

immediately recognized that this could be an effective way of funding PBOP because it would not involve additional charges to current ratepayers and it would not result in any loss of tax revenue to the United States Treasury. Therefore, Congressional legislation was identified as an issue and respondent utilities were requested to report the effects of any proposed Congressional legislation related to PBOP in the second phase of this investigation.

Except for SoCal Gas, the respondent utilities were not aware of any Congressional legislation that could potentially affect PBOP. Although SoCal Gas testified that it was aware of several bills that have been introduced which could potentially affect PBOP, it was not able to identify any specific bills or to provide a current status of such bills at the evidentiary hearing. SoCal Gas did testify that because there was no real consensus formed to support any of the bills that any possibility of such bills being passed was pure speculation.

Of the three interested parties participating in this phase of the investigation, only DRA addressed potential legislative impacts. DRA's testimony corroborated the respondents' general consensus that there was no pending legislation. However, DRA did recommend a list of areas that should be explored in considering the effects of proposed Congressional legislation.

DRA's checklist may be helpful in analyzing the effect of future legislation. However, such a checklist is not useful in this proceeding because no party has identified any pending legislation that the checklist could be applied to. DRA apparently agrees with this conclusion because its witness recommended that this proceeding not remain open to consider potential future legislation. Absent any testimony to the contrary, the legislative impacts issue need not be addressed as it has no present impact in this investigation.

XIII. Safeguard Mechanism

An integral part of our PBOP investigation is to address safeguards needed to protect ratepayers' interest upon the adoption of accrual accounting for PBOP. Three safeguard concerns were identified in this phase of the investigation. Two of the concerns are identical to the safeguard concerns addressed in the first phase of this investigation. They are that PBOP funded amounts will be used for only PBOP and the need for necessary monitoring procedures to track plan activities and performance. The third concern (not previously addressed) is whether full recovery of accrued PBOP will reduce incentives for the utilities to aggressively negotiate PBOP with employee unions.

DRA acknowledged that regulators, such as the Commission, are prohibited under the NLRA and by court decisions from "prescribing" outcomes for collective bargaining. However, DRA emphasized that the utilities are given no regulatory assurance of rate recovery for negotiated agreements between the utilities and the unions for unfair or unreasonable arrangements. Such regulatory review of negotiated agreements has traditionally taken place in general rate proceedings. However, DRA is concerned that there is no safeguard to prevent the utilities' management from conducting labor negotiations between test years in order to maximize excess funding. Therefore, DRA concluded that adoption of the Statement for ratemaking purposes may risk unreasonable funding, resulting in both rate shock and rate volatility.

On the other side of this issue, the utilities asserted that full funding of PBOP will not, in any way, compromise good faith negotiations with unions regarding the level of retirement benefits provided to employees.

PG&E's Richard Weingart explained that although the NLRA's good faith bargaining rule does not have a provision which protects ratepayers' interest, the utilities maintain a strong

economic motivation to negotiate labor contracts which reduce the overall cost of the utilities' operations. This economic motivation is enhanced by expanded competition within the industry requiring the utilities to keep their rates within a competitive level.

Weingart further explained that it is not appropriate to isolate a single issue, such as PBOP, in the broad context of the collective bargaining process because collective bargaining encompasses a multitude of issues which require the giving and taking of concessions. From the utilities' perspective, a primary interest in the collective bargaining process is controlling the costs of operations. To assess that controlling interest one can not assess the reasonableness of PBOP as a single issue without regard to other provisions agreed upon in the negotiation of a labor agreement.

Irrespective of assessing PBOP as a single negotiation issue, several of the utilities substantiated that they have reduced and are continuing to reduce PBOP costs through the collective bargaining process. For example, PG&E implemented several PBOP plan changes as a result of it's 1991 contract negotiations which resulted in a PBOP cost reduction of approximately \$4 million. Pacific Bell's Dennis Evans also testified of PBOP cost containment measures which were implemented by Pacific Bell in the past few years.

There is nothing in the record to demonstrate that the utilities will have any less incentive to aggressively negotiate PBOP benefits in good faith if they are authorized full recovery of accrued PBOP costs. On the contrary, the evidence substantiates that the utilities have every incentive to continue negotiating cost containment to their respective PBOP plans.

DRA's and the utilities' testimony on our first two safeguard concerns mirror their respective testimony in the first phase of this investigation. Because we have already found that

sufficient FASB, IRS, ERISA, and NLRA reporting, disclosure, and fiduciary requirements are in place to ensure that funds placed in a PBOP plan will be tracked and will be used only for PBOP, there is no need to require redundant safeguards at this time. To require supplemental safeguard procedures will only increase the cost of providing PBOP.

