, and telecommunications utilities under the traditional cost of service regulation and telecommunications utilities under the new incentive regulation are required to accrue their post-retirement benefits other than pensions (PBOP) for both regulatory accounting and ratemaking purposes.

The affected utilities are required to utilize the Financial Accounting Standards Board (FASB) Statement No. 106 as modified by this order to record and accrue their PBOP liability. Modifications to the Statement include the use of the utilities employees total utility service life attribution method for both the utility's transition benefit obligation (TBO) and ongoing PBOP costs, and amortization of the TBO over 20 years. Recovery of PBOP costs shall be limited to tax-deductible contributions up to a maximum of 1% of the utility's prior-years' total operating revenue.

The affected utilities are also required to record a regulatory asset[1] to reflect the difference between the utility's total PBOP liability and the amount currently being paid by ratepayers. Recovery of the regulatory asset shall begin during

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1 A regulatory asset is the recording of the utilities' costs not currently recoverable for ratemaking purpose. To qualify as a regulatory asset, it must be probable that future revenue in the amount at least equal to the asset will result from inclusion of that cost in allowable costs for ratemaking purposes, and must be based on available evidence that future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.

the year when tax-deductible limits exceed PBOP costs and continue until the regulatory asset reaches zero.

Utilities under the new incentive regulation shall not be allowed recovery of their PBOP contributions made prior to adoption of the Statement as a Z factor adjustment. Funded contributions, under the same conditions applied to the traditional cost of service utilities, shall be recoverable through the Z factor adjustment.

Those affected utilities operating under other states' jurisdiction with their California operations being 10% or less of their total utility operations (as measured by gross revenues) may choose to be exempted from the accrued PBOP requirement for regulatory accounting purposes only. However, for ratemaking purposes, such utilities shall be required to impute the effect of accrued PBOP, as explained in this order, as part of their general rate filings. Such utilities shall also assume that their funding begins on January 1, 1993 and shall assume earnings on their imputed PBOP contributions to be at their authorized weighted cost of capital rate.

II. Background

FASB[2] issued an "exposure draft"[3] on February 14, 1989 with the intent to issue an official FASB statement that had the potential to trigger ratemaking impacts resulting from a change in the accounting for PBOP from a cash basis of accounting to an accrual basis of accounting. This meant that employers would be required to recognize the future cost of providing PBOP to their employees by accruing these costs in the employers' financial statements as they are earned during the employees' years of service. The FASB defined PBOP as those benefits other than pensions that employees receive upon their retirement from work. These benefits include medical and dental care, life insurance, and legal services.

It became apparent that the FASB would adopt a PBOP statement that would impact regulated utilities. It was also perceived that the PBOP liability for California regulated utilities would be significant. Therefore, this investigation was opened to assess the ratemaking effects of PBOP and to consider the establishment of consistent general policies and procedures for all California regulated utilities that provide PBOP.

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2 FASB is an authoritative body which establishes a common set of accounting concepts, standards, procedures, and conventions, commonly known as "Generally Accepted Accounting Principles" (GAAP). GAAP is recognized by the accounting profession as a whole and is used to most enterprises as a basis for their external financial statements and reports.

3 An exposure draft is a proposed FASB order issued for comments from the accounting industry. Such comments are taken in consideration with the exposure draft prior to the adoption and issuance of an official opinion by the FASB.

III. Phase I

The first phase of this investigation examined the benefits and detriments of funding PBOP prior to the FASB's issuance and prior to the effective date of its official statement. The first phase of the investigation also considered PBOP funding plans and methods to ensure that PBOP funds would be used for only PBOP benefits.

It was during that phase of the investigation that the FASB made minor changes to its exposure draft and adopted its official PBOP statement, Statement of Financial Accounting Standards No. 106 (SFAS 106 or Statement), in December 1990.

