

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



June 18, 2014

**Advice Letters:
2555-G/2521-E
2555-G-A/2521-E-A**

Brian Cherry
Vice President, Regulation and Rates
Pacific Gas and Electric Company
P.O. Box 770000
San Francisco, CA 94177

**SUBJECT: 2003 HEADROOM CALCULATION COMPLYING WITH BANKRUPTCY
SETTLEMENT DECISION AND ACCOUNTING FOR CERTAIN EXECUTIVE
COMPENSATION COMPLYING WITH 2003 GENERAL RATE CASE DECISION**

Dear Mr. Cherry:

Advice Letters 2555-G/2521-E and 2555-G-A/2521-E-A are effective July 24, 2004, subject to the requirements of CPUC Resolution E-4647, dated June 12, 2014.

Sincerely,

A handwritten signature in cursive script that reads "Edward Randolph".

Edward Randolph
Director, Energy Division

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**RESOLUTION E-4647
June 12, 2014**

R E S O L U T I O N

Resolution E-4647. Pacific Gas and Electric Company (PG&E) presents its 2003 headroom calculation and accounting, in compliance with Decision (D.) 03-12-035; provides information on its accounting for the senior executive retention program pursuant to Ordering Paragraph 11 of D.04-05-055; and seeks approval to revise the name of the revised Utility Generation Balancing Account (UGBA) to the Generation Revenue Adjustment Mechanism (GRAM).

PROPOSED OUTCOME:

- No adjustments need to be made to PG&E's 2003 headroom account entries;
- Shareholders and not ratepayers paid for PG&E's senior executive retention program;
- PG&E shall propose a method to allocate 2004 refunds recorded in the headroom account to distribution and transmission customers;
- PG&E is authorized to revise the name of the UGBA to the GRAM.

SAFETY CONSIDERATIONS:

- Pursuant to Public Utilities Code Section 451, PG&E must take all actions necessary to promote the safety, health, comfort, and convenience of utility patrons, employees, and the public.

ESTIMATED COST:

- None.

By Advice Letter 2555-G/2521-E filed on June 14, 2004, and Supplemental Advice Letter 2555-G-A/2521-E-A filed on December 30, 2004.

SUMMARY

This resolution resolves PG&E's advice letter regarding its headroom account. The advice letter was filed in 2004, and Energy Division has not been able to address advice letter until now. All the funds that were recorded in the account were returned to customers by the end of 2006. This resolution resolves an issue raised by the Alliance for Retail Energy Markets (AReM) about the allocation of funds recorded in the account in 2004.

As part of the restructuring of the electric industry, the California Public Utilities Commission (CPUC or Commission) adopted the concept of headroom in D.96-12-076. That decision defined headroom as the difference between recovered revenues at the 1996 frozen rate levels and the reasonable costs of providing utility services, or the authorized revenue requirement. Headroom was to be used to offset competition transition costs.

Headroom was further defined in Decision (D.) 03-12-035 in the CPUC's PG&E Bankruptcy Investigation (I.02-04-026). PG&E was not allowed to include bankruptcy-related costs, litigation costs or any other costs of PG&E Corporation or of any other PG&E affiliate in the determination of the 2003 headroom amount nor may any retention bonuses of PG&E's directors, officers, managers or any other employees be included in such a determination.

D.04-05-055 in PG&E's 2003 general rate case required CPUC staff to audit PG&E's Senior Executive Retention Program established in December 2000 to ensure that it was funded by shareholders, not ratepayers. This resolution determines that:

- PG&E calculated 2003 headroom in compliance with D.03-12-035 in the CPUC's PG&E Bankruptcy Investigation. No adjustments need to be made to PG&E's 2003 headroom account entries. The 2003 excess headroom revenues of \$118 million as calculated by PG&E have been returned to PG&E's customers who paid generation rates in compliance with CPUC directives.
- The CPUC staff audit required by D.04-05-055 in PG&E's 2003 general rate case finds that PG&E's Senior Executive Retention Program established in December 2000 was funded by shareholders, not ratepayers.

- PG&E is directed to consult with AReM which protested the advice letter addressed by this resolution. After consulting with AReM, PG&E shall file a Tier 2 advice letter to propose a method to reallocate \$64 million in refunds that were recorded in the Headroom Account in 2004 and were credited to customers who paid generation rates, to distribution and transmission customers.
- PG&E is authorized to revise the name of the Utility Generation Balancing Account to the Generation Revenue Adjustment Mechanism.

BACKGROUND

The California Public Utilities Commission adopted the Modified Settlement Agreement (MSA) in D.03-12-035 resolving issues in PG&E's bankruptcy proceeding.

PG&E filed for bankruptcy protection in April 2001 as a result of the financial difficulty it faced during the electricity crisis of 2000 and 2001. In September 2001 PG&E and PG&E Corp, its co-proponent in the U.S. Bankruptcy Court for the Northern District of Ca., filed a plan of reorganization in PG&E's bankruptcy case. The CPUC opposed PG&E's plan and the CPUC filed its own plan in the case followed by an amended plan filed jointly with the Official Creditors Committee. The Bankruptcy Court subsequently facilitated a mandatory settlement process and this effort resulted in the Proposed Settlement Agreement (PSA) between PG&E, PG&E Corp. and CPUC staff. In December 2003 the Bankruptcy Court issued a Memorandum approving a Settlement Plan which embodied the terms and conditions of the PSA, but did not issue a Confirmation Order pending action taken by the CPUC.

The CPUC considered the PSA in I.02-04-026, the proceeding that addressed the ratemaking implications of the CPUC's plan of reorganization for PG&E. In D.03-12-035 the CPUC adopted the Modified Settlement Agreement (MSA), revising portions of the PSA.

The Commission adopted the concept of headroom in D.96-12-076, which was defined as the difference between revenues at the 1996 frozen rate levels and the utility's reasonable costs of service and was to be used to offset competition transition costs. D.03-12-035 in the PG&E Bankruptcy Investigation further defined headroom.

D.96-12-076 in the Electric Restructuring proceeding defined headroom as the difference between a utility's revenue at frozen rate levels, and the utility's reasonable costs of providing service, or the utility's authorized revenue requirement. Headroom as defined in that proceeding was to be used to offset competition transition costs. As described below, the specifics of the headroom were further defined in D.03-12-035 in the PG&E Bankruptcy Investigation.

D.03-12-035 established 2003 "headroom" levels, associated ratemaking, and constraints on what may be included in headroom.

The MSA adopted by D.03-12-035 provided that "headroom" revenues accrued by PG&E during 2003 must not exceed \$875 million on a pre-tax basis. The MSA required that PG&E refund to customers any headroom greater than \$875 million (excess headroom).

D.03-12-035 adopted the PSA's definition of headroom, i.e., "Headroom' means PG&E's total net after-tax income reported under Generally Accepted Accounting Principles, less earnings from operations, plus after-tax amounts accrued for bankruptcy-related administration and bankruptcy-related interest costs, all multiplied by 1.67, provided that the calculation will reflect the outcome of PG&E's 2003 general rate case."¹

D.03-12-035 acknowledged that the PSA definition differs from the CPUC's definition of headroom as stated in D.96-12-076 in the Electric Restructuring proceeding R.94-04-031/I.94-04-032, i.e., "In general, headroom revenues consist of the difference between recovered revenues at the frozen rate levels (including the reduced rate levels for residential

¹ D.03-12-035, section VI.C.2. D.03-12-035 adopted the PSA definition with the clarification that it is not intended to and does not affect the Department of Water Resource's rights under AB 1X (2001), or the Rate Agreement between the Commission and DWR.

and small commercial customers beginning in 1998) and the reasonable costs of providing utility services, which for convenience we refer to as the authorized revenue requirement. (70 CPUC 2d at 223)”²

D.03-12-035 required that PG&E demonstrate to the CPUC that it has fairly and accurately accounted for headroom when implementing the MSA.³ Ordering Paragraph (OP) 4 of D.03-12-035 required that for purposes of calculating headroom for 2003 in no event may the litigation costs, bankruptcy-related costs or any other costs of PG&E Corporation or of any other PG&E affiliate be included in the determination of the headroom amount nor may any retention bonuses of PG&E’s directors, officers, managers or any other employees be included in such a determination.

D.04-02-062 reduced PG&E’s electric rates in 2004; part of the rate reduction arose from returning \$95 million in excess headroom revenues to customers.

D.03-12-035 contemplated that PG&E’s electric rates would decline in 2004 eliminating the collection of additional headroom.⁴ D.04-02-062 in I.02-04-026 adopted a settlement agreement that reduced PG&E’s electric revenues and rates. PG&E’s revenue requirements were reduced by approximately \$799 million or 8%. The revenue decrease resulted in a rate reduction effective March 1, 2004 implemented by advice letter (AL) 2465-E and supplements to that advice letter. AL 2465-E shows that the revenue decrease included a \$95 million reduction associated with 2003 headroom revenues in excess of the \$875 million limit set forth in the MSA.⁵ \$95 million was PG&E’s preliminary estimate of excess 2003 headroom revenues.

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ Headroom revenues in excess of \$875 million were returned to bundled service customers through a reduction in generation rates. See PG&E’s AL 2465-E-B which was approved effective January 1, 2004 in compliance with D.04-02-062.

Resolution E-3862 established PG&E's Headroom Account and eliminated the Transition Revenue Account.

PG&E filed AL 2510-G/2460-E on December 31, 2003 to make tariff changes necessary to implement the MSA adopted by D.03-12-035. Resolution E-3862 dated April 1, 2004 addressed this advice letter and established new regulatory accounts, including the Headroom Account (HA). The HA was created effective January 1, 2004 to record 2003 headroom revenues.

The Transition Revenue Account (TRA) was an accounting mechanism established by the CPUC during electric restructuring to track the difference between actual billed revenues and PG&E's authorized revenue requirements.⁶ Resolution E-3862 eliminated the TRA effective January 1, 2004, and required that any credit amount authorized by the Commission for the TRA after December 31, 2003 be credited to the HA, unless otherwise authorized by the CPUC.

D.04-05-055 in PG&E's 2003 general rate case addressed the Senior Executive Retention Program and required an audit to assure that payments made under the program were not borne by ratepayers.

In December 2000 PG&E Corporation adopted a Senior Executive Retention Program (SrERP) to retain key officers of PG&E Corp., PG&E, and PG&E's affiliate. In January 2004, PG&E Corp. awarded \$84.5 million in retention bonuses to 17 executives.

D.04-05-055 in PG&E's 2003 test year general rate case (GRC) A.02-11-017, determined that the SrERP expenses are ineligible for recovery from ratepayers via existing rates, the test year 2003 revenue requirement or rates, headroom, the regulatory asset, or any other ratemaking tools that involve ratepayer funds.⁷ OP 11 of D.04-05-055 required accounting measures to ensure that the SrERP awards were not, are not, and will not be charged to ratepayers, and required that PG&E file an advice letter regarding its compliance with OP 4 of D.03-12-035, concerning 2003

⁶ See Resolution E-3514, December 16, 1997.

⁷ D.04-05-055, Section 10.3.3.2. The regulatory asset was a separate and additional part of PG&E's rate base created by the MSA.

headroom. This decision also required CPUC staff to audit the accounting and treatment of the SrERP awards to be reported in the advice letter.

PG&E filed AL 2555-G/2521-E to comply with D.03-12-035 and D.04-05-055.

PG&E filed Advice Letter (AL) 2555-G/2521-E on June 14, 2004 to provide its 2003 headroom calculations in compliance with D.03-12-035. PG&E also provided in this advice letter information on its accounting of SrERP awards in compliance with D.04-05-055.

PG&E's 2003 headroom revenue recorded in the HA and presented in the advice letter was \$993.2 million, \$118.2 million more than the \$875 million headroom limit established by the MSA.

PG&E proposed in AL 2555-G/2521-E to use the Headroom Account to refund \$64.1 million in electric distribution and transmission revenues collected in 2004.

PG&E also proposed in AL 2555-G/2521-E that the HA be used solely as a procedural vehicle to refund \$64.1 million in additional revenues to customers collected in 2004. The \$64.1 million was comprised of:

- \$51.8 million in over-collected electric revenue requirements for post-retirement benefits other than pensions (PBOP) accrued during the 1999 through 2002 GRC cycle. PG&E noted in AL 2555-G/2521-E that Resolution G-3362, dated March 16, 2004, approved PG&E's request filed in AL 2432-E to credit this amount to the TRA, and that Resolution E-3862 eliminated the TRA and provided that amounts authorized by the Commission to be recorded in the TRA after December 31, 2003, should be recorded to the HA.
- A \$7.2 million credit to ratepayers resulting from an August 28, 2003, Federal Energy Regulatory Commission (FERC) order in PG&E's Transmission Owner (TO)3 rate case. PG&E requested in AL 2458-E that this amount be reflected in the TRA. Energy Division made AL 2458-E effective in January 2004. Consistent with Resolution E-3862, PG&E proposed that this refund be made through the HA.
- A \$5.1 million refund required by FERC Order 470, dated March 9, 2004, in PG&E's TO6 rate case.