However, this is not meant to preclude in any fashion CACD or DRA from requesting and obtaining additional data from the utilities regarding their PBOP activities. Consistent with our Phase I position, we will take the most conservative approach as it relates to PBOP funding and require that the utilities establish trusts for the receipt, investment, administration, and disposition of any PBOP funds which we may authorize the utilities to recover in rates. As a condition of the recovery process of PBOP costs being authorized in this order, the utilities should continue to be required to make their trust agreements and accounting records³⁰ readily available to CACD and DRA upon their request.

XIV. Z Factor Treatment

In the first phase of this investigation GTEC and Pacific Bell requested Z factor recovery treatment for their PBOP contributions. However, because of an incomplete record, their request was deferred for consideration to this phase of the investigation. Prior to considering Z factor recovery treatment, it is necessary to review how the Z factor was established and the required criteria to recover cost.

³⁰ These records shall include but not be limited to revenue requirements authorized, actual amounts contributed to PBOP trusts, statement of expenditures, and actuarial reports.

A. Z Factor Criteria

D.89-10-031, 22 CPUC 2d 43 (1989), established a NRF for GTEC and Pacific Bell. This NRF centered around a price cap indexing mechanism that was designed to provide protection to both ratepayers and shareholders from risks that the indexing method may over- or underestimate revenue changes needed to keep the utilities financially healthy. At the same time, the price cap indexing mechanism placed on GTEC's and Pacific Bell's management more responsibility to control their expenses and to assume more risks in exchange for simplified regulation and an opportunity to earn higher rates of return.

The Z factor was established as the component of the price cap mechanism to protect both the ratepayers and shareholders against exogenous events which affect utility costs but are not reflected in an economy-wide GNPPI.

The NRF decision concluded that only exogenous factors which are not reflected in the economy-wide inflation factor and which are clearly beyond the utility's control should be reflected in the Z factor in the price cap index (22 CPUC 2d at 228). That decision also recognized that the range of exogenous factors which could affect utility costs to an extent warranting explicit rate adjustments through the Z factor cannot be foreseen completely. However, the following factors were accepted as a starting point:

1. Changes in federal and state tax laws to the extent they affect the utilities disproportionately.
2. Mandated jurisdictional separations.
3. Changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission.
4. Changes in regulatory amortizations.
5. The reflection of tax benefits resulting from premature retirements of high coupon bonds.

GTEC and Pacific Bell contend they should be able to recover pre-funded PBOP contributions and future PBOP costs they will incur due to the adoption of the Statement as a Z factor.

B. Recovery of Pre-Funded PBOP Contributions

GTEC pre-funded \$27.1 million in a fully tax-deductible bargained VEBA in December of 1991 and anticipated pre-funding an additional \$25.2 million in 1992 in order to mitigate the impact on GTEC's ratepayers of implementing the Statement if the accounting change is adopted for ratemaking purposes.

Pacific Bell pre-funded PBOP contributions of \$117 in 1989 and \$91 million in 1990. However, it discontinued making further pre-funded contributions in 1991 and 1992 because of the uncertainty that it would recover in rates its pre-funded contributions in a timely manner and because of the many demands for its capital resources. Upon assurance that PBOP contributions would be recovered in rates on a timely basis, Pacific Bell would be willing to continue pre-funding in 1992. If the Commission denies recovery of its pre-funded contributions for 1989 and 1990, then Pacific Bell's TBO would need to be re-calculated to reflect a higher obligation. Such a recalculation would not result in retroactive ratemaking because Pacific Bell has yet to expense its 1989 and 1990 pre-funded PBOP contributions. Pacific Bell has recorded its pre-funded contributions as a prepaid asset. Retroactive ratemaking results from the recovery of past expenses in future rates.

DRA opposed both GTEC's and Pacific Bell's request for Z factor recovery of their pre-funded contributions for two reasons. First, DRA believed that such recovery would constitute retroactive ratemaking. Second, DRA does not believe pre-funded contributions satisfy the Z factor criteria established in the NRF decision.

Both GTEC and Pacific Bell exercised good intentions in pre-funding their PBOP costs to minimize the ratepayers' impact associated with the Statement by utilizing tax-deductible trusts

which accumulated tax-free earnings. Nevertheless to authorize Z factor recovery, we must first conclude that pre-funding meets the criteria established in the NRF decision.

There is no dispute that the Statement will have a material impact. However, DRA does not believe that GTEC's and Pacific Bell's pre-funding activities meet the criterion that pre-funding is clearly beyond the utility's control.