The first phase concluded with the issuance of Decision (D.) 91-07-006. In that decision we found that the funding of PBOP with tax-deductible trust plans prior to January 1993, the effective date of the Statement, was in the ratepayers' best interest. We also found that adequate legal and accounting safeguards were already in existence to ensure that amounts contributed to PBOP plans would be used to provide only PBOP benefits.

Pursuant to the first decision in this investigation, the Commission gave utilities permission to fund and to recover their PBOP costs prior to the Statement's effective date, at tax-deductible contribution levels. Such recovery was subject to a reasonableness review of the utility's trust plans, actuarial assumptions, contributions, and investments in each utility's next general rate proceeding.

IV. Phase II

This decision addresses the second and final phase of the PBOP investigation. In all, there were 10 issues for this phase of the investigation, 8 of which were identified in the investigation, and the remaining 2 identified in D.91-07-006 as modified by D.91-10-024. Because several of these issues overlap each other, they have been consolidated into 5 major issues for discussion in this decision as follows:

a. Revenue requirement impacts.
b. Accounting and ratemaking treatment.
c. Legislation impacts.
d. Safeguard mechanisms.
e. "Z factor" treatment.

V. Evidentiary Hearing

A prehearing conference on Phase II issues was held before Administrative Law Judge Galvin on October 29, 1991 in San Francisco. There were 13 days of evidentiary hearings between December 2, 1991 and February 28, 1992.

Brown Bridgman Retiree Health Care Group, the Department of Navy, the Division of Ratepayer Advocates (DRA), GTE California Incorporated (GTEC), Pacific Bell, Pacific Gas and Electric Company (PG&E), Roseville Telephone Company (Roseville), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (Edison), Southern California Gas Company (SoCal Gas), and Southwest Gas Corporation (Southwest Gas) provided testimony on the Phase II issues.

Opening briefs were filed on March 27, 1992 and the matter was submitted upon the receipt of reply briefs on April 22, 1992.

Subsequent to the receipt of reply briefs, DRA filed a motion to strike portions of PG&E's and SoCal Gas's reply briefs which discussed and included a Duff & Phelps publication issued after the close of evidentiary hearings in this investigation. DRA asserted that the discussion and publication should not be allowed because it represented new testimony not scrutinized under examination.

Both PG&E and SoCal Gas acknowledged that the publication is not a part of the record in this proceeding and that it did not exist until after the close of evidentiary hearings. However, they contend that the publication should be considered as argument to substantiate the financial concerns expressed by their witnesses.

To the extent that the utilities' discussions and the publication summarized the financial concerns expressed by PG&E's and SoCal Gas's witnesses, they have been considered in this order. However, to the extent that the discussions and publication provided new information not already a part of the record, they were not considered in this order.

VI. Revenue Requirements

As explained in our background discussion, it was the general consensus at the time this investigation was opened that the California regulated utilities' PBOP liability would be significant. Subsequent to the institution of this investigation the FASB issued its Statement which enabled the utilities to quantify the impact of adopting the Statement for ratemaking purposes. The Statement requires all entities to discontinue the prevalent practice of recording PBOP benefits on the cash basis of accounting, or only when payment is actually made for PBOP benefits. The cash basis is being replaced with the accrual basis of accounting. Under the accrual basis entities must record PBOP benefits over the time period that their employees earn PBOP benefits, or the employees' working lives. The effective date of this Statement for California regulated utilities is January 1, 1993.