Pursuant to Resolution E-3906 on PG&E's 2005 annual electric true-up, PG&E supplemented AL 2555-G/2521-E to propose revisions to its Headroom Account tariff to specify that the account would be used to return the 2004 electric distribution and transmission revenues to customers.

PG&E submitted supplemental AL 2555-G-A/2521-E-A on December 30, 2004 to revise the purpose section of the HA tariff to specify that the account is also used to make the 2004 refunds listed above. PG&E originally proposed these tariff changes in its annual electric true-up (AET) advice letter, AL 2570-E which addressed consolidated electric revenue and rate changes effective January 1, 2005. Resolution E-3906 dated December 16, 2004 addressed AL 2570-E and required PG&E to resubmit the tariff changes as a supplement to AL 2555-G/2521-E.

PG&E also requested approval in AL 2555-G/2521-E to revise the name of the Utility Generation Balancing Account (UGBA) authorized in Resolution E-3822 to the Generation Revenue Adjustment Mechanism (GRAM).

PG&E also proposed in AL 2555-G/2521-E to change the name of the UGBA to the GRAM. According to PG&E, this would allow the current UGBA to be clearly distinguished from an UGBA previously adopted in D.02-04-016 that addressed utility retained generation (URG). The current UGBA is a revenue adjustment mechanism which assures that PG&E recovers its authorized generation revenue requirement regardless of sales fluctuations. Changing the name of this account will in no way change the function, or entries made to the account. The previous UGBA, which has been closed, tracked the difference between PG&E's 2002 retained generation revenue requirement adopted in D.02-04-016 and PG&E's actual generation costs.

NOTICE

Notice of AL 2555-G/2521-E was made by publication in the Commission's Daily Calendar. PG&E stated that a copy of the AL was mailed and distributed in accordance with Section III-G of General Order 96-A. PG&E also served the advice letter on the service lists for the Commission's bankruptcy investigation, I.02-04-026, and PG&E's 2003 GRC, A.02-11-017.

PROTESTS

The Alliance for Retail Energy Markets protested AL 2555-G-A/2521-E-A on the grounds that the 2004 refunds PG&E proposed to include in the HA should be provided to both bundled and direct access customers.

On January 19, 2005 Alliance for Retail Energy Markets (AReM) protested supplemental AL 2555-G-A/2521-E-A regarding PG&E's proposed tariff changes to the HA to include the 2004 refunds in the account.⁸

AReM protested PG&E's proposal to use the HA to refund to customers the \$64.1 million received in 2004 associated with the PBOP overcollection and the refunds in the FERC TO3 and TO6 cases. AReM noted that these revenues were originally collected through transmission and distribution charges paid by bundled and direct access (DA) customers. AReM asserted that the HA is a subcomponent of PG&E's generation rates and DA customers would not receive any share of the refunded revenues. AReM recommended that the Commission reject PG&E's proposal to credit these revenues to the HA and require PG&E to create a new account to credit the refunds to customer classes in the manner that the overcharges were initially collected.

In reply to AReM's protest PG&E stated that it would credit the 2004 refunds recorded in the HA to the appropriate customer classes.

PG&E replied to AReM's protest on January 26, 2005. PG&E stated that it anticipated it will credit refunds to customer classes in the manner that the revenues were initially collected. PG&E stated that the proposed revisions to the HA do not dictate that revenues to be refunded must be provided only to bundled customers.

PG&E also stated that the TO3 and TO6 refund amounts cannot be refunded only to bundled customers since all customers paid transmission costs, and these amounts would be amortized as adjustments to

⁸ Resolution E-3906 established that the supplement would not be subject to protests since AL 2570-E where PG&E originally proposed these tariff changes was not protested, and AL 2555-G/2521-E which provided notice of PG&E's intent to use the HA for the 2004 refunds was not protested. AReM filed an application for modification of Resolution E-3906 to allow protests on the supplement. D.05-05-003 granted AReM's application.

transmission rates in proportion to customers' payment for transmission services. PG&E proposed that the PBOP refund be returned to distribution customers (which include DA customers) by crediting this amount to PG&E's distribution revenue adjustment mechanism (DRAM). PG&E stated that it anticipated the very issue AReM raised, and that the issue can be easily addressed by making sure that the different components of the HA are refunded to different categories of customers, as appropriate. According to PG&E no additional balancing accounts are necessary.

DISCUSSION

PG&E calculated the 2003 headroom in compliance with D.03-12-035 in the CPUC's PG&E Bankruptcy Investigation. No adjustments need to be made to PG&E's 2003 headroom account entries.

PG&E presented its headroom revenues recorded as of December 21, 2003 in AL 2555-G/2521-E in compliance with D.03-12-035. No adjustments need to be made to the 2003 head room revenues as presented by PG&E in its advice letter.

CPUC staff's audit of PG&E's Senior Executive Retention Program confirms that ratepayers did not bear any of the program cost.

Attached to this resolution, as an appendix, is an audit report by CPUC staff of PG&E's Senior Executive Retention Program (SrERP). The audit which was conducted in 2005 finds that PG&E's ratepayers did not bear any of the cost of the SrERP program.

PG&E returned to bundled service customers, the 2003 excess headroom balance of \$118 million.

In compliance with D.04-02-062, PG&E reduced electric revenue requirements and rates by \$799 million effective March 1, 2004 to implement rate reductions contemplated in D.03-12-035 which approved the MSA in PG&E's bankruptcy proceeding. As noted above the \$799 million reduction included a credit of \$95 million in excess headroom revenues that was recorded in the HA in 2003. The \$95 million figure represented PG&E initial estimate of the headroom revenues in excess of \$875 million that D.03-12-035 required PG&E to return to customers.

In 2004 PG&E began filing its annual electric true-up (AET) advice letters to consolidate electric revenue requirements and rates effective on January 1 of the following year. The consolidated revenue requirements included in the AET advice letters include balances in various balancing accounts.

The HA was among the balancing accounts which were amortized in electric rates in compliance with resolutions addressing AET advice letters.

Pursuant to CPUC Resolutions E-3906 and E-3956 which consolidated electric revenue requirements and rates effective January 1, 2005 and January 1, 2006, respectively, PG&E returned to bundled service customers, the remaining amounts accrued in the HA in 2003 in excess of \$875 million.

In compliance with Resolution E-3956 PG&E returned to bundled service customers the \$64 million associated with the distribution and transmission-related refunds that were collected in 2004 and recorded in the HA subject to the outcome of AL 2521-E/2521-E-A. PG&E concurred that the refunds recorded in the HA in 2004 for over-collected post-retirement benefits (other than pensions accrued during the 1999-2002 GRC cycle), and that transmission-related refunds recorded in the account should be provided to customers who paid distribution and transmission rates, respectively.

In September 2005 PG&E filed AET AL 2706-E to consolidate electric revenue requirements and rates effective January 1, 2006. In that advice letter PG&E noted that while the balance in the HA had to date been refunded to bundled service customers through lower generation rates, the customers who should receive the refunds recorded in the HA in 2004 for over-collected revenue requirements for post-retirement benefits other than pensions accrued during the 1999-2002 GRC cycle are those who paid distribution rates in that time frame. PG&E additionally stated that the electric transmission refunds recorded in the HA in 2004 should be provided to customers paying electric transmission rates. PG&E also stated that it intended to request CPUC authority via a supplement to AL 2521-E to adjust the HA accounting for 2004 and remove the PBOP refund from the HA and record it in the distribution revenue adjustment mechanism, remove the TO6 refund from the HA and record it in the end-use customer refund adjustment mechanism applicable to transmission rates, and reallocate the TO3 refund from generation to transmission customers.⁹

⁹ PG&E AL 2706-E, pp. 16-17.

In November 2005 PG&E submitted comments on draft resolution E-3956 which addressed PG&E's AET AL 2706-E. In those comments PG&E recommended that the remaining balance in the HA be amortized on January 1, 2006, and stated that it no longer proposed the accounting and rate design changes for the 2004 PBOP, TO3, and TO6 refunds it had initially proposed in AL 2706-E as described above. Instead PG&E now proposed that the 2004 refunds remain in the HA, subject to true-up in future AET filings.¹⁰

Resolution E-3956 adopted by the CPUC on December 15, 2005 approved PG&E's proposal to amortize the HA balance as set forth in PG&E's November 2005 comments. The resolution stated that the calculation of the HA amount remains subject to the outcome of AL 2521-E/-E-A.¹¹ In compliance with Resolution E-3956, PG&E amortized the 2004 PBOP, TO3, and TO6 refunds through the HA, and these refunds have been returned to bundled service customers pending disposition of AL 2521-E/-E-A which is the subject of this resolution.

We direct PG&E to consult with AReM and to propose a method to reallocate to distribution and transmission customers, the refunds that were recorded in the HA in 2004 and returned to bundled service customers through generation rates pursuant to Resolution E-3956 which stated that the final disposition of the refunds was subject to the outcome of AL 2521-E/-E-A.

As described above, PG&E anticipated that the one distribution-related refund, and two transmission-related refunds that were recorded in the HA in 2004 would be returned to customers through distribution and transmission rates, which is the proper way to return those refunds. This is clear from PG&E's reply to AReM's protest, and from PG&E's discussion in AL 2706-E described above.

¹⁰ PG&E's November 16, 2005 comments on draft resolution E-3956, Section I, pp. 1, 2.

¹¹ Resolution E-3956, Comments Section, p. 13.

Resolution E-3956 granted PG&E's request, submitted in comments on the draft of that resolution, to leave the 2004 refunds in the HA and to amortize those amounts through a credit to generation rates subject to the outcome of AL 2521-E/-E-A.

In resolving AL 2521-E/-E-A by this resolution we require PG&E to now develop a proposal to reallocate to distribution and transmission customers the 2004 refunds that were amortized through the HA and credited only to bundled service customers. PG&E's proposal shall include interest, which is to be calculated at the three-month commercial paper rate, associated with the \$64.1 million in 2004 dollars that was returned only to bundled service customers through a reduction to generation rates, and now must be reallocated to customers who pay distribution and transmission rates. PG&E shall develop this proposal in consultation with AReM. Ideally, PG&E and AReM will agree upon a proposal to reallocate these refunded amounts.

After consulting with AReM, PG&E shall file its proposal in a Tier 2 advice letter no later than sixty days from the effective date of this resolution. AReM's protest on PG&E's AL 2521-E-A is granted in so far as the protest asserted that the refunds recorded in the HA in 2004 should be returned to electric distribution and transmission customers.

PG&E is authorized to change the name of the Utility Generation Balancing Account to the Generation Revenue Adjustment Mechanism.

PG&E is authorized to change the name of the Utility Generation Balancing Account to the Generation Revenue Adjustment Mechanism. If PG&E decides to change the name of the account, it shall file a Tier 1 advice letter within 20 days of today's date with revised tariffs specifying the name change.

COMMENTS

Public Utilities Code section 311(g)(1) generally requires resolutions to be served on all parties and subject to at least 30 days public review and comment prior to a vote of the CPUC. Accordingly, the draft resolution was served on PG&E and AReM and issued for public review and comment no later than 30 days prior to a vote of the CPUC.

PG&E and AReM submitted comments in support of the draft resolution.

FINDINGS AND CONCLUSIONS

1. CPUC Decision (D.) 03-12-035 resolved ratemaking issues regarding PG&E's emergence from bankruptcy and required that PG&E refund to customers 2003 headroom revenues in excess of \$875 million.
2. Headroom revenues were recorded in the Headroom Account (HA) established by Resolution E-3862.
3. 2003 headroom revenues in excess of \$875 million were returned to bundled service customers through a reduction in generation rates.
4. CPUC D.04-05-055 in PG&E's 2003 general rate case adopted accounting and reporting measures to ensure that the \$84.5 million in Pacific Gas and Electric Corporation Senior Executive Retention Program (SrERP) awards were not charged to ratepayers.
5. D.04-05-055 directed PG&E to file and serve an advice letter regarding compliance with OP 4 of D.03-12-035 which states that for the purpose of calculating the headroom for 2003 in no event may the litigation costs, bankruptcy related costs or any other costs of PG&E Corporation or of any other PG&E affiliate be included in the determination of the headroom amount nor may any retention bonuses of PG&E's directors, officers, managers or any other employees be included in such a determination.
6. D.04-05-055 also required that CPUC staff audit PG&E's SrERP program to ensure that the SrERP awards were not charged to ratepayers.
7. PG&E filed Advice Letter (AL) 2555-G/2521-E in June 2004 in compliance with D.04-05-055, to provide its 2003 headroom calculations as required by D.03-12-035.
8. In the same AL, PG&E also proposed to use the Headroom Account (HA) as a procedural vehicle to refund to ratepayers amounts recorded in the HA in 2004 which included \$51.8 million in over-collected electric revenue requirements for post-retirement benefits other than pensions (PBOP) accrued during the 1999-2002 GRC cycle, a \$7.2 million credit resulting from an order by the Federal Energy Regulatory Commission (FERC) in PG&E's Transmission Owner (TO)3 rate case and a \$5.1 million refund in PG&E's TO6 rate case ordered by FERC Order 470.