Pre-funding was authorized in the first phase of this investigation. However, it was authorized on a permissive basis. No utility was required to make pre-funded contributions. Although this permissive pre-funding was effective August 1, 1991, Pacific Bell actually began pre-funding in December 1989.³¹ Clearly, Pacific Bell's pre-funding of 1989 contributions was not beyond its control, especially since its contributions were made almost two years prior to Commission authorization and a full year prior to the FASB's adoption of the Statement. Similarly, Pacific Bell's 1990 contributions were made almost eight months prior to Commission authorization.

Pacific Bell's decision to discontinue pre-funding and to not pre-fund in 1991 and 1992 further substantiated that pre-funding was not only permissive but was well within the utilities' control. Pacific Bell's proposal to continue pre-funding in 1992 if assurance is given that rate recovery will be provided on a timely basis continues to substantiate that pre-funding is in the control of the utilities.

Neither GTEC nor Pacific Bell has met its burden of proof to demonstrate that pre-funded contributions were clearly beyond their control. Absent such a finding we must deny GTEC and Pacific Bell authority to recover pre-funded PBOP via the Z factor.

³¹ We also note that Pacific Bell's 1989 pre-funded contribution took place within two months after the NRF decision was issued.

Because pre-funded contributions have not met the Z factor criteria, the retroactive ratemaking issue raised by DRA and Toward Utility Rate Normalization (TURN) is moot and need not be addressed further.

C. Recovery of Funded PBOP Contributions

GTEC and Pacific Bell believe that Z factor recovery is applicable for accrued PBOP costs because these costs satisfy the criteria established in the NRF decision. Once again, the criteria consist of exogenous factors which are clearly beyond the control of the utilities and which are not reflected in the economy-wide GNPPI.

The utilities explained that the control factor will be met if we adopt the Statement because they will have no choice but to implement accrued PBOP. DRA agreed with the utilities that the adoption of the Statement is clearly beyond the utilities' control and that such action would be an exogenous factor.³² However, DRA argued that the utilities do not satisfy the control criterion because the utilities control PBOP costs. For example, the utilities will have the ability to control the amount of funded accrued liability, select the appropriate funding mechanism, and reduce or increase their PBOP expenses.

No party disputed DRA's contention that the utilities have the ability to control the day-to-day management of PBOP costs. However, the same may be true of most other factors that expressly qualify for Z factor treatment. For example, changes in federal and state tax laws, identified in the NRF decision as a Z

³² DRA went on to provide conflicting testimony on whether such an exogenous factor exists because of the economic nature of PBOP costs. Its direct testimony stated that an exogenous factor does not exist because there are no major changes to the economic cost of providing PBOP, Exhibit 75 page 69. However, DRA's witness subsequently testified that the cost change does exist from an economic standpoint, RT 1105 Line 13.

factor adjustment, are beyond the control of the utilities. At the same time, the utilities will continue to control the actual payment of taxes and the level of taxes resulting from the tax change.

Accordingly, to the extent that the utilities incur costs to comply with Commission required accounting changes, particularly here where the utilities may only recover those sums paid to the independent trusts specifically authorized by this decision, such costs satisfy the Z factor control criterion. Therefore, costs associated with the change from cash to accrual accounting for PBOP not recovered through the GNPPI should be recovered through a Z factor adjustment. Consistent with the 1% cap being imposed on utilities under the traditional cost of service regulation, we will impose a 1% recovery cap on Pacific Bell's and GTEC's net change in their annual price cap revenue base.

Both GTEC and Pacific Bell conducted detailed studies on the impact that the Statement would have on the GNPPI to assure that double recovery would not take place. Although the utilities used consistent economic theory in their studies, they did use a different behavior assumption related to whether firms already considered accrued PBOP costs in their hiring and output decisions.

Pacific Bell's study assumed that competitive firms were already making their hiring and output decisions on the basis of accrued PBOP while GTEC took the conservative approach and assumed the opposite of Pacific Bell. Their results were similar. GTEC concluded that the GNPPI would recover 0.73% of the additional cost while Pacific Bell concluded that the GNPPI would recover 0.12%.

DRA concluded that some degree of rate recovery already exists in the GNPPI because health care, dental care, and life insurance components are components of the GNPPI. It was apparent that GTEC and Pacific Bell did not disagree with DRA because they

quantified the impact, although not material, in their respective studies. Pacific Bell further clarified that the Z factor adjustment is necessary to reflect accrual accounting while the GNPPI reflects the change in inflation for PBOP gross national output price increases.