The annual PBOP costs to be accrued and recorded is called the "Net Periodic Postretirement Benefit Cost." Components of this cost include service cost,[4] interest cost,[5] actual return on plan assets,[6] and amortization of the TBO.[7]

California ratepayers will be substantially impacted if the Statement is adopted for ratemaking purposes. It was estimated that if the Statement is adopted without any modification that the ratepayers of GTEC, Pacific Bell, and SDG&E would see a $0.38, $0.75, and $0.19 monthly increase in their utility bills, respectively. Absent specific cost recovery methods and consideration of each individual utility's tax situation, net-to-gross multiplier factors may be necessary to reflect post-tax dollar payments from the ratepayers' perspective. Therefore, it is not possible to determine the resulting revenue requirement for each utility should full PBOP liability funding be adopted for ratemaking purposes at this time. However, the utilities have provided a comparison of their PBOP costs between the cash basis and accrual basis of accounting. In 1993 alone, the first year of the Statement implementation, California regulated entities that provide PBOP, except for AT&T Communications of California, Inc.,[8] would incur nearly an additional half a billion dollars in cost as summarized in the following tabulation:

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4 Actuarial present value of the expected obligation attributed to employees' service during the current period.

5 An increase in the TBO due to the passage of time.

6 A change in the fair value of plan assets from the beginning to the end of a time period, adjusted for contributions and benefit payments.

7 The recognition of all PBOP benefit obligations at January 1, 1993 less any plan assets at that date.

8 Data for California-only operations was not available.

UTILITY	CASH BASIS	ACCRUAL BASIS	INCREASED COST
	(Millions of Dollars)		
Edison	$ 33.7	$ 86.3	$ 52.6
PG&E[9]	25.5	150.6	125.1
SDG&E	4.0	7.4	3.4
SoCal Gas	6.6	29.9	23.3
Southwest Gas[10]	.1	.3	.2
GTEC	18.3	77.1	58.8
Pacific Bell	111.3	282.7	171.4
Roseville	.1	.2	.1
	$199.6	$634.5	$434.9

VII. Transition Benefit Obligation

The substantial increase in PBOP costs under the accrual basis of accounting is primarily attributable to the TBO. This is because the Statement requires all entities to record as an operating expense the cost of all PBOP benefits earned prior to January 1, 1993. However, the entities have the option of recording the TBO as a one-time operating expense or amortizing it on a straight-line basis over either the average remaining service period of the active employees or over a 20-year time period. A majority of the California utilities that provide PBOP intend to amortize the approximately $5 billion TBO over a 20-year time period at a rate of $237 million per year as summarized below.

9 Medical only. Excluded insurance benefits because the cash basis amount was not disclosed. The insurance accrual basis amount is $10,207,000.

10 California operations only.

UTILITY	TOTAL TBO	YEARLY AMORTIZATION
	(MILLIONS OF	DOLLARS)
Edison	$ 626.0	$ 31.3
PG&E[11]	920.0	45.9
SDG&E	59.2	3.0
SoCal Gas	266.0	13.3
Southwest Gas[12]	1.9	0.1
GTEC	601.8	30.1
Pacific Bell	2,266.0	113.3
Roseville	1.6	0.1
TOTAL	$4,742.5	$ 237.0

VIII. True-up of Phase I Funding

Not all of the utilities that provide PBOP benefits to their employees implemented the permissive PBOP funding authorized by the first phase of this investigation. However, because utilities such as Pacific Bell, PG&E, and SoCal Gas began accrual funding of PBOP prior to the Statement's effective date, they were expected to true-up their interim pre-funding revenue requirements in the second phase of the investigation.

Ordering Paragraph 5 of the Phase I order gave PG&E the authority to accrue PBOP contributions in a memorandum account until its 1992 attrition rate adjustment (ARA) filing, at which time rate recovery would be authorized. Because PG&E's filing of its 1992 ARA took place after the second phase of this investigation, it was not possible for PG&E to true-up its PBOP funding in this investigation. However, PG&E did propose that the

11 Excluded $70 million applicable to the insurance TBO.

12 California operations only.

amount authorized in its 1992 ARA serve as a ceiling for revenue requirements associated with PBOP funding in excess of its pay-as-you-go costs, and that any excess revenues associated with the 1991 and 1992 contributions be returned to ratepayers through a true-up procedure in its 1996 General Rate Case (GRC).