9. PG&E also sought approval in AL 2555-G/2521-E to change the name of the Utility Generation Balancing Account (UGBA) to the Generation Revenue Adjustment Mechanism (GRAM).
10. PG&E filed supplemental AL 2555-G-A/2521-E-A in December 2004 pursuant to Resolution E-3906 to propose tariff revisions to the HA which specified that the HA would be used to return to customers the refunds recorded in the HA in 2004 associated with over-collected revenues for PBOPs accrued during the 1999-2002 GRC cycle, the credit ordered by FERC in PG&E's TO3 FERC rate case, and the refund ordered by FERC Order 470 in PG&E's TO6 rate case.
11. On January 19, 2005 the Alliance for Retail Energy Markets (AReM) protested supplemental AL 2555-G-A/2521-E-A regarding PG&E's inclusion of the 2004 refunds in the HA. AReM asserted that the HA is a subcomponent of generation rates, and that PG&E should be required to create a new account to credit the 2004 refunds to the customer classes that paid transmission and distribution charges in the manner that the overcharges were initially collected.
12. PG&E replied to AReM's protest on January 26, 2005, and stated that its proposal to include the 2004 refunds in the HA does not dictate that these revenues be refunded only to bundled service customers. PG&E stated in its reply that it anticipated the issue that AReM raised in its protest and can easily be addressed by making sure that different components of the HA are refunded to different categories of customers as appropriate.
13. The 2003 Headroom Account balance presented by PG&E in AL 2555-G/2521-E complies with D.03-12-035, and no adjustments to the balance are necessary.
14. CPUC staff audited PG&E's Senior Executive Retention Program (SrERP) in compliance with D.04-05-055 in PG&E's 2003 GRC, and the audit determined that PG&E's ratepayers did not pay any of the costs associated with the SrERP.
15. PG&E has returned to bundled service customers the 2003 excess headroom balance recorded in the HA.

16. In compliance with Resolution E-3956, PG&E returned to bundled service customers through a reduction to generation rates the distribution and transmission related refunds that were recorded in the HA in 2004, subject to the outcome of AL 2521-E/E-A which is addressed by this resolution.
17. The 2004 distribution- and transmission-related refunds that were recorded in the HA and returned to bundled service customers through generation rates, subject to the outcome of AL 2521-E/E-A, should be reallocated to distribution and transmission customers.
18. After consulting with AReM, PG&E should file a Tier 2 advice letter by December 31, 2014 which includes a proposal on how to reallocate to distribution and transmission customers, with interest, the \$64.1 million recorded in the HA in 2004.
19. PG&E should be authorized to change the name of the Utility Generation Balancing Account to the Generation Revenue Adjustment Mechanism.

THEREFORE IT IS ORDERED THAT:

1. PG&E's calculation of the 2003 headroom amount as shown in Advice Letter 2555-G/2521-E is approved.
2. PG&E's request in AL 2555-G-A/2521-E-A to modify the Headroom Account (HA) tariff to specify that the account will be used to implement three refunds to customers that occurred in 2004 is approved, as clarified below in this order.
3. The three refunds that were recorded in the HA in 2004 and returned to bundled service customers through generation rates pursuant to Resolution E-3956 subject to the outcome of PG&E's AL 2521-E/E-A which is resolved herein, shall be reallocated with interest calculated at the three-month commercial paper rate, to distribution and transmission customers.
4. PG&E shall consult with the Alliance for Retail Energy Markets (AReM) on a method to reallocate the refunds recorded in the HA in 2004 with interest to distribution and transmission customers.

5. After consulting with AReM and no later than sixty days from the effective date of this resolution, PG&E shall file a Tier 2 advice letter with a proposal to reallocate the refunds recorded in the HA in 2004 with interest to distribution and transmission customers. PG&E shall serve the advice letter on AReM and on PG&E's General Order 96-B advice letter service list.
6. PG&E is authorized to rename the Utility Generation Balancing Account (UGBA) to the Generation Revenue Adjustment Mechanism (GRAM). If PG&E decides to change the name of the UGBA to the GRAM it shall file a Tier 1 advice letter within 20 days of the effective date of this order to modify its tariffs to reflect the name change.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on June 12, 2014; the following Commissioners voting favorably thereon:

/s/ PAUL CLANON
PAUL CLANON
Executive Director

MICHAEL R. PEEVEY
President
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
CARLA J. PETERMAN
MICHAEL PICKER
Commissioners

APPENDIX

Pacific Gas and Electric Corporation Senior Executive Retention Program (SrERP) Audit

The California Public Utilities Commission (Commission) staff's audit concurs with Pacific Gas and Electric Company (PG&E) that ratepayers did not bear any of the Senior Executive Retention Program (SrERP) payments, including through a reduction in headroom. SrERP costs were also not included in PG&E's 2003 general rate case (GRC) revenue requirement.

Commission Staff Audited Pacific Gas and Electric Company's Payment for the Senior Executive Retention Program

This report presents the Commission staff audit findings of PG&E's payment for the SrERP. Ordering Paragraph (OP) 11b of Decision (D.) 04-05-055 in PG&E's 2003 GRC Application (A.) 02-11-017 required Commission staff to audit PG&E's payments under the SrERP.

Under Pacific Gas and Electric Corporation's (PG&E Corporation) SrERP program, retention grants were issued to 17 senior officers. These senior officers were comprised of senior executives of PG&E Corporation, PG&E, and of PG&E Corporation's subsidiary.

A total SrERP expense of \$84.5 million was paid out in 2004.

Commission Staff's Audit Findings Concur with PG&E that SrERP Payments Were Not Borne by Ratepayers

PG&E Corporation paid a total of \$84.5 million to 17 senior executives in 2004 through its SrERP program. PG&E Corporation invoiced its subsidiaries, including PG&E, for direct and allocated charges in 2001, 2002, and 2003. PG&E's portion of the \$84.5 million was \$53.2 million.

Of PG&E's \$53.2 million total SrERP payment, the 2003 year payment of \$38 million was adjusted to a "below-the-line" account (i.e., generally not eligible for recovery from ratepayers). As such, PG&E's 2003 payment was fully borne by shareholders.

PG&E's 2001 and 2002 SrERP payments were not adjusted and remained in an "above-the-line" account, i.e., Account 923 in which administrative and general expenses for outside services are recorded. Costs recorded in above-the-line accounts are generally eligible for recovery from ratepayers.

D.04-05-055 raised the concern that recording the SrERP expense in an above-the-line account reduced headroom, and could result in less headroom for ratepayer benefit. D.04-05-055 states that during the rate freeze initiated by electric restructuring in 1998, headroom was the difference between revenues at frozen rate levels and "actual costs of providing service" (D.04-05-055, section 10.3.3.1). As discussed below, the term "actual costs of providing service" used in this context means the utility's authorized revenue requirement. Because authorized revenue requirement was used to calculate headroom, the actual recorded expenses did not have any impact on headroom for 2001 and 2002.

Additionally, no SrERP expenses that PG&E recorded in Account 923 were included in its 2003 GRC revenue requirement or were used to support PG&E's GRC request. As such, PG&E's SrERP payments in 2001 and 2002 were not borne by ratepayers.

Ordering Paragraph 11 of D.04-05-055 Established Accounting and Reporting Measures to Ensure that Ratepayers Do Not Bear the Cost of the SrERP

OP 11 of Decision 04-05-055 established accounting and reporting measures to ensure that the \$84.5 million in SrERP awards were not, are not, and will not be charged to ratepayers.

OP 11(a) of D.04-05-055 ordered that PG&E file and serve an advice letter regarding compliance with OP 4 of D.03-12-035. D.03-12-035 resolved issues in I.02-04-026 addressing the ratemaking implications of PG&E's Plan of Reorganization in its bankruptcy court case. OP 4 of D.03-12-035

required among other things that retention bonuses of PG&E's directors, officers, managers or any other employees be excluded for purposes of calculating headroom for 2003. OP 11(a) of D.04-05-055 also required that the advice letter show:

- Adjustments to Account 923 for 2001 and 2002 to reverse accruals for the SrERP;
- The accounting of all SrERP payments, including those made in January 2004 (even if cash distributions were deferred), to demonstrate that the payments were and are not charged to ratepayers; and
- Anything else reasonably necessary to ensure that ratepayers have not paid, and will not pay, any portion of the \$84.5 million in SrERP expenses.

OP 11(b) of D.04-05-055 ordered that the CPUC Executive Director direct Commission staff to audit the accounting and treatment of the \$84.5 million as reported in the advice letter or supplemental advice letter.

This audit report meets the OP 11(b) mandate. It addresses PG&E's Advice Letter (AL) 2555-G/-G-A/2521-E/-E-A filed in compliance with OP 11(a) of D.04-05-055.

The Scope of the Audit was Limited to PG&E's SrERP Payment

The scope of the audit ordered by OP 11(b) was limited to "...the accounting and treatment of the \$84.5 million as reported in the advice letter or supplemental advice letter...."

The objective of the audit was to verify that the \$84.5 million in SrERP payment was borne by shareholders.

Commission staff's Audit was a Compliance Audit

The audit to verify PG&E's SrERP payment is a regulatory compliance audit. Standards used were those that enabled staff to accomplish its objectives. The following procedures were generally employed:

1. Review D. 04-05-055, with focus on sections pertaining to the SrERP.

2. Review PG&E's AL 2555-G/-G-A/2521-E/-E-A filed in compliance with OP 11 of D.04-05-055 in PG&E's 2003 GRC proceeding.
3. Review "Report to the California Public Utilities Commission Regarding Executive Compensation and Bonuses" submitted by PG&E in response to the "Administrative law Judges' Ruling Setting Aside Submission and Taking Further Evidence Regarding Executive Compensation and Bonuses" issued February 3, 2004, by Administrative Law Judges (ALJs) Julie M. Halligan and Burton W. Mattson in A.02-11-017.
4. Review "Supplemental Report of Pacific Gas and Electric Company Providing Further Information on Accounting for Executive Compensation and Bonuses" submitted by PG&E in response to the "Administrative law Judges' Ruling Requesting Further Information on Accounting for Executive Compensation and Bonuses" issued February 23, 2004, by ALJs Julie M. Halligan and Burton W. Mattson in A.02-11-017.
5. Analyze PG&E provided supporting documentations.
6. Interview PG&E staff.

PG&E Corporation Adopted a Senior Executive Retention Program

In December 2000, the Nominating and Compensation Committee (now known as the Nominating, Compensation, and Governance Committee of PG&E Corporation (Committee)) adopted the PG&E Corporation SrERP. The SrERP was a shareholder-funded program.

The purpose of the SrERP was to retain key senior officers through the energy crisis, bankruptcy proceedings, and the proposed Plan of Reorganization. Seventeen senior executives of PG&E Corporation, of PG&E, and of PG&E Corporation's subsidiary, PG&E National Energy Group (NEG), (now known as National Energy and Gas Transmission, Inc. (NEGT)) received retention grants in January and February of 2001.

Under the terms of the SrERP, restricted phantom stock units¹² were granted to key senior officers. The SrERP consisted of two components, a time-based component and a performance-based component. Fifty percent of the grant vested¹³ automatically on December 31, 2004. The other half vested only if PG&E Corporation's performance, as measured by relative total shareholder return (TSR) on a cumulative basis from January 22, 2001, was at or above the 55th percentile of its comparator group¹⁴. The entire grant was subject to accelerated vesting if, as of December 31, 2003, the Corporation's performance, as measured by relative TSR, was at or above the 75th percentile of its comparator group.

The performance criteria for accelerated vesting were met and the entire grant vested on December 31, 2003.

PG&E Corporation granted a total of 3,044,600 phantom stock units.

¹² Phantom stock plan is a form of deferred compensation. Under this plan, each employee who was awarded is granted a certain number of stock units. Each unit represents a share of the company's common stock. The employee does not actually receive or own any stock. The stock's value is a measuring device for the plan. On maturity, the employee receives a dollar amount equal to the value of the underlying units plus the amount of appreciation on the units awarded to the employee.

¹³ Vesting is the process by which employees accrue non-forfeitable rights to employer contributions that are made to the employee's account.