In this instance we have the benefit of two different economic studies which demonstrate that the GNPPI will not be impacted to any significant degree. Although economic studies, such as the ones used by GTEC and Pacific Bell, are objective, the results are dependent on the subjective inputs. From these subjective inputs the parties advance arguments in support of their respective analyses and in criticism of the input assumptions used by other parties. In the final analysis, it is the application of judgment, not the precision of these economic studies, which is the key to determining the extent of impact.

Our analysis of the evidence shows that the GNPPI will be impacted minimally, as demonstrated by the utilities' economic studies. This analysis of the evidence also leads us to conclude that the recovery of the accrual required by adopting the Statement with modification through the Z factor will not provide the utilities with any measurable double recovery through the GNPPI adjustment. Based on our judgment, the NRF utilities should be authorized to use the Z factor adjustment to recover accrual impacts from adopting the Statement as modified by this order.

In relation to Pacific Bell's economic study, GTEC's study was very conservative. In fact, GTEC attempted to determine whether adoption of the Statement would impact other components of the GNPPI. Based on its additional analysis, GTEC concluded that some of the costs associated with the change in GNPPI may influence wage rates in the national economy. If the wage rate in the national economy is reduced in relative terms due to the impact of the Statement, an additional 14.38% of the PBOP costs may be recovered by GTEC in the GNPPI due to a reduction in the wages that

GTEC pays to its employees relative to what it would have paid in the absence of the Statement.

Although GTEC's study shows that it could receive additional recovery benefits through the wage component of the GNPPI, there is no evidence in the record to substantiate or to sway our judgment that NRF utilities will, in fact, receive any additional recovery benefits. Because there is a possibility that the NRF utilities may receive ancillary benefits to the detriment of ratepayers, we do not want to foreclose future consideration of GTEC's speculative result. It would be best to consider this issue after the Statement has been implemented and after a period of time has lapsed so that we may draw upon historical data. Therefore, as part of their October 1993 price cap filing, GTEC and Pacific Bell should include studies to demonstrate whether the wage component of the GNPPI has been affected by adoption of the Statement and recommendations on how the impacts, if any, should be reflected in rates.

We must consider whether NRF utilities should make a one-time Z factor filing or annual Z factor filings to reflect PBOP costs. We note that pay-as-you go costs are projected to increase over time. Furthermore, if we retained pay-as-you go accounting, any increase in pay-as-you-go costs would not be entitled to Z factor treatment. Therefore, the NRF utilities' additional recovery for PBOP costs through the Z factor should be limited to the difference between what is required by accrual accounting and what their pay-as-you-go costs otherwise would have been. It appears that the difference between the amount required for PBOP costs under accrual accounting and the amount required under pay-as-you-go accounting may decrease over time. Indeed, we have earlier noted evidence that the cost of an accrual funded plan would eventually be less expensive than a pay-as-you-go plan. Therefore, we should not authorize NRF utilities to recover as a permanent Z factor the increase in rates for PBOP necessary during

the first year. If we did that, the NRF utilities might realize a windfall. Accordingly, it appears that yearly adjustments to the Z factor recovery for PBOP costs will be required. Our decision today will order such annual adjustments. We are, however, concerned that such annual adjustments not involve excessive litigation of the reasonableness of costs, contrary to the spirit of our NRF decision. Accordingly, we will hold further hearings to determine the simplest method for annually revising the amount of recovery without extensive litigation.

XV. 311 Comments

The ALJ's proposed decision on this matter was filed with the Docket Office and mailed to all parties of record on October 5, 1992, pursuant to Rule 77 of the Commission's Rules of Practice and Procedure.

Comments from AT&T Communications of California, Inc., the Department of Navy, DRA, Edison, GTE, Pacific Bell, Permit Group, Inc., PG&E, SDG&E, SoCal Gas, Southwest Gas, and TURN were timely filed with the Docket Office on October 26, 1992.

Reply comments received from appearances of record such as AT&T Communications of California, Inc., the Department of Navy, DRA, GTE, Pacific Bell, SoCal Gas, and TURN were timely filed with the Docket Office and timely received by the ALJ.

We have carefully reviewed the comments and reply comments filed by the parties to this proceeding that focused on factual, legal or technical errors in the proposed decision and in citing such errors made specific references to the record, pursuant to Rule 77.3. To the extent that these comments and reply comments required discussion or changes to the proposed decision, the discussion or changes have been incorporated into the body of this order. Comments and reply comments which merely re-argued

positions taken in briefs or presented information not in the record were not considered.

Findings of Fact

1. Our intent in this investigation was to consider the ratemaking effects of PBOP and to establish consistent general policies and procedures to be applied to all utilities that provide PBOP.