SoCal Gas was granted authority to fund PBOP and to implement rates to recover PBOP costs in its Test Year 1990 GRC, D.90-01-016, 35 CPUC 2d 80 at 132 and 133. Although SoCal Gas was authorized to recover PBOP costs, the GRC decision placed SoCal Gas on notice that those prior and current test years' contributions plus a reasonable rate of return will be assumed by the Commission to be available gross of tax to offset pay-as-you-go expenses in SoCal Gas's next GRC. Because SoCal Gas's prior and current test years' PBOP contributions will be reviewed in its next GRC, the true-up requirement is not applicable to SoCal Gas in this investigation.

Since the FASB established January 1, 1993 as the Statement's effective date, it is not feasible for the remaining utilities funding PBOP in advance of the Statement date to true-up their PBOP costs in this investigation. Therefore, those affected utilities should true-up their PBOP costs as part of their next GRC application. The telephone utilities subject to the new regulatory framework (NRF) mechanism should true-up their PBOP costs in their next annual price cap filing, consistent with the method addressed in the "Z factor" discussion in this order.

IX. Justification for Revenue Requirement

The utilities revenue requirement data was based on actuarial valuations of the projected cost of the respective utilities' PBOP benefits. These valuations included demographic and economic assumptions, and were performed in accordance with generally accepted actuarial principles and the Statement criteria.

Demographic actuarial assumptions included historical mortality, turn-over, disability, and retirement data. Economic assumptions included long-term assumptions believed to be reasonable and consistent with one another to reflect the long-term view of future cost patterns of the individual PBOP plans in existence.

A substantial portion of the evidentiary hearing was devoted to the revenue requirement recovery issue. In essence, this issue concerned financial and regulatory considerations.

A. <u>Financial Consideration</u>

Financial consideration consists of the utilities' ability to maintain their financial strength and to minimize their cost of capital. In this regard, Edison and SDG&E represented that full funding of the PBOP liability would be in the ratepayers' and utilities' long-term best interest because it would help maintain the utilities' financial strength and minimize the utilities' cost of capital. Edison further represented that if we approved only partial PBOP funding, the financial risks already facing the utilities would be exacerbated and "could" result in increased cost to the ratepayer.

On the other side of this financial issue, DRA provided substantive testimony to alleviate the utilities' concern of an exacerbated financial risk. Its testimony substantiated that Standard & Poor's and Moody's Investors Service, Inc. (Moody's) already factor in the effect of PBOP liabilities. The additional PBOP reporting required by the Statement would be helpful for the rating agencies to fine-tune their assessments and could even reveal a significantly smaller burden than previously assumed by the rating agencies. It will not result in the downgrade of debt ratings in any event.

Edison countered that Standard & Poor's and Moody's ratings are irrelevant to the concerns of the equity (common stock) market because these agencies' ratings only assess fixed income securities.

There is no dispute that the bond and stock markets are significantly different. Bond holders may have a much greater level of security than shareholders because debt payments precede stockholder dividends. However, the higher, or more favorable the rating given to the utilities' debt by rating agencies, the lower the cost, or interest rate, needed to service debt. In turn, this lower service cost directly results, absent any disallowance of PBOP costs, in the availability of additional money for shareholder dividends and/or capital improvements. Although the degree of risk assessed by rating agencies and potential stockholders is not expected to be equal, we would expect some correlation to exist between debt and common equity risk.

We recognize, as addressed by the Department of Navy, that the rating agencies have not directed their Statement comments to a specific industry, such as the utility industry. However, its testimony corroborated DRA's testimony regarding the rating agencies' current practice of projecting PBOP liabilities to arrive at rating factors.

The Department of Navy also provided testimony on the rating practices of Duff & Phelps. In addition to rating debt like the other rating agencies, Duff & Phelps ranks and rates common stock securities. As elaborated in Duff & Phelps' October 9, 1989 "Credit Decisions," there is no basis to conclude that the Statement would have any measurable impact on the companies' ability to access capital markets because the capital markets will see through to the economies which have not changed.