¹⁴ The comparator group consists of 11 other major energy companies selected by the PG&E Corporation Nominating and Compensation Committee. These companies were selected because they are comparable to PG&E Corporation in size and because their approach to compensation emphasized long-term incentives. All of the companies in the comparator group were included in the Standard & Poor's 500 Stock Index. The 11 companies are: Edison International, Sempra Energy, Consolidated Edison, Public Service Ent Group, Exelon Corp., Southern Co./Mirant, American Electric Power, TXU, Centerpoint/Reliant/Texas Genco, Duke Energy Corp, and Enron Corp.

Each of the 17 senior executive officers received phantom stock grants ranging from \$1.25 million to \$6 million. Six of the 17 senior executives received the SrERP grant on January 22, 2001. The other 11 senior executives received the SrERP grant on February 21, 2001.

The grant amounts in dollars were converted into phantom stock units, using the closing price of PG&E Corporation common stock on the grant date. For example, the grant amount of \$1.25 million was converted into 128,205 units based on the closing price of \$9.75 per share on the grant date of January 22, 2001. A grant of \$1.25 million on the grant date of February 21, 2001 was converted into 95,715 units based on closing price of \$13.06 per share for that date. PG&E Corporation granted a total of 3,044,600 phantom stock units to the senior executives at an initial cost of \$34,500,000.

Once the performance criteria were met and the entire grant vested, the number of stock units were then converted back into dollars using the PG&E Corporation's common stock closing price of \$27.77 per share on December 31, 2003. As such, an initial grant on January 22, 2001 of 128,205 units became \$3.560 million on December 31, 2003. An initial grant on February 21, 2001 of 95,715 units became \$2.658 million on December 31, 2003. The total stock unit grant of 3,044,600 was valued at \$84.5 million on December 31, 2003.

The following table illustrates the phantom units on grant date and vesting date.

Grant Amount	Grant Date	Stock Price at Grant Date	Phantom Stock Units Granted	Stock Price at Vesting 12/31/03	Grant Amount Received
A	b	c	d=a/c	e	f=d*e
\$6,000,000	1/22/01	\$9.75	615,385	\$27.77	\$17,089,231
3,500,000	1/22/01	9.75	358,974	27.77	9,968,718
2,250,000	1/22/01	9.75	230,769	27.77	6,408,462
1,250,000	1/22/01	9.75	128,205	27.77	3,560,256
1,250,000	1/22/01	9.75	128,205	27.77	3,560,256
1,250,000	1/22/01	9.75	128,205	27.77	3,560,256

1,250,000	2/21/01	13.06	95,712	27.77	2,657,925
1,250,000	2/21/01	13.06	95,712	27.77	2,657,925
1,250,000	2/21/01	13.06	95,712	27.77	2,657,925
1,250,000	2/21/01	13.06	95,712	27.77	2,657,925
3,500,000	2/21/01	13.06	267,994	27.77	7,442,190
2,250,000	2/21/01	13.06	172,282	27.77	4,784,265
2,250,000	2/21/01	13.06	172,282	27.77	4,784,265
2,250,000	2/21/01	13.06	172,282	27.77	4,784,265
1,250,000	2/21/01	13.06	95,712	27.77	2,657,925
1,250,000	2/21/01	13.06	95,712	27.77	2,657,925
1,250,000	2/21/01	13.06	95,712	27.77	2,657,925
\$34,500,000			3,044,567	\$27.77	\$84,547,639

Accounting Rules required that Expenses Associated with SrERP be Booked on an Accrual Basis

Under the terms of the SrERP, the retention grants were to vest no earlier than December 31, 2003 and no payments were to be made until 2004. However, as required under Generally Accepted Accounting Principles (GAAP), expenses associated with the SrERP program were booked beginning in 2001 on a quarterly basis through 2003. The quarterly accrual was determined using a PG&E Corporation's common stock price multiplied by 1/16 to reflect each quarterly accrual multiplied by the number of stock units awarded. Once the performance criteria for accelerated vesting were met, the entire cost was booked.

PG&E Corporation Charged PG&E for SrERP Expenses, and PG&E Recorded the Expenses to Various Accounts

On a quarterly basis, PG&E Corporation recorded the accrual for the retention grants. PG&E Corporation then invoiced PG&E for the utility's portion of the accrued SrERP expense. The invoice from PG&E Corporation included both direct charges for PG&E senior executives and an allocated charge for PG&E Corporation's senior executives¹⁵.

¹⁵ The charges were allocated to PG&E using a "multi-factor." The multi-factor ratio is computed as the arithmetic average of three factors (O&M expense,

Footnote continued on next page

After PG&E received the monthly invoice, PG&E recorded the total invoiced amounts to various accounts, both “below the line¹⁶” and “above the line.” PG&E recorded the SrERP portion of the invoiced amounts as an expense and as a liability payable to PG&E Corporation, once it emerged from bankruptcy.

PG&E emerged from bankruptcy on April 12, 2004. In June 2004, PG&E reimbursed PG&E Corporation for these past invoiced amounts.

PG&E was Charged \$53.2 Million of the \$84.5 Million in SrERP Payments

The January and February 2001 grant of 3,044,600 stock units, when converted back into dollars using the December 31, 2003 closing stock

employee headcount, and assets) that measure the utility in relation to the total of the holding company affiliates. As such, the larger holding company affiliates bear a larger portion of the allocated costs. The allocation method was approved by the CPUC in PG&E’s 1999 test year GRC Decision 00-02-046. During 2001 to 2003, PG&E’s allocation percentage ranged from 77.12% to 84.11%.

¹⁶ The terms “above the line” and “below the line” are colloquialisms not officially defined by the CPUC or other regulators that generally means, respectively, eligible for regulatory recovery and non eligible for regulatory recovery. The Uniform System of Accounts (USOA), adopted by the CPUC for public utilities subject to its jurisdiction, identifies five expense accounts - 426.1, Donations; 426.2, Life Insurance; 426.4, Expenditures for certain civic, political and related activities; and 426.5, Other deductions - that are considered nonoperating for accounting purposes. These accounts are often called “below the line.” The USOA expressly notes, however, that the “classification of expenses as nonoperating ... is for accounting purposes” and “does not preclude [Federal Energy Regulatory] Commission consideration of proof to the contrary for ratemaking or other purposes. Similarly, expenses may be recorded in other accounts, often call “above the line” for accounting purposes, but the utility may not seek recovery of such expenses in rates. (From PG&E Advice Letter 2555-G/2521-E, Attachment 3, footnote 5).

price was valued at \$84.5 million. Of the \$84.5 million, PG&E was charged \$53.2 million in total direct and allocated costs. The balance of \$31.3 million was charged to PG&E Corporation’s subsidiaries NEG (now NEGT), Pacific Venture Capital LLC (PVC), and PG&E Telecom LLC (Telecom).

The \$53.2 million charged to PG&E was made up of \$19.3 million in direct charges and \$33.9 million in allocated charges.

PG&E Corporation’s subsidiaries also incurred SrERP direct and allocated charges. The subsidiaries had total direct charges of \$23.8 million and total allocated charges of \$7.5 million.

As the direct and allocated SrERP costs were charged to PG&E Corporation’s subsidiaries, and not to PG&E, there is no FERC account on PG&E’s financial books associated with these payments. Therefore, by definition, the SrERP cost of \$31.3 million charged to PG&E Corporation’s subsidiaries was not borne by ratepayers.

The following table provides total SrERP direct and allocated costs by year and organization.

Year	PG&E Utility		PG&E Corporation’s Subsidiaries		Total
	Direct Charge	Allocated Charge	Direct Charge	Allocated Charge	
2001	\$0	\$11,541,562	\$0	\$3,142,543	\$14,684,105
2002	1,646,990	1,965,608	2,280,133	583,134	6,475,865
2003	17,611,308	20,401,482	21,521,549	3,854,233	63,388,572
Subtotal	\$19,258,298	\$33,908,652	\$23,801,682	\$7,579,910	
Total	\$53,166,950		\$31,381,592		\$84,548,542

PG&E booked 2003 SrERP charges of \$38 million to a “below the line” account.

PG&E booked \$53.2 million in direct and allocated SrERP charges from 2001 to 2003. A review of the records provided by PG&E show that initially, PG&E booked the \$53.2 million direct and allocated SrERP

charges to an above the line FERC 923 account. However, on November 30, 2003, PG&E reversed the direct and allocated SrERP charges for 2003 from an above the line account to a below the line FERC 426 account. As such, PG&E SrERP charge for 2003, totaling \$38 million has not been borne by ratepayers.

The 2001 and 2002 direct and allocated SrERP charges have not been reversed, as the financial records are closed at each year end.

SRERP Expenses Recorded in 2001 and 2002 in Account 923 were Not Included in PG&E's 2003 Authorized GRC Revenue Requirement and Were Not Used to Establish that Revenue Requirement.

PG&E's SrERP direct charges of \$1,646,990 in 2002 and allocated charges of \$11,541,562 for 2001 and \$1,965,608 for 2002 were recorded to an above-the-line FERC 923 account. PG&E was not able to reverse these entries in later years as the financial records are closed annually. Nor did PG&E make any adjustments in future years for these expenses. As such, the SrERP charges (direct and allocated) for 2001 and 2002 remained in an above-the-line account and could impact ratepayers to the extent that these recorded expenses were included in a GRC revenue requirement. However, the audit confirmed that the 2001 and 2002 SrERP expenses were not included in PG&E's test year 2003 GRC revenue requirement request, nor were they used to support PG&E's 2003 revenue requirement request. Rather, as PG&E explained in its filing¹⁷, PG&E used the 2002 budget, which excluded the retention grants. As such, the recorded expenses related to the retention grants were not included in the 2003 revenue requirement in the GRC. Additionally, The Commission's Office of

¹⁷ On February 10, 2004, PG&E Submitted its "Report To The California Public Utilities Commission Regarding Executive Compensation and Bonuses" in PG&E's 2003 GRC.

On February 27, 2004, PG&E submitted its "Supplemental Report of Pacific Gas and Electric Company Providing Further Information on Accounting for Executive Compensation and Bonuses" in PG&E's 2003 GRC.

Ratepayer Advocates (ORA), confirmed this in its review of PG&E's 2003 GRC showing on A&G expense. In its report on Provider Cost Center (PCC) 20000 "Holding Company Corporate Items" (where expenses related to Holding Company senior executives were charged), ORA found that: "PG&E excluded the cost of stock options and deferred compensation from its forecasts." ORA accepted PG&E's 2003 forecast for Holding Company PCC 20000, although it disagreed with PG&E's allocation of these costs to the Utility.

PG&E Adjusted Memorandum and Balancing Accounts that Used Recorded Expenses in its 2003 GRC

When PG&E booked its invoiced SrERP charges to a below-the-line account, ratepayer were not impacted as the below-the-line accounts are generally not included as part of PG&E's GRC revenue requirement. When PG&E booked its invoiced SrERP expenses to an above-the-line account, ratepayers could have been impacted to the extent that the above-the-line accounts are used to establish PG&E's GRC revenue requirements in the future. While PG&E did not use any recorded SrERP expenses to estimate its 2003 GRC revenue requirement PG&E did enter some of these expenses in certain memorandum and balancing accounts. In its advice letter filing, PG&E identified that in 2001 and 2002, PG&E included \$977,000 of recorded - as opposed to adopted - Account 923 A&G expenses in certain memorandum and balancing accounts used to book some of PG&E's generation costs in those years. PG&E identified that in 2001 approximately \$98,000 of the accrued expense for the SrERP was booked to the Fossil Generation Memorandum Account and approximately \$68,000 was booked to the Electric Energy Transaction Administration account. In 2002, approximately \$811,000 of accrued SrERP expense was booked to the Utility Generation Balancing Account.

To assure the CPUC that this \$977,000 of SrERP expense is accounted for consistent with "below-the-line" treatment, PG&E stated that it would adjust these entries out of regulatory memorandum and balancing accounts in 2001 and 2002.

PG&E demonstrated this adjustment in Attachment 1, page 2, line 29 of advice letter 2555-G/2521-E.

Headroom was Not Impacted by 2001 and 2002 SrERP Expenses Being Recorded Above the Line.

D.04-05-055 states that "...under the rate freeze the difference between the revenues at the frozen rates levels and the actual costs of providing utility service, often referred to as 'headroom,' is used to pay for procurement and energy crisis - related undercollections. To the extent the expense entries associated with the SrERP were entered into Account 923 and other memorandum and balancing accounts, less revenues are available for headroom." (D.04-05-055, section 10.3.3.1). Given the Commission's definition of headroom discussed below, the phrase "actual costs of providing utility service" in D.04-05-055 cited here can only be interpreted as the utility's authorized revenue requirement.

Commission staff's review of SrERP payments included reviewing the definition of headroom. The expenses used to determine the headroom are part of the utility's authorized revenue requirement, and the booking of actual SrERP expenses in 2001 and 2002 to Account 923 did not affect headroom.