2. The funding of PBOP with tax-deductible trusts is in the ratepayers' best interest.

3. The utilities have been given permissive authority to fund and to recover their PBOP costs prior to the Statement's effective date.

4. The Statement requires all entities to replace the prevalent practice of recording PBOP benefits on the cash basis of accounting with the accrual basis of accounting for financial accounting and reporting purposes.

5. The Statement will become applicable to California regulated utilities effective January 1, 1993.

6. GTEC's, Pacific Bell's, and SDG&E's average residential customer's bill will increase \$0.38, \$0.75, and \$0.19 per month if the Statement is adopted without modification.

7. SoCal Gas was granted authority to fund PBOP and to implement rates to recover PBOP costs in its Test Year 1990 GRC.

8. It is not feasible for the utilities that are pre-funding PBOP to true-up their PBOP costs in this investigation.

9. Standard and Poor's and Moody's already factor in the effect of PBOP liabilities.

10. 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.

11. The higher, or more favorable, the rating given to the utilities' debt by rating agencies, the lower the costs, or interest rate, to service debt.

12. A correlation exists between debt and common equity risk.

13. There is no basis to conclude that the Statement would have any measurable impact on the companies' ability to access capital markets.

14. Inter-generational inequity will not be resolved by adopting the Statement without modification.

15. Adoption of the Statement would place the recovery of PBOP on a more consistent basis with the recovery of pension and nuclear decommissioning costs.

16. PBOP, pensions, and nuclear decommissioning funding must currently recognize the expense of liabilities that will not come due for a considerable period of time.

17. The absence of a specific code requirement for the recovery of PBOP costs is not a basis to treat PBOP costs differently from the recovery of decommissioning cost.

18. Code sections that mandated a funded accrual basis of cost recovery for nuclear decommissioning were not added to the code until 5 years after we authorized energy utilities to implement an accrual basis of accounting for decommissioning costs.

19. The Nuclear Decommissioning Act did not come into existence until 3 years after utilities were authorized to fund their decommissioning cost on an accrual basis of accounting.

20. PBOP are currently being paid to retirees in a manner similar to pension benefits.

21. The funding of pensions in advance of the utility's payment of benefits is a proper cost of service.

22. The USOA Rewrite decision was applicable to only regulated telephone utilities and did not automatically adopt future GAAP changes for regulatory purpose.

23. Rate shock, as it relates to PBOPs, represent an increase of 1% or more of total operating revenue. This definitive level is not and should not be viewed as a precedent for any other proceeding.

24. Procedures can be implemented to mitigate any rate shock.

25. The basic cost of service policy dictates that the utilities should have the opportunity to recover in rates reasonable operating expenses, including PBOP costs, taxes, and a fair return on invested capital.

26. The controlling element in fixing rates is what it costs the utility to perform service.

27. The utilities have already taken steps to contain and to reduce PBOP costs.

28. Shareholder and employee funding of PBOP is not a viable funding alternative at this time.

29. Utilities need union approval to use excess pension assets of union employees for PBOP.

30. IRC § 420 provides for the limited transfer of excess pension assets to a § 401(h) account for only the years 1991 through 1995 and only if the pension plan is fully funded.

31. A majority of the utilities do not have surplus pension funds.

32. Surplus pension assets generally result from volatile changes in the investment markets which cannot be predicted with any accuracy.

33. Surplus pension assets are not a viable funding alternative for PBOP costs.

34. Cost of service is an indispensable factor in setting fair and reasonable rates for regulated service.

35. Employees do not qualify for PBOP unless they specifically provide utility service for a minimum period of time.

36. Similar to the receipt of pension benefits, employees are not entitled to receive PBOP until after they retire from utility service.

37. The longer that employees work, the less expensive the cost of PBOP paid for by ratepayers.

38. Approximately one-third of the TBO represent PBOP applicable to current retired employees.

39. Similar to pension benefits, PBOP actuarial reports would be performed on a periodic basis to reflect changes in actuarial assumptions including plan benefits, inflationary factors, and mortality rates.

40. The Statement's method of accounting for PBOP on the accrual basis of accounting meets the cost of service criterion.

41. The cash basis of PBOP recovery fails to incorporate the cost of service principle.

42. The accrual basis of revenue recovery meets the assurance criterion and provides a degree of certainty that sufficient funds will be available to pay the utilities' PBOP costs.

43. Adoption of the Statement would give the utilities flexibility to assess PBOP on an ongoing basis.

44. Employees are not earning an incremental increase in PBOP as the employees age.

45. The Statement's benefits/years-of-service method can provide for a disproportionate allocation of benefits cost over the employees' working life.