Although the rating agencies did not provide testimony in this investigation, DRA and the Department of Navy provided persuasive testimony to explain how the rating agencies consider PBOP liabilities in assessing risk and in establishing rating factors for debt and common stock.

There is no dispute that risk exists. What is in dispute is the degree of risk that will occur if the Statement is not adopted. However, this is not the proper proceeding to assess or to provide compensation for degrees of risk related to a single factor. Such assessment is properly addressed in rate of return proceedings where the utilities' risk is evaluated and balanced to reflect their overall risk, such as in annual cost of capital proceeding for major energy utilities and in GRC proceedings for other utilities.

The utilities have not substantiated that their financial strength and capital cost should be considered in deciding whether the Statement should be adopted for regulatory accounting and ratemaking purposes.

B. Regulatory Consideration

Regulatory considerations consist of inter-generational inequity, cost recovery procedures, Generally Accepted Accounting Principles (GAAP), time value of money, rate shock, and speculative results.

1. Inter-Generational Inequity

An inter-generational inequity presently arises with PBOP costs because, under the present cash basis of accounting, future generations of ratepayers pay for the cost of PBOP benefits earned today while current ratepayers pay for the cost of PBOP benefits earned in prior years.

There is no dispute that inter-generational inequity exists. SoCal Gas explained that funding will ensure that the appropriate group of ratepayers funds the benefit as it is accruing, and that a pool of funds will be available to guarantee that the earned benefits will be given. The remaining utilities also believe that now is the time to correct this inequity and to properly reflect the cost of providing service. According to the utilities, failure to adopt the Statement will result in the PBOP liability's growth to a level that will result in major rate shock to future generations of ratepayers.

Even DRA, opposed to adoption of the Statement, concurred that if accrual accounting, as proposed by FASB, is adopted it would result in a more equitable distribution between ratepayer generations by matching the generation of employees providing service and earning PBOP benefits with the generation of ratepayers consuming that service.

However, adoption of the Statement without modification will not result in inter-generational equity. This is because, as testified by the Department of Navy, the Statement requires that the TBO related entirely to prior periods be amortized and included as a component of the PBOP accrual amount. The amortization of this TBO would result in a continuation of this inequity over the duration of the TBO amortization period, not to exceed 20 years. Therefore, inter-generational inequity needs to be considered in deciding whether the Statement should be adopted for regulatory accounting and ratemaking purposes.

2. <u>Consistent Cost Recovery Mechanisms</u>

Several of the utilities contended that rate recovery of the PBOP liability is necessary to be consistent with their current recovery of pension and nuclear decommissioning costs.

Edison, for one, asserted that adoption of the Statement would place PBOP funding on a cost basis consistent with the "cost of service" principle applied to the funding of both pension and nuclear decommissioning costs. Not only would it make available funds to pay PBOP, it would require current ratepayers to pay their full cost of service and lessen the burden on future ratepayers with a growing liability not applicable to service that the future ratepayers would receive. In addition, current ratepayers' costs would be minimized through the maximization of earnings on the PBOP funding.

The Department of Navy concurred with the utilities' assessment that the recovery of PBOP accrued funding would be on a more consistent basis with the recovery of pension and nuclear decommissioning cost. However, it asserted that consistency should not be the driving force because the objective of each recovery program is different. For example, the objective of setting aside funds for future decommissioning of a nuclear plant is in the public interest to alleviate a potentially dangerous activity which, if done improperly, could jeopardize public safety. The Department of Navy did not believe that this same public policy objective existed with respect to the funding of PBOP benefits.

DRA acknowledged that PBOP, pensions, and nuclear decommissioning funding must currently recognize the expense of liabilities that will not come due for a considerable period of time and that a long lag time creates uncertainty about the expected cost. However, DRA does not believe that the decommissioning cost recovery procedure is relevant to this investigation because, unlike nuclear decommissioning, there is no Public Utilities (PU) Code requirement to fund PBOP, and because the California Nuclear Facility Decommissioning Act required affected utilities to set up an externally managed, segregated sinking fund. DRA cited PU Code §§ 8321-8330 which provide specific funding requirements for the decommissioning of nuclear facilities.