An authorized revenue requirement is a forecasted (budgeted) cost that the Commission allows the utility to recover from customers in rates. Generally the forecast for determining revenue requirements in the GRC is based on historical recorded information.¹⁸ For headroom calculation the correct expenses to use are those included in the authorized revenue requirement, as opposed to actual or recorded expenses.

The Commission defined headroom in its 1996 opinion on cost recovery, D.96-12-077, in the electric restructuring (ER) proceeding R.94-04-031/I.94-04-032:

"Freezing rates stabilizes collected revenues (subject to sales variation), and declining costs create "headroom," i.e.,

¹⁸ As noted above, recorded SrERP expenses were not included in PG&E's 2003 GRC revenue requirement and were not used to establish PG&E's 2003 GRC revenue requirement.

revenues beyond those required to provide service, that can be applied to offset transition costs. The utilities' reasonable costs of providing service are currently identified as their authorized revenue requirements. (70 CPUC 2d at 219.) (emphasis added)

"In general, headroom revenues consist of the difference between recovered revenues at the frozen rate levels (including the reduced rate levels for residential and small commercial customers beginning in 1998) and the reasonable costs of providing utility services, which for convenience we refer to as the authorized revenue requirement." (70 CPUC 2d at 223.) (emphasis added)

Additionally, in D.97-10-057 in the ER proceeding, the Commission adopted a Transition Revenue Account (TRA) for PG&E. PG&E proposed that "The TRA would be an accounting mechanism designed to facilitate the calculation of the revenues available to offset uneconomic generation costs entered into the Transition Cost Balancing Account (TCBA). Specifically, the TRA would be credited with all billed revenues. From that total, PG&E would subtract the authorized revenue requirements for distribution, transmission, public benefits programs, and nuclear decommissioning. PG&E would then subtract any payments to the PX and Independent System Operator (ISO). The remaining balance would determine "headroom," the amount available to offset uneconomic generation costs entered into the TCBA. PG&E proposes that the amounts subtracted for distribution, transmission, public benefits programs, and nuclear decommissioning would be exactly the authorized revenue requirements for each category, rather than the actual revenues it collects." (76 CPUC 2d at 146, emphasis added). The Commission adopted PG&E's proposal to create a TRA with the exception that the determination of transmission rates is subject to the jurisdiction of the Federal Energy Regulatory Commission (76 CPUC 2d at 155).

Finally, the portion of PG&E's Preliminary Statement in its tariffs describing the TRA stated in part that the accounting procedure is:

- e. A debit entry equal to the annual applicable Distribution TRA Separated Revenue Requirement Amount divided by twelve;
- f. A debit entry to the annual applicable Nuclear Decommissioning TRA Separated Revenue Requirement Amount divided by twelve;
- g. A debit entry equal to the annual applicable Public Purpose Programs TRA Separated Revenue Requirement Amount divided by twelve...

PG&E's TRA tariff was eliminated and replaced with other ratemaking mechanisms pursuant to Resolution E-3862 dated April 1, 2004.

Headroom was determined using authorized revenue requirement, and 2001 and 2002 actual expenses had no impact on headroom. Thus, PG&E's booking of 2001 and 2002 SrERP expenses into an above the line Account 923 did not reduce headroom. PG&E's 2001 and 2002 SrERP payments were not borne by ratepayers via reduced headroom.

(END OF APPENDIX)



**Pacific Gas and
Electric Company**

June 14, 2004

Advice 2555-G/2521-E

(Pacific Gas and Electric Company ID U 39 M)

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Public Utilities Commission of the State of California

Subject: **2003 Headroom Calculation Complying with Bankruptcy
Settlement Decision and Accounting for Certain Executive
Compensation Complying with 2003 General Rate Case
Decision**

In compliance with and pursuant to paragraphs 1z and 8b of the Modified Settlement Agreement (MSA) adopted by Decision (D.) 03-12-035 in Pacific Gas and Electric Company's (PG&E's) bankruptcy settlement proceeding,¹ PG&E hereby provides the calculation of and accounting for PG&E's 2003 headroom² revenues. The headroom revenues in excess of the \$875 million cap for 2003 are to be credited to PG&E's ratepayers.³ PG&E requests that this excess headroom amount, once this advice filing has been approved by the Commission Staff, replace the 2004 beginning balance in the Headroom Account (HA) that was adopted by the Commission and credited to ratepayers subject to true-up in D.04-02-062 and Advice 2465-E. In addition, PG&E provides information on its accounting for certain executive compensation expenses pursuant to Ordering Paragraph 11 of D.04-05-055 in PG&E's 2003 General Rate Case (GRC) proceeding. PG&E also asks that the name of the new Utility Generation Balancing Account (UGBA), authorized in Resolution E-3822⁴, be revised to the Generation Revenue Adjustment Mechanism (GRAM), to clearly distinguish it from the UGBA previously adopted in D.02-04-016 in the Utility Retained Generation (URG) proceeding.⁵

¹ Investigation (I.) 02-04-026.

² "Headroom" is defined in paragraph 1z of the MSA as "PG&E's total net after-tax income reported under Generally Accepted Accounting Principles, less earnings from operations, plus after-tax amounts accrued for bankruptcy-related administration and bankruptcy-related interest costs, all multiplied by 1.67, provided that the calculation will reflect the outcome of PG&E's 2003 general rate case (A.02-09-005 and A.02-11-067)."

³ D.03-12-035, Appendix (App.) C, par. 8b.

⁴ Resolution (Res.) E-3822.

⁵ D.02-04-016, Ordering Paragraph (O.P.) 5.



Purpose

The purpose of this advice filing is to present and demonstrate PG&E's 2003 headroom calculation and accounting, in compliance with paragraphs 1z and 8b of the MSA adopted in D.03-12-035. PG&E also provides information on its accounting for certain executive compensation expenses pursuant to Ordering Paragraph 11 of D.04-05-055. As a separate matter, for administrative ease, PG&E also is using this advice letter to seek approval to revise the name of the revised UGBA to the GRAM.⁶

Background

The MSA adopted by D.03-12-035 required that PG&E "must demonstrate to the satisfaction of the Commission that PG&E has fairly and accurately accounted for the headroom," including complying with clarifications that "in no event may the litigation costs, bankruptcy-related costs or any other costs of PG&E Corporation or of any other PG&E affiliate be included in the determination of the headroom amount nor may any retention bonuses of PG&E's directors, officers, managers or any other employees be included in such a determination."⁷ This headroom calculation, once filed, will establish the 2004 beginning balance in the HA. In Advice Letter 2465-E, PG&E presented an estimated 2003 headroom calculation dated January 26, 2004. This advice filing presents the true-up of that 2003 headroom calculation as provided for in Ordering Paragraph 2 of D.04-02-062.

The 2003 headroom calculation is intended to show the headroom amount on PG&E's financial books as of December 31, 2003, with certain additional updated adjustments as provided for in paragraphs 1z and 8b of the MSA. These updated adjustments are as follows:

- Entries that are affected by the 2003 GRC decision, which is retroactive to January 1, 2003.⁸ This update was explicitly provided for in D.03-12-035.⁹
- Entries that are affected by any "true-up" in PG&E's calculation of headroom and the headroom credit pursuant to D.04-02-062, such as those due to settlements with Energy Service Providers (ESPs) that are credited to the Regulatory Asset pursuant to paragraph 2d of the MSA rather than included in the calculation of headroom pursuant to paragraphs 1z and 8b. This clarification of the accounting for headroom and the Regulatory Asset credits was explicitly provided for in D.03-12-035.¹⁰

⁶ Res.E-3822 revised the previously adopted UGBA to function as a revenue adjustment mechanism effective January 1, 2004.

⁷ D.03-12-035, mimeo at p.54.

⁸ In D.02-12-073, the Commission determined that the 2003 GRC Decision, when issued, would be effective retroactive to January 1, 2003.

⁹ D.03-12-035, App.C, par.1z.

¹⁰ D.03-12-035, mimeo at p.52.



In addition, D.03-12-035 requires that any additional headroom collected from ratepayers on or after January 1, 2004, is to be refunded to ratepayers under a method to be determined later by the Commission.¹¹ Pursuant to this requirement, the following items affect the calculation of amounts to be entered into the HA in 2004:

- Resolution G-3362, dated March 16, 2004, provided that the \$52 million true-up for the electric portion of the Post-Retirement Benefit other than Pension (PBOP) amount adopted in PG&E's 1999 GRC decision be reflected in the Transition Revenue Account (TRA) or successor accounts.¹² Resolution E-3862, dated April 1, 2004, provided that amounts authorized by the Commission to be recorded in the TRA after December 31, 2003, should be recorded to the HA.¹³
- In Advice 2458-E, PG&E requested and received approval¹⁴ to credit to ratepayers a retail refund amount of \$7.2 million resulting from the August 28, 2003, FERC Order in PG&E's Transmission Owner (TO) 3 case.¹⁵ Advice 2458-E asked that the refund be reflect in the TRA. Consistent with Resolution E-3862, PG&E proposes that this refund now be made through the CPUC-jurisdictional HA.
- FERC Order 470, dated March 9, 2004, in PG&E's TO6 case disallows accelerated depreciation of electric transmission assets.¹⁶ The decision instructs PG&E to credit a retail refund amount of \$5.1 million to ratepayers¹⁷, which PG&E proposes be through the CPUC-jurisdictional HA.

These three items, because they were booked in 2004, do not affect the 2003 headroom calculation. Rather, the HA is solely used as a procedural vehicle to refund the amounts to ratepayers as provided by D.03-12-035.

One entry on PG&E's financial books in 2004 has not been included as an entry to the HA in this advice filing: the gain on sale of the Los Medanos property. D.03-06-028 provided that the Los Medanos gain-on-sale be reflected in the TRA.¹⁸ However, D.99-10-001 established another balancing account, the Real Property Gain/Loss on Sale Memorandum Account (RPGLSMA), for the purpose of tracking gains on sale for transactions entered into prior to the end of the rate freeze. PG&E believes this is the appropriate account to use to track the Los Medanos gain-on-sale. Consequently, PG&E filed a petition for modification of

¹¹ D.03-12-035, mimeo at p.54.

¹² R.G-3362, p.5.

¹³ R. E-3862, p.15.

¹⁴ The Energy Division approved Advice 2458-E by letter dated January 26, 2004.

¹⁵ The TO3 case is FERC Docket ER99-2326-000.

¹⁶ FERC Order 470 was issued in Dockets ER03-409-002 (PG&E's FERC TO6 case application) and ER03-666-002 (PG&E's FERC Existing Transmission Contract Rates (ETC) application).

¹⁷ FERC Order 470, Initial Decision, Par. 7, p.3; O.P. (A), p.12.

¹⁸ A.00-05-032; D.03-06-028, p.10; O.P.12.



D.03-06-028 on June 4, 2004, seeking Commission approval to use the RPGLSMA to record the Los Medanos gain-on-sale.

As discussed above, PG&E is also complying with Ordering Paragraph 11 of D.04-05-055, PG&E's 2003 GRC decision, which requires PG&E in this advice filing to also show:

- i. Adjustments to Account 923 for 2001 and 2002 to reverse accruals for the SrERP [Senior Executive Retention Program];
- ii. The accounting of all SrERP payments, including those made in January 2004 (even if cash distributions were deferred), to demonstrate that the payments were not and are not charged to rate payers; and
- iii. Anything else reasonably necessary to ensure that ratepayers have not paid, and will not pay, any portion of the \$84.5 million in SrERP expenses.¹⁹

This SrERP-related information is provided in Attachment 3 to this advice filing. Please note that the adjustments for 2001 and 2002 to reverse accruals for the SrERP are shown on page 2, line 29, of Attachment 1.

Description of Attachments

Attachment 1, page 1, to this advice filing presents the calculation of the 2003 headroom amount. For reference purposes, page 2 of Attachment 1 shows the headroom calculations for 2000 through 2002 that were reviewed in I. 02-04-026.

Attachment 2 provides an explanation of each line item on Attachment 1, page 1.

Attachment 3 provides the information on accounting for all SrERP payments.

Name Change for the New UGBA

Finally, PG&E seeks approval to revise the name of the new UGBA authorized in Resolution E-3822 to the Generation Revenue Adjustment Mechanism or GRAM. This will allow this new balancing account to be distinguished from the UGBA previously adopted in D.02-04-016 in the URG proceeding. Because the two accounts serve different functions, the shared name may cause confusion.

The purpose of the original UGBA was to track the difference between the adopted 2002 URG revenue requirement and actual 2002 URG costs. The purpose of the new UGBA is to track the difference between the revenue from rates against the authorized revenue requirement, with any over- or under-collection reflected in future rates. Because the new UGBA performs a

¹⁹ D.04-05-055, p.142.



function similar to that of the Distribution Revenue Adjustment Mechanism (DRAM) for distribution costs, it is appropriate for the analogous generation account to be called the GRAM. The proposed change to the name of the UGBA does not change the function of the account adopted in Resolution E-3822.