46. It is reasonable to flow through the cost of the employees' PBOP over the employees' entire working life.

47. The Statement's 20-year amortization method of TBO benefits will substantially mitigate inter-generational inequity.

48. Ratepayers would be required to pay an additional \$670,000 for every \$1 million that the utilities contribute to taxable PBOP funded plans.

49. The funding of PBOP with tax-deductible contributions enhances a balance of interest between shareholders and ratepayers.

50. The FASB allows utilities to reflect a regulatory asset in their external financial statements with the assurance that such costs will be recovered through rates in the future.

51. The SEC has not taken a policy position on what criteria should be used to determine whether a regulatory asset should be allowed.

52. Reasonable PBOP costs are defined to be those PBOP costs applicable to regulated services that meet the Statement criteria as modified by this order and are invested in tax-deductible plans administered by an independent trust, that are necessary to meet funding requirements based on fair actuarial assumptions, contributions, and investments, and that are not used to enhance pension benefits.

53. The regulatory asset will not impact the utilities' cash flow until the utilities are able to make additional tax-deductible contributions.

54. The utilities have every incentive to continue negotiating cost containment to their respective PBOP plans.

55. There are sufficient FASB, IRS, ERISA, and NLRA reporting, disclosure, and fiduciary requirements in place to ensure that funds placed in a PBOP plan will be tracked and will be used for only PBOP.

56. A Z factor was established as a component of the price cap mechanism for NRF utilities to protect both ratepayers and shareholders against exogenous events.

57. Only exogenous factors which are not reflected in the GNPPI and which are clearly beyond the utility's control can be reflected as a Z factor adjustment.

58. The first phase of this investigation authorized pre-funded PBOP contributions on a permissive basis.

59. Pacific Bell began pre-funding PBOP in December 1989, almost 2 years prior to Commission authorization and a full year prior to the FASB's adoption of the Statement.

60. Pacific Bell chose not to pre-fund PBOP in 1991 and 1992.

61. Pacific Bell will continue to pre-fund PBOP in 1992 if assurance is given that rate recovery will be provided on a timely basis.

62. The adoption of the Statement is clearly beyond the control of the utilities.

63. To the extent that the utilities incur administrative costs to comply with the accounting changes required by this decision, and recover only those sums paid to the independent trusts specifically authorized by this decision, such costs satisfy the Z factor control criterion.

64. The Z factor adjustment is necessary to reflect accrual accounting while the GNPPI reflects the changes in inflation for PBOP gross national output price increases.

65. Economic studies demonstrate that the GNPPI will not be impacted to any significant degree by adoption of the Statement.

66. It is possible that the NRF utilities may receive ancillary benefits to the detriment of ratepayers through the GNPPI wage factor with the adoption of the Statement.

67. In order to implement the Statement by January 1, 1993, this order should be effective on the date signed.

Conclusions of Law

1. Affected utilities should true-up their PBOP costs as part of their next GRC filing or price cap filing.

2. The recovery of PBOP costs for regulatory accounting and ratemaking purposes should be based on consistent cost of service policy and cost recovery mechanisms.

3. The Statement as modified by this order should be adopted for regulatory accounting and ratemaking purposes.

4. The Statement's benefits/years-of-service approach should not be adopted for regulatory accounting and ratemaking purposes unless such approach will not result in more than a 10% difference in cost over the total utility service life attribution method.

5. The utilities should use the employees' total service life attribution method to distribute the cost of employees' PBOP benefits for both the TBO and ongoing PBOP cost unless the use of the benefits/year-of-service approach results in minimal increase in costs.

6. The utilities should amortize the TBO over 20 years.

7. The utilities under traditional ratemaking and the telecommunications utilities under the NRF process should recover their PBOP costs in rates to the extent that they are able to make contributions to tax-deductible plans.

8. Commission policy should not be governed by whether or not utilities can record a regulatory asset under Statement No. 71.

9. Regulatory accounting and ratemaking should not be governed by IRS, ERISA, or SEC requirements.

10. The utilities should establish a regulatory asset for regulatory accounting purposes.

11. The recovery of tax-deductible contributions in any given year should not increase over the prior PBOP expense recovery by more than 1% of the utilities' prior year's total operating revenue for traditional cost of service regulated utilities.

12. Recovery of the regulatory asset should begin during the year when tax-deductible limits exceed PBOP costs and continue until the regulatory asset has reached a zero balance.

13. Regulatory assurance language should be included in rate orders which address rate recovery of PBOP costs.

14. Any concern regarding recovery of PBOP costs associated with future deregulated services should be addressed in the proceeding that considers deregulation of those services.