DRA summarized that, unlike nuclear facilities, PBOP has no public health and safety impact, environmental impact, or national security interest that justifies PBOP accrual recovery similar to nuclear decommissioning costs.

DRA's and the Department of Navy's public health and safety concerns were not disputed. Such criteria may be important but do not necessarily comport with the reasonable cost of service criteria that utilities must meet to obtain an opportunity to recover costs through rates. Further, neither party substantiated the relevancy of their public health and safety concerns to the recovery of PBOP costs.

Although PU Code §§ 8321-8330 mandate a funded accrual basis of cost recovery for the decommissioning of nuclear facilities, the absence of a code section for PBOP costs, in itself, is not a basis to treat PBOP costs differently from the recovery of decommissioning costs.

DRA's arguments are irrelevant to the investigation. This is because the code sections relied on by DRA were not added to the PU Code until 1988,[13] approximately 5 years after energy utilities were authorized to implement an accrual basis of accounting for decommissioning costs pursuant to D.83-04-013, 11 CPUC 2d at 115. Similarly, the Nuclear Facility Decommissioning Act cited by DRA did not come into existence until 1985, approximately 3 years after utilities were authorized to fund their decommissioning costs on an accrual basis of accounting. Clearly, DRA's statutory basis for treating the recovery of PBOP costs differently from the recovery of decommissioning cost is without merit.

Since developing a consistent cost recovery mechanism is an issue in this investigation, it should be beneficial to review the criteria considered in the establishment of a cost recovery mechanism for nuclear decommissioning costs. D.83-04-013 of Order Instituting Investigation (OII) 86, issued January 21, 1981, resulted from our concern that adequate funds be available for the decommissioning of nuclear facilities, and that such cost be distributed equitably over time among the customers who benefit from the nuclear plant operation. In that decision we rejected the direct operating expense method because it was found that ratepayers at the time of decommissioning would unfairly bear the total costs, and those ratepayers who benefited from the power plant operating would not bear any cost.

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13 Stats 1980, Ch 1560, Sec 5.

We used four specific criteria to assess and evaluate various cost recovery mechanisms; assurance, cost, flexibility, and equity. Although the criteria were established in 1983, nothing convinces us that the criteria are outdated. Rather than re-inventing the wheel, we will use the same criteria in this investigation. Such criteria are be applicable in this investigation to assess the various cost recovery mechanisms and to determine whether such mechanisms should be applied consistently.

DRA further believed that the pension funding method is not relevant because unlike PBOP, which have no minimum funding requirement, all entities that provide pensions are required under Internal Revenue Service (IRS)/Employee Retirement Income Security Act (ERISA) requirements to fund employee pensions on an accrual basis.

However, no party argued that PBOP are currently being paid in a manner similar to pension benefits. Since at least 1955 (D.50258, 53 CPUC 275 at 292), the Commission has recognized the social benefit of maintaining a sound pension fund and has consistently held that the funding of a pension in advance of the utility's payment of benefits is a proper current cost of service.

Consistent cost of service policy and cost recovery mechanisms are valid concerns that need to be considered in determining whether the Statement should be adopted for accounting and ratemaking purposes.

3. <u>GAAP Consistency</u>

Pacific Bell believes that our recent trend to conform regulatory accounting with GAAP, such as in the Uniform Systems of Accounts (USOA) Rewrite including the implementation of accrual accounting for incentive awards and workers' compensation, makes it desirable to adopt the Statement for ratemaking purposes.

We concur that the accrual accounting for incentive awards and workers' compensation was previously adopted. However, Pacific Bell was accounting for incentive awards on the accrual