Protests

Anyone wishing to protest this filing may do so by sending a letter by **July 6, 2004**, which is 20 days from the date of this filing. The protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. Protests should be mailed to:

IMC Branch Chief – Energy Division
California Public Utilities Commission
505 Van Ness Avenue, 4th Floor
San Francisco, California 94102

Facsimile: (415) 703-2200
E-mail: jjr@cpuc.ca.gov

Protests also should be sent by e-mail and facsimile to Mr. Jerry Royer, Energy Division, as shown above, and by U.S. mail to Mr. Royer at the above address.

The protest should be sent via both e-mail and facsimile to PG&E on the same date it is mailed or delivered to the Commission at the address shown below.

Pacific Gas and Electric Company
Attention: Brian Cherry
Director, Regulatory Relations
77 Beale Street, Mail Code B10C
P.O. Box 770000
San Francisco, California 94177

Facsimile: (415) 973-7226
E-mail: RxDd@pge.com

Effective Date

PG&E requests that this advice filing become effective on regular notice, **July 24, 2004**, which is 40 days after the date of filing.

Notice

In accordance with General Order 96-A, Section III, Paragraph G, a copy of this advice letter is being sent electronically and via U.S. mail to parties shown on the

attached list. Address changes should be directed to Sharon Tatai at (415) 973-2788. Advice letter filings can also be accessed electronically at:

<http://www.pge.com/tariffs>

Karen A. Tomcala / DP

Vice President - Regulatory Relations

Attachments

cc: Service Lists for A.02-11-017 and I.02-04-026.

Pacific Gas and Electric Company

2003 Headroom Calculation

As of December 31, 2003, With Updated Data*

(Millions of Dollars -- Parentheses Denote Reductions to Headroom)

Line	Description	2003
1	Transition Cost Balance Activity (Pre-Tax)	
2	Transition Revenue Account (TRA)	(3,754.4)
3	Transition Cost Balancing Account (TCBA)	(459.2)
4	Generation Asset Balancing Account (GABA)	26.2
5	Generation Memo Accounts (GMA)	1,712.8
6	Energy Resource Recovery Account (ERRA)	142.8
7	Self-Generation Program Memo Account (SGPMA)	19.2
8	Demand Responsiveness Program Memo Account (DRPMA)	3.3
9	Net Energy Metering Memo Account (NEMMA)	1.4
10	Interruptible Load Programs Memo Account (ILPMA)	0.2
11	Capital Audit Consultant Cost Memo Account (CACMA)	0.2
12	Real Time Energy Metering Memo Account (RTEMMA)	(0.1)
13	DWR/ISO Balancing Account Activity	(69.3)
14	Divestiture Costs	27.9
15	Advanced Metering And Demand Response Account (AMDRA)	5.5
16	Distributed Energy Resource Energy Account (DERMA)	0.5
17	Subtotal, Transition Cost Balance Activity (pre-tax) (To Line 31)	(2,342.9)
18	2003 GRC Decision Adjustments (Pre-Tax)	
19	2003 GRC Distribution RRQ Adjustment	200.0
20	2003 GRC Generation RRQ Adjustment	78.6
21	2003 GRC Diablo Canyon Property Tax Reserve	(6.1)
22	2003 GRC Humboldt SAFSTOR RRQ Increase	0.5
23	Subtotal GRC Decision Adjustments (To Line 32)	273.0
24	Additional Generation Asset Accounting Impacts (Pre-Tax)	
25	New "Plant" Asset	2,098.8
26	Amortization of New "Plant" Asset	(601.6)
27	New Regulatory Asset	120.8
28	Amortization of New Regulatory Asset	(56.4)
29	Subtotal Additional Generation Asset Accounting Impacts (To Line 33)	1,561.6
30	HEADROOM CALCULATION	
31	Transition Cost Balance Activity (pre-tax) (From Line 17)	(2,342.9)
32	2003 GRC Decision Adjustments (pre-tax) (From Line 23)	273.0
33	Additional Generation Asset Accounting Impacts (pre-tax) (From Line 29)	1,561.6
34	DWR Accrual Due to Change in Methodology	(341.4)
35	FERC TO (Transmission Owner Case) 1, 2 and 3 Transfer	(32.1)
36	Bilateral Reserve	(26.1)
37	Reversal of Interest Accrued in Transition Cost Balancing Accounts	(33.6)
38	Utility Retained Generation (URG) Adjustment	(171.3)
39	GRC Rehearing (1999 GRC)	111.0
40	Gain on Settlement with DA Service Providers: Reclass to Reg Asset	11.0
41	Enron Bilateral Settlement	(17.6)
42	Mirant Bilateral Settlement	0.8
43	WAPA Capacity Revenue Adjustment	66.5
44	Interest on Nuclear Decommissioning Trust	(0.7)
45	Grizzly Power Sale	(59.7)
46	WAPA Regulation Credits - 2003 Beginning Balance Adjustment	15.6
47	WAPA FERC Rate Change Adjustment	1.5
48	Direct Access CRS Undercollection Accrual	(3.4)
49	2002 UGBA Audit Adjustment	(9.2)
50	Other	3.8
51	Pre-tax Adjusted Headroom	(993.2)
52	Less Headroom Limit	(875.0)
53	2003 Headroom Account (HA) Regulatory Liability	(118.2)
54	2004 Headroom Account (HA) Entries	2004
55	2004 Beginning of Year HA Balance (from Line 53)	(118.2)
56	Post-Retirement Benefits Other than Pension (PBOP) True-up	(51.8)
57	FERC TO3 Retail Refund	(7.2)
58	FERC TO6 Retail Refund	(5.1)
59	Total HA Regulatory Liability in 2004	(182.3)

* This table uses the format from page 1 of Exhibit 120B in I.02-04-026, dated September 23, 2003, updated for: 1) end-of-year 2003 data; 2) the 2003 GRC Decision 04-05-055; and 3) certain additional adjustments not included in Exhibit 120B.

**Pacific Gas and Electric Company
2000 - 2002 Headroom Calculation ***

(Millions of Dollars -- Parentheses Denote Reductions to Headroom)

Line	Description	2000	2001	2002
1	Transition Cost Balance Activity (Pre-Tax)			
2	Transition Revenue Account (TRA)	6,631.5	244.5	(3,121.6)
3	Transition Cost Balancing Account (TCBA)	(1,871.6)	702.6	(1.1)
4	Generation Asset Balancing Account (GABA)	2,171.0	88.1	39.2
5	Generation Memo Accounts (GMA)	-	(1,579.7)	(133.1)
6	Energy Resource Recovery Account (ERRA)	-	-	-
7	Self-Generation Program Memo Account (SGPMA)	-	-	7.8
8	Demand Responsiveness Program Memo Account (DRPMA)	-	-	4.7
9	Net Energy Metering Memo Account (NEMMA)	-	-	0.6
10	Interruptible Load Programs Memo Account (ILPMA)	-	-	2.2
11	Capital Audit Consultant Cost Memo Account (CACOMA)	-	-	0.6
12	Real Time Energy Metering Memo Account (RTEMMA)	-	-	0.5
13	DWR/ISO Balancing Account Activity	-	-	69.3
14	Divestiture Costs	21.0	(2.7)	(0.3)
15	Subtotal, Transition Cost Balance Activity (pre-tax) (To Line 31)	6,951.9	(547.2)	(3,131.2)
16	HEADROOM CALCULATION			
17	Transition Cost Balance Activity (pre-tax) (From Line 15)	6,951.9	(547.2)	(3,131.2)
18	Procurement Surcharge Balancing Account (PSBA) Reserve	-	65.0	(65.0)
19	DWR Accrual Due to Change in Methodology	-	-	368.6
20	FERC TO (Transmission Owner Case) 1, 2 and 3 Transfer	-	39.3	-
21	Reliability Must Run-Out of Market (RMR-OOM) Reserve	-	25.6	-
22	Bilateral Reserve	-	42.9	-
23	Reversal of Interest Accrued in Transition Cost Balancing Accounts	-	(259.2)	33.9
24	Attrition Reserve	-	(38.0)	38.0
25	Vegetation Management Balancing Account (VMBA) Reserve	-	(17.0)	17.0
26	Utility Retained Generation (URG) Adjustment	-	-	356.1
27	GRC Rehearing (1999 GRC)	-	(85.0)	(26.0)
28	WAPA FERC Rate Change Adjustment	-	-	39.3
29	Adjustment to Remove SrERP costs	-	(0.2)	(0.8)
30	Other	-	-	0.9
31	Pre-tax Adjusted Headroom	6,951.9	(773.8)	(2,369.2)

* This table uses the format from page 1 of Exhibit 120B in I.02-04-026, dated September 23, 2003, for years 2000 through 2002. For 2000, this amount includes transition and procurement costs incurred in prior years; it is a cumulative amount. Line items on Exhibit 120B with no entries in years 2000 to 2002 have been deleted. Line 29 has been added per D.04-05-055 in PG&E's 2003 General Rate Case.

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

Introduction

Attachment 1 to this advice filing shows the elements of the headroom calculation.¹ Generally, PG&E makes adjustments to headroom to reflect timing differences in the recognition of revenues and expenses that affect headroom. This Attachment 2 presents a brief definition of the line items shown in the 2003 headroom calculation presented in Attachment 1, page 1.

Explanations of Line Items

1. **Transition Cost Balance Activity.** Lines 2 through 17 list the transition balancing accounts that track electric costs and revenues.
2. **Transition Revenue Account (TRA).** The TRA was established to facilitate the calculation of the revenues available to offset uneconomic generation assets recorded in the Transition Cost Balancing Account. (D.97-10-057, Ordering Paragraph (OP) 15; Resolution (Res.) E-35141; Advice Letter (AL) 1705-E.)
3. **Transition Cost Balancing Account (TCBA).** The TCBA records all revenues available to offset Competition Transition Charge (CTC) and CTC-eligible generation-related costs. (D.97-06-060; Res.E-3538; AL 1720-E-A.)
4. **Generation Asset Balancing Account (GABA).** The GABA: 1) records the debits corresponding to the credit to the TCBA for the estimated market value on an aggregate basis of remaining non-nuclear generation assets, less net book value; 2) records the net gain or loss from the final valuation of the assets; and 3) transfers the resulting balance of the GABA to the TCBA upon final valuation of the last generation asset to be valued. (D.00-02-048; D.00-06-004.)
5. **Generation Memo Accounts (GMA).** There are several GMA accounts. The Non-Must-Run Hydroelectric/Geothermal and Fossil Memorandum Accounts (NMRHGMA) record operating expenses and revenues received by PG&E from the PX/ISO related to operation of non-must-run conventional hydroelectric, Helms, and geothermal plants. Non-must-run plants are those not deemed necessary to maintain transmission system reliability. A credit

¹ "Headroom" is defined in paragraph 1z of the Modified Settlement Agreement (MSA) as "PG&E's total net after-tax income reported under Generally Accepted Accounting Principles, less earnings from operations, plus after-tax amounts accrued for bankruptcy-related administration and bankruptcy-related interest costs, all multiplied by 1.67, provided that the calculation will reflect the outcome of PG&E's 2003 general rate case (A.02-09-005 and A.02-11-067)." (D.03-12-035.) However, PG&E voluntarily excluded from this definition certain items totaling \$70 million, which the Company believe^{3d} were inappropriate to recover from ratepayers.

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

balance is transferred to the TCBA annually or upon market valuation. (D.97-06-060; AL 1735-E-A.) The Must-Run Hydroelectric/Geothermal and Fossil Plant Memorandum Accounts (MRHGMA) record the revenues received by PG&E from the PX/ISO related to the operation of must-run hydroelectric/geothermal plants and the plants' associated costs. The balance is transferred to the TCBA annually or upon final market valuation. (D.97-12-096; Res. E-3538; AL 1723-E-B.)