15. The PBOP regulatory asset should not be a component of rate base subject to a return on investment.

16. The utilities should establish trusts for the receipt, investment, administration, and disposition of PBOP for any PBOP funds which we may authorize the utilities to recover in rates. Earnings of such trust may be taxable to the trust or to the employees.

17. The utilities under the NRF should not be allowed to recover their pre-funded PBOP contributions through the Z factor adjustment because they have not demonstrated that funding PBOP prior to adoption of the Statement with modification was beyond their control.

18. Effective January 1, 1993 with the adoption of the Statement as modified by this order, NRF utilities should be allowed to recover reasonable costs associated with the change from cash to accrual accounting through the Z factor adjustment.

19. NRF utilities should include as part of their October 1993 price cap filing a study to demonstrate whether the wage component of the GNPPI has been affected by the Statement and should make recommendations on how such impact, if any, should be reflected in rates.

20. Yearly adjustments to the Z factor recovery for PBOP costs should be required.

O R D E R

IT IS ORDERED that:

1. The Financial Accounting Standards Board Statement of Accounting Standards No. 106 (Statement), Employers' accounting for post-retirement benefits other than pensions (PBOP), shall be adopted with the following modifications, as discussed in this order, for regulatory accounting and ratemaking purposes and shall be effective January 1, 1993, the effective date of the Statement.

- a. The employees' total service life attribution method shall be used to distribute the cost of employees' PBOP for

both the transition benefit obligation (TBO) and ongoing PBOP costs. However, if a utility can demonstrate to the Commission Advisory and Compliance Division prior to January 1, 1993 that the benefits/years-of-service approach will result in a minimal increase as defined in this order, the utility may opt for the benefits/years-of-service approach.

- b. The Statement's benefits/years-of-service approach shall not be used for regulatory accounting and ratemaking purposes unless it results in minimal increase in cost (10%) over the employees' total service life attribution method.
- c. The TBO shall be amortized over a 20-year time period beginning January 1, 1993.

2. Regulated utilities under traditional cost-of-service ratemaking and the new regulatory framework (NRF) shall be authorized to recover their PBOP costs associated with the adoption of the Statement and actually paid to independent trusts to the extent that the utilities:

- a. Establish and use independent trusts for the receipt, investment, administration, and disposition of PBOP.
- b. Make tax-deductible contributions which do not need to be grossed up by a net-to-gross multiplier. Earnings to the trust may be tax-free or taxable to the trust or employees.
- c. Use PBOP trust funds for only PBOP.
- d. Incur PBOP costs that the Commission finds are reasonable and necessary to meet funding requirements based on fair actuarial assumptions, contributions, and investments.
- e. Do not use PBOP to enhance pension benefits.

- f. Recovery of tax-deductible contributions in any given year shall not increase over the prior year's PBOP expense recovery by more than 1% of the utilities total prior year's operating revenue. For those utilities under NRF, the 1% limit shall be applied to the net changes in their annual price cap revenue base.
- g. The utilities shall, to the extent allowed by the Internal Revenue Service (IRS) and employee unions, apply surplus pension assets (as defined by the IRS) to fund their PBOP expense.

3. To the extent that PBOP trust assets cannot or are not used for PBOP obligations, then those assets shall be returned to ratepayers as allowable by law. Utility rates are hereafter made subject to refund, but only to the extent necessary to allow such a return to ratepayers of any PBOP assets that cannot be used for PBOP expenses or that have been used for other purposes.

4. The utilities shall establish and maintain a regulatory asset pursuant to Financial Accounting Standards Board's Statement No. 71 and as discussed in this order. The recovery of such regulatory asset in future rates shall begin during the year when tax-deductible limits exceed PBOP costs and shall continue until the regulatory asset has reached a zero balance.

5. The regulatory asset required by this order shall not be considered a rate base component subject to a return on investment.

6. GTE California Incorporated (GTEC) and Pacific Bell shall not be authorized to recover their pre-funded PBOP costs through the Z factor adjustment provided for under the new regulatory framework.

7. Effective January 1, 1993 GTEC and Pacific Bell shall be authorized to recover through a Z factor adjustment their PBOP costs associated with the change from cash to accrual accounting as provided for in this order. To effect this recovery in the first year, GTEC and Pacific Bell shall make a compliance filing to the

Commission Advisory and Compliance Division's Telecommunications Branch Chief no later than three business days after the date of this decision. This filing shall set forth the revenue requirement impact of this decision and the incremental surcharge adjustment necessary to recover their respective revenue requirement in the 1993 annual price cap index. Copies of this compliance filing shall be served upon I.90-07-037 and I.87-11-033 service lists. Recovery of future years PBOP cost shall be accomplished in each subsequent years price cap filing, as further described in the following ordering paragraph.