6. Energy Resource Recovery Account (ERRA). The ERRA records and recovers power costs, excluding DWR costs, associated with PG&E's authorized procurement plan. (D.02-10-062; D.02-12-074; and PU Code Section 454.5(d)(3).)
7. Self-Generation Program Memo Account (SGPMA). The SGPMA tracks the incurred costs and authorized revenue requirements for implementing the self-generation program authorized by D.01-03-073. Qualifying self-generation is defined as distributed generation technologies (microturbines, small gas turbines, wind turbines, photovoltaics, fuel cells and internal combustion engines, and combined heat and power or cogeneration) installed on the customer's side of the utility meter that provide electricity for all or a portion of that customer's electric load. (D.01-03-073; AL 2140-E-C.)
8. Demand Responsiveness Program Memo Account (DRPMA). The DRPMA tracks the incurred costs and authorized revenue requirements for conducting a pilot program to provide interactive consumption and cost information for small customers. (D.01-03-073; AL 2140-E-C.)
9. Net Energy Metering Memo Account (NEMMA). The NEMMA records the costs associated with interconnection of the net energy metered customers' generators with projects between 10 kW and 1 MW in size, that are not being recovered from net metered customers through interconnection charges. The NEMMA includes costs for interconnection studies, distribution system modifications, and application review fees. (D.02-03-057; AL 2229-E.)
10. Interruptible Load Programs Memo Account (ILPMA). The ILPMA records costs incurred by PG&E to implement and administer new interruptible load rotating outage programs during calendar years 2001 and 2002 and continuing until modified or terminated in the rate design phase of the next GRC or similar proceeding as ordered in D.02-04-060, where these costs are in excess of the costs authorized in current rates but represent new expenditures or activities that PG&E has been ordered to undertake pursuant to D.01-04-006 and D.02-04-060. (D.01-04-006; AL 2099-E-A.)
11. Capital Audit Consultant Cost Memo Account (CACCMMA). The CACCMMA records payments made by PG&E to reimburse the Commission for the costs of an Energy Division contract with the Capital Audit consultant, as ordered in the 1999 GRC. (D.00-02-046, OP 12; AL 2077-E-A.)
12. Real Time Energy Metering Memo Account (RTEMMA). The RTEMMA records PG&E's Operations and Maintenance (O&M) expenses and capital-related revenue requirements associated with the real time energy metering equipment and related infrastructure, only to

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

the extent those costs are not reimbursed under the California Energy Commission's metering programs approved by AB X1-29. (ABX1-29; AL 2122-E.)

13. DWR/ISO Balancing Account Activity. The Department of Water Resources (DWR) / Independent System Operator (ISO) Balancing Account provides for recovery from ratepayers of payments that PG&E makes to the DWR or the ISO for ISO-related charges. (D.02-03-058; AL 2214-E.)
14. Divestiture Costs. The Generation Divestiture Transaction Cost Memorandum Account (GDTCTMA) records transaction costs (excluding PG&E labor) associated with the divestiture of generation facilities. The balance was to be transferred to the TCBA upon market valuation and reviewed in the ATCP. Following the ATCP review, the hydro costs were re-transferred from the TCBA to the GDTCTMA. (D.95-12-063; AL 1609-E.)
15. Advanced Metering and Demand Response Account (AMDRA). The AMDRA records and recovers the incremental, one-time set-up and on-going O&M and Administrative and General (A&G) expenses incurred to develop and implement, or in reasonable anticipation of implementing, the demand response programs adopted in Phase I of the Advanced Metering proceeding. (D. 03-03-036; AL 2357-E.)
16. Distributed Energy Resource Energy Account (DERMA). The DERMA records the waived standby charges and any quantifiable benefits provided by distributed energy resources. (PU Code 353.1, 353.3 and 353.9; Res.E-3777; AL 2124-E-A.)
17. Subtotal, Transition Cost Balance Activity (pre-tax). This subtotal sums the amounts on PG&E's General Ledger for the balancing accounts listed on lines 2 through 16, as of December 31, 2003.
18. 2003 GRC Decision Adjustments. Lines 19 through 22 are adjustments to headroom resulting from D.04-05-055 in PG&E's 2003 test year General Rate Case (GRC) (A.02-11-017). Such adjustments to headroom are specifically provided for in D.03-12-035.
19. 2003 GRC Distribution RRQ Adjustment. This amount is the 2003 GRC-authorized distribution revenue requirement increase over the previously-authorized distribution base revenue requirement, stated on a pre-tax basis. (D.02-02-043; D.04-05-055.)
20. 2003 GRC Generation RRQ Adjustment. This amount is the 2003 GRC-authorized generation revenue requirement increase over the previously-authorized generation base revenue requirement, stated on a pre-tax basis. (D.02-04-016; D.04-05-055.)
21. 2003 GRC Diablo Canyon Property Tax Reserve. This adjustment refunds the \$6.1 million over-collection in the Diablo Canyon Power Plant (DCPP) Property Tax Balancing Account related to actual DCPP Power Plant property taxes paid in 2003. (D.04-05-055, App. A, Generation Settlement, Section III.D.2.)

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

22. 2003 GRC Humboldt SAFSTOR RRQ Increase. In its 2002 Nuclear Decommissioning Cost Triennial Proceeding (NDCTP) (A.02-03-020), PG&E proposed that common cost inputs included in the revenue requirement calculation for SAFSTOR operations at Humboldt Bay Power Plant Unit 3 be a placeholder only, subject to update with the results of the 2003 GRC. This adjustment trues-up the 2003 common cost placeholder amounts adopted in the NDCTP Decision for the amounts adopted in the 2003 GRC Decision. This 2003 Humboldt SAFSTOR revenue requirement increase is only effective from the date of the NDCTP Decision on October 7, 2003; thus, a pro rata calculation is made to derive the 2003 adjustment from the annual amounts adopted in the 2003 GRC Decision. (D.04-05-055.)
23. Subtotal GRC Decision Adjustments. This subtotal sums the amounts of adjustments to 2003 headroom (listed on lines 19 through 22) made as a result of the 2003 GRC Decision.
24. Additional Generation Asset Accounting Impacts. The adjustments on lines 25 through 28 show the amortization of the previously written-off plant and regulatory assets that are re-established as part of rate base pursuant to the Utility Retained Generation (URG) Decision. (D.02-04-016; AL 2233-E; AL 2240-E-B; AL 2240-E-C.)
25. New "Plant" Asset. This amount is the previously written-off plant assets that are re-established as part of rate base pursuant to D.02-04-016.
26. Amortization of New "Plant" Asset. This amount is the amortization/depreciation on the plant in line 25 accrued between the time of the write-off and the time of re-establishment.
27. New Regulatory Asset. This amount is the previously written-off regulatory assets that are re-established as part of rate base pursuant to D.02-04-016.
28. Amortization of New Regulatory Asset. This amount is the amortization/depreciation on the regulatory assets in line 27 accrued between the time of the write-off and the time of re-establishment.
29. Subtotal Additional Generation Regulatory Asset Impacts. This subtotal sums the additional adjustments to headroom related to the URG decision (listed on lines 25 through 28).
30. Headroom Calculation. This section (lines 34 through 50) reflects adjustments made to headroom booked on a Generally Accepted Accounting Principles (GAAP) basis to reflect uncertainty of recovery due to timing of Commission decisions and other regulatory events.
31. Transition Cost Balance Activity. This is the balance from line 17.
32. 2003 GRC Decision Adjustments. This is the balance from line 23.
33. Additional Generation Asset Accounting Impacts. This is the balance from line 29.
34. DWR Accrual Due to Change in Methodology. PG&E accrued \$369 million in 2002 of amounts potentially owed to DWR for energy deliveries. The additional amounts accrued

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

were not recorded in the TRA as DWR power charges but were recorded as a reduction to headroom earnings through a reserve, because PG&E believed the remittance formula it was using to calculate the payments to DWR as technically correct, even though conceptually inaccurate. D.03-09-018 settled the amounts owed by PG&E to DWR. These amounts, therefore, were recorded in the TRA and the reserve was reversed.

35. FERC TO (Transmission Owner Case) 1, 2 and 3 Transfer. In 2001, a \$39 million reserve was established to reflect potential refunds based on the excess of as-filed TO rates over the estimated rates PG&E would settle on with the FERC. In 2003, PG&E settled these TO cases with the FERC (with one depreciation issue held open in TO3, discussed in line 57, below). Per Advice 2346-E, PG&E received approval from the CPUC to adjust recorded transmission revenues in the TRA and reversed the reserve in 2003.
36. Bilateral Reserve. PG&E has receivables from Enron and Mirant associated with terminated bilateral contracts. The gain on termination was recorded as an offset to purchased power in the TRA. PG&E took a \$42.9 million reserve against the \$86 million receivable in 2001 because it believed that the full amount of the receivable was not probable of recovery. PG&E has reached settlements with Enron and Mirant and has received cash payments of approximately \$65 million and \$44 million, respectively, reflecting these settlements. PG&E has received more in cash than was anticipated when PG&E recorded a reserve against the Enron receivable in November 2001. Correspondingly, PG&E reversed approximately \$17 million of the reserve. This reversal creates an increase in headroom. PG&E received less cash from Mirant than was recorded in the TRA. Consequently, PG&E recorded a reduction of \$0.8 million of headroom in 2003 associated with the Mirant Settlement (see line 42).
37. Reversal of Interest Accrued in Transition Cost Balancing Accounts. PG&E accrues interest on its outstanding balances in the TRA, TCBA, GMAs, and GABA at the 90-day commercial paper rate. These interest amounts are removed from headroom for the purposes of calculating PG&E's unrecovered costs. PG&E reserved against the interest consistent with the write-off of the underlying costs taken at the end of 2000. This entry removes the interest at the commercial paper rate from headroom and balancing account totals and substitutes the total of incremental interest associated with PG&E's bankruptcy.
38. Utility Retained Generation (URG) Adjustment. In 2002, PG&E accrued the sunk cost portion of the URG revenue requirement for 2002 based on the URG Decision (D.02-04-016), pending the final approval of PG&E's URG advice filing (AL2240-E-B, July 2003). This is the portion of the revenue requirement that PG&E recorded in the Utility Generation Balancing Account (UGBA) when it was approved per AL 2240-E-B.
39. GRC Rehearing (1999 GRC). These adjustments implement revenue requirement changes resolved in several decisions that addressed applications for rehearing and petitions for modification of D.00-02-046 in PG&E's 1999 test year GRC (A.97-12-057). These included: D.01-10-031, D.02-12-002, D.03-02-006, and D.03-04-002. PG&E had not recorded the adjustments in 1999, 2000 and part of 2001 because the 1999 GRC rehearing and other proceedings were still pending. In 2001, absent a final revenue requirement, PG&E determined that it should record the effects of these proceedings against headroom. PG&E

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

allocated \$32.3 million to 1999, \$32.3 million to 2000, and \$20.4 million to 2001 for a total \$85 million adjustment recorded in 2001. PG&E recorded adjustments of \$26 million in 2002 reflecting D.02-12-002, and \$36.6 million in 2003 reflecting D.03-02-006, D. 03-04-002, and a catch-up entry to record revenue requirements from decisions in years 1999-2001 that were not included in the original \$85 million 2001 adjustment. The final 1999 revenue requirement was approved in June 2003 (Advice Letter 2459). PG&E transferred the reserve amount to the TRA consistent with Resolution 2380-E. PG&E does not expect any further adjustments to headroom associated with the 1999 GRC.

40. Gain on Settlement with DA Service Providers: Reclass to Reg Asset. The bankruptcy court approved settlements reducing the pre-petition amounts owed by PG&E to the following Direct Access (DA) Energy Service Providers: 1) \$10.4 million reduction in liability to New West Energy (settlement occurred in June 2003); 2) \$0.5 million reduction in liability to Commonwealth Energy (settlement occurred in November 2002); and 3) \$0.1 million reduction in liabilities to Clean Earth Energy (\$26,000) and Utilisource (\$70,000) (settlement occurred in November 2002 and February 2003, respectively). Pursuant to the MSA, the gains on settlement with DA service providers were transferred from the headroom calculation and applied against the Settlement Regulatory Asset.
41. Enron Bilateral Settlement. In July 2003, PG&E received a letter of credit payment from Enron in settlement of the remaining terminated bilateral receivable. The amount of this payment exceeded the recorded principal balance by \$17.6 million, which was recorded as a decrease to bilateral purchased power expense.
42. Mirant Bilateral Settlement. In June 2003, PG&E received a letter of credit payment from Mirant in settlement of the remaining terminated bilateral receivable. The amount of this payment was less than the recorded principal balance by \$0.8 million, resulting in an increase to bilateral purchased power expense.
43. WAPA Capacity Revenue Adjustment. Prior to July 2003, WAPA capacity revenues under contract 2948A had not been recorded in the transition cost balancing accounts. In June 2003, PG&E determined that these revenues should be treated the same as energy revenues and were therefore reflected as a credit to the TRA.
44. Interest on Nuclear Decommissioning Trust (NDT). In May 2003, the CPUC approved transfer from the NDT to the TRA of approximately \$2.7 million per year in nuclear decommissioning funds for the three-year period 1999 through 2001. This line item represents the interest accrued on the amounts in the trust over the 1999 through 2001 period. (Res. E-3823.)
45. Grizzly Power Sale. During the third quarter of 2003, PG&E determined that the Grizzly Power Sale (Santa Clara) contract, as well as the 50MW-5MW firm sales contract, could be considered designated sales contracts and the net revenue or cost recorded for recovery in the TCBA. During the energy crisis, the ISO imbalance charges PG&E incurred to service these contracts exceeded the sale for resale revenue PG&E collected from Santa Clara and

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

therefore a net debit of \$57.7 million (increase to unrecovered transition costs) was recorded to the TCBA to reflect the net cost incurred under these contracts since April 1998. Under the new interconnection agreement, PG&E provides power under the Grizzly Power Sale contract through its merchant portfolio. Because the costs of PG&E's merchant portfolio are already recorded in the TRA and ERRAs, from September 2002 forward the only impact to the TCBA is the inclusion of the sale for resale revenues.