8. In addition to the requirements of Ordering Paragraph 2, NRF utilities shall recover through annual Z factor filings only the amount required to be accrued that year to cover future PBOP payments, minus their pay-as-you-go costs. Furthermore, the Z factor should only recover this amount to the extent it is actually put into a trust. The Z factor treatment of PBOP costs shall be trued up in each subsequent years' Z factor filings to ensure compliance with these requirements. Further hearings shall be held in this or other more appropriate proceeding to determine the simplest possible method for ensuring compliance with these requirements in Z factor filings without extensive litigation.

9. GTEC and Pacific Bell shall include as part of their October 1993 price cap filing a study to demonstrate whether the wage component of the Gross National Product Price Index has been affected by PBOP and to recommend how such impact, if any, should be reflected in rates.

10. Those utilities that are tracking their pre-funded PBOP contributions in an interest-bearing memorandum account pursuant to Ordering Paragraph 5 of Decision 91-07-006 shall be authorized to continue inputting interest on such contributions up to January 1, 1993, the effective date of the Statement. Interest shall not continue to accrue after the effective date of the Statement.

11. Utilities operating in other jurisdictions with their California operations being 10% or less of their total utility operations based on the four-factor method shall be exempted from the accrued PBOP requirements imposed by this order. However, for ratemaking purpose, such utilities shall be required to impute the effect of accrued PBOP, as explained in this order, as a part of future general rate filings. Such utilities shall also assume that their funding begins on January 1, 1993 and that earnings on their imputed PBOP contributions will be set at their authorized weighted cost of capital rate.

12. Pacific Gas and Electric Company's PBOP issue left open in Application (A.) 88-12-005 and Investigation (I.) 89-03-033 which was consolidated into this investigation has been resolved. Accordingly, A.88-12-005 and I.89-03-033 are no longer consolidated with this investigation.

13. This decision disposes of the issues in our PBOP investigation, except the matter addressed in Ordering Paragraph 8. Accordingly, this proceeding shall remain open.

This order is effective today.

Dated December 3, 1992, at San Francisco, California.

DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

I will file a partial dissent.

/s/ PATRICIA M. ECKERT
Commissioner

APPENDIX A

List of Appearances

Respondents: John Barker, for California American Water Company; Beck, Young, French, & Ackerman, by Jeffrey F. Beck and Sheila B. Brutoco, Attorneys at Law, for Citizens Utilities Company of California; Kenneth K. Okel and Kathleen S. Blunt, Attorneys at Law, for GTE California Incorporated; Vicki L. Thompson and David R. Clark, Attorneys at Law, for San Diego Gas & Electric Company; William A. Ettlinger, Attorney at Law, for AT&T Communications, Inc.; E. Garth Black, Attorney at Law, for Roseville Telephone Company; Orrick, Herrington & Sutcliffe, by Robert Gloistein, Attorney at Law, for Contel of California, Inc.; Robert B. Keeler and John R. Fallon, Attorneys at Law, for Southern California Gas Company; Richard S. Jarrett, for CP National; Robert M. Johnson, Attorney at Law, for Southwest Gas Corporation; Daniel J. McCarthy and Gregory L. Castle, Attorneys at Law, for Pacific Bell; Roger J. Peters, Kermit R. Kubitz, and Gary P. Encinas, Attorneys at Law, for Pacific Gas and Electric Company; Richard K. Durant, Carol B. Henningson, M. D. McDonald, and Frank A. McNulty, Attorneys at Law, for Southern California Edison Company; Robert A. Loehr, Attorney at Law, and Fred R. Meyer, for San Jose Water Company; and James D. Salo, Attorney at Law, for Sierra Pacific Power Company; Stoel, Rives, Boley, Jones & Grey, by Robert V. Sirvaitis and James C. Paine, Attorneys at Law, for Pacific Power & Light Company.

Interested Parties: Brown, Bridgman Retiree Health Care Group, by Stanley H. Clow and Fred D. Van Remortel; Nossaman, Guthner, Knox & Elliott, by Jose E. Guzman, Jr., Attorney at Law, for Westport Management Services, Inc.; Thomas Long and Michel Florio, Attorneys at Law, for Toward Utility Rate Normalization; and Norman J. Furuta, Attorney at Law, for the Department of Navy and Federal Executive Agencies.

Division of Ratepayer Advocates: James S. Rood and Rufus G. Thayer, Attorneys at Law, and Mark Loy.

(END OF APPENDIX A)