46. WAPA Regulation Credits – 2003 Beginning Balance Adjustment. This amount represents retail WAPA regulation credits totaling \$15.6 million for the period January 2000 through August 2002. This was recorded as a beginning balance adjustment for 2003, to be consistent with the Grizzly Power Sale and WAPA Capacity Revenue prior period adjustments.
47. WAPA FERC Rate Change Adjustment. This adjustment was made to reflect anticipated changes to WAPA contract power purchase rates.
48. Direct Access Credits Undercollection Accrual. This amount represents an accrual adjustment to the Direct Access CRS \$0.027 per kWh remittance to DWR. The accrual differed from the actual payment to DWR primarily due to the inclusion of non-firm discounts in the accrual; when compared to payments to DWR, the accrual was less than the payments, thus creating this shortfall and the adjustment. (D.02-12-045; Res. E-3813.)
49. 2002 UGBA Audit Adjustment. In ORA's audit of the 2002 actual URG costs in the UGBA, ORA recommended that A&G expenses booked to the UGBA be reduced by \$9.15 million. PG&E agreed to include the 2002 UGBA audit adjustment in its 2003 headroom calculation.
50. Other. This amount is primarily comprised of reserves related to minor ISO and Qualified Facilities costs.
51. Pre-tax Adjusted Headroom. This subtotal sums the 2003 headroom amounts and adjustments (listed on lines 31 through 50).
52. Less Headroom Limit. This is the limit on 2003 headroom set in D.03-12-035.
53. 2003 Headroom Account Regulatory Liability. This amount represents the difference between the 2003 headroom amount (line 51) and the headroom limit (line 52). This difference must be refunded to ratepayers (D.03-12-035.)
54. 2004 Headroom Account (HA) Entries. D.03-12-035 requires that any additional headroom collected from ratepayers on or after January 1, 2004, be refunded to ratepayers under a method to be determined later by the Commission. The adjustments on lines 56, 57, and 58 are such 2004 additional headroom adjustments. These three items, because they were booked in 2004, do not affect the 2003 headroom calculation. Rather, the HA is solely used as a procedural vehicle to refund the amounts to ratepayers as provided by D.03-12-035.

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 2
Description of Line Items in 2003 Headroom Calculation

55. 2003 Beginning of Year HA Balance. This is the balance from line 53.
56. Post-Retirement Benefits Other than Pension (PBOP) True-up. Resolution G-3362, dated March 16, 2004, provided that the \$52 million true-up for the electric portion of the PBOP amount adopted in PG&E's 1999 GRC decision be reflected in the TRA or successor accounts. Resolution E-3862, dated April 1, 2004, provided that amounts authorized by the Commission to be recorded in the TRA after December 31, 2003, should be recorded to the HA.
57. FERC TO3 Retail Refund. PG&E received a final decision from the FERC regarding TO3 rates on August 28, 2003, resolving the one open depreciation issue. PG&E received approval from the CPUC to adjust recorded transmission revenues in the TRA. Consistent with Resolution E-3862, PG&E proposes that this refund now be made through the CPUC-jurisdictional HA. (AL 2458-E.)
58. FERC TO6 Retail Refund. PG&E received a final decision from the FERC regarding TO6 rates on March 9, 2004. The decision instructs PG&E to credit a retail refund amount of \$5.1 million to ratepayers, which PG&E proposes be made through the CPUC-jurisdictional HA.
59. Total HA Regulatory Liability. This amount represents the total HA-related refund that PG&E proposes be made to ratepayers.

PACIFIC GAS AND ELECTRIC COMPANY
Attachment 3
Senior Executive Retention Program Compliance Report

1. Introduction

Decision 04-05-055 in PG&E's 2003 test year General Rate Case (GRC)¹ adopted additional reporting requirements related to PG&E's Senior Executive Retention Program (SrERP). Among these, Ordering Paragraph 11a of Decision 04-05-055 requires:

- a. PG&E shall file and serve an advice letter regarding compliance with Ordering Paragraph 4 of D.03-12-035. The advice letter shall also show:
 - i. Adjustments to Account 923 for 2001 and 2002 to reverse accruals for the SrERP;
 - ii. The accounting of all SrERP payments, including those made in January 2004 (even if cash distributions were deferred), to demonstrate that the payments were and are not charged to ratepayers; and
 - iii. Anything else reasonably necessary to ensure that ratepayers have not paid, and will not pay, any portion of the \$84.5 million in SrERP expenses. (pp.141-142)

This Attachment 3 presents the SrERP-related information required in Ordering Paragraph 11a.

Please note that PG&E previously provided this information in three reports:

- On February 10, 2004, PG&E submitted its "Report To The California Public Utilities Commission Regarding Executive Compensation And Bonuses"² in PG&E's 2003 GRC.
- On February 27, 2004, PG&E submitted its "Supplemental Report of Pacific Gas and Electric Company Providing Further Information on Accounting for Executive Compensation And Bonuses"³ in PG&E's 2003 GRC.

¹ Application 02-11-017.

² The February 10 Report was submitted in response to the "Administrative Law Judges' Ruling Setting Aside Submission And Taking Further Evidence Regarding Executive Compensation And Bonuses" issued February 3, 2004, by Administrative Law Judges (ALJs) Julie M. Halligan and Burton W. Mattson.

³ The Supplemental Report was submitted in response to the "Administrative Law Judge's Ruling Requesting Further Information on Accounting for Executive Compensation And Bonuses" issued February 23, 2004, by ALJs Julie M. Halligan and Burton W. Mattson.

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Senior Executive Retention Program Compliance Report

- On June 1, 2004, PG&E submitted its GO 77-K Report, including a list of senior officers who received SrERP payments and the amounts of the payments, as well as information on how PG&E accounted for the SrERP payments.

2. Summary

Under the PG&E Corporation SrERP, retention grants were issued to 17 senior officers in January and February 2001. These officers and the grant amounts are shown in Table 1 of this Attachment 3. The group was comprised of senior executives of PG&E Corporation, of PG&E, and of PG&E Corporation's subsidiary, PG&E National Energy Group (NEG), now known as National Energy and Gas Transmission, Inc. (NEGT).

As described below, the cost of the SrERP payments for PG&E senior officers and a portion of the costs for PG&E Corporation senior officers were charged as expense on PG&E's financial books in 2001, 2002, and 2003. In 2001 and 2002, these costs were charged to an above-the-line Account 923. However, PG&E has submitted reports to the Commission demonstrating that – despite these costs being charged to an above-the-line account in 2001 and 2002 – none of these costs were borne by ratepayers. In 2003, these costs were charged to a below-the-line Account 426.

The costs of the SrERP payments for NEG T senior officers were not and will not be charged to PG&E. Thus, there is no FERC account on PG&E's financial books associated with these payments.

3. Background Accounting Information

Under the terms of the Program, the retention grants were to vest no earlier than December 31, 2003, and no payments were to be made until 2004. However, as required under Generally Accepted Accounting Principles, expenses associated with the Program were booked beginning in 2001 on a quarterly basis through 2003.

When PG&E Corporation booked the accrual in 2001 for the retention grants, it charged PG&E for the total amounts accrued for PG&E senior executives and an allocation of the accrual for PG&E Corporation senior executives. (No amounts related to NEG T senior executives were included in the invoice to PG&E.⁴)

⁴ Thomas B. King was a senior executive employed by NEG at the time the grants were made in 2001. In November 2003, Mr. King became the Senior Vice President of PG&E's Utility Operations. During the period that Mr. King was an NEG officer, the expenses related to his payment were not charged to PG&E, but to NEG.

PACIFIC GAS AND ELECTRIC COMPANY
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Senior Executive Retention Program Compliance Report

This charge was included in the 2001 invoices sent by the Holding Company to the Utility; future charges were included in subsequent quarterly invoices sent through 2003. As a result, PG&E booked expenses related to the Program as accruals in 2001, 2002, and 2003, as required by generally accepted accounting principles.

In 2001 and 2002, on PG&E's financial books, these invoiced costs from the Holding Company were charged to Administrative and General (A&G) expense Account 923, Outside Services, which is usually considered an "above-the-line" account. However, as PG&E previously explained in the February 10 Report and the Supplemental Report, these amounts were not used to develop PG&E's revenue requirement request in its 2003 GRC.⁵

Nevertheless, in 2001 and 2002, PG&E included a portion of recorded – as opposed to adopted – Account 923 A&G expenses in certain memorandum and balancing accounts used to book some of PG&E's generation costs in those years. Specifically, in 2001, approximately \$98,000 of the accrued expense for the SrERP was booked to the Fossil Generation Memorandum Account and approximately \$68,000 was booked to the Electric Energy Transaction Administration account. In 2002, approximately \$811,000 of accrued SrERP expense was booked to the Utility Generation Balancing Account.

Because electric rates were frozen in 2001 and 2002, these expense entries into these regulatory accounts did not affect PG&E's CPUC-jurisdictional rates or the amount customers paid in those years. Customer rates and PG&E's earnings were unaffected by these entries. Had PG&E not booked these particular expense entries into the various regulatory accounts listed above in 2001 and 2002, both customer rates and PG&E's earnings in those years would have been exactly the same.

⁵ The terms "above the line" and "below the line" are colloquialisms not officially defined by the CPUC or other regulators that generally mean, respectively, eligible for regulatory recovery and not eligible for regulatory recovery. The Uniform System of Accounts (USOA), adopted by the CPUC for public utilities subject to its jurisdiction, identifies five expense accounts—426.1, Donations; 426.2, Life Insurance; 426.4, Expenditures for certain civic, political and related activities; and 426.5, Other deductions—that are considered nonoperating for accounting purposes. These accounts are often called "below-the-line." The USOA expressly notes, however, that the "classification of expenses as nonoperating . . . is for accounting purposes" and "does not preclude [Federal Energy Regulatory] Commission consideration of proof to the contrary for ratemaking or other purposes. Similarly, expenses may be recorded in other accounts, often called "above-the-line," for accounting purposes, but the utility may not seek recovery of such expenses in rates.

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Senior Executive Retention Program Compliance Report

Nevertheless, to assure the Commission that this \$977,000 of SrERP expense is accounted for consistent with "below-the-line" treatment, PG&E is adjusting these entries out of the regulatory memorandum and balancing accounts in 2001 and 2002.⁶ This adjustment is shown in Attachment 1, page 2, line 29, of this Advice Letter.

In 2003, the invoiced amounts for the SrERP were charged on PG&E's financial books to Account 426, a "below-the-line" account.

No transaction was recorded on PG&E's financial books in January 2004 as a result of the payments made under the Program, because the expenses allocated to PG&E already were accrued on PG&E's books in 2001, 2002, and 2003. Since there was no transaction on PG&E's books in January 2004, there is no reference to any FERC expense account. Because these amounts were fully expensed in the past, no amounts will be expensed in the future. The SrERP costs will not affect future rates.

The January 2004 payments to PG&E utility officers under PG&E Corporation's SrERP were made from PG&E Corporation's cash on hand. As discussed above, PG&E Corporation expensed the cost on a quarterly basis and included PG&E's share of the Program costs in its invoices to PG&E in 2001, 2002, and 2003. PG&E recorded these amounts billed by PG&E Corporation as expenses and as payables to PG&E Corporation, to be paid by PG&E once it emerged from bankruptcy. In June 2004, PG&E reimbursed PG&E Corporation for these past invoiced amounts. The accounting transaction on PG&E's financial books for this payment was a credit to cash (Account 131) and a debit to accrued liabilities (Accounts 232 and 234).

4. Additional Support from 2003 GRC Record Evidence

This section provides support from the record in PG&E's 2003 GRC that PG&E Corporation SrERP grants were excluded from PG&E's revenue requirement request in that case. This section provides documentation that demonstrates that the cost estimates presented in the GRC did not include such grants.

⁶ PG&E reviewed the descriptions of and entries to the other balancing and memorandum accounts that existed in 2001 and 2002. The review indicated that there are no other instances of the allocation of expenses recorded in Account 923. Further, PG&E reviewed its recent FERC electric Transmission Owner (TO) case applications. The review indicated that no SrERP costs were included in those TO revenue requirement requests. Finally, regarding Gas Transmission Northwest's (previously known as Pacific Gas Transmission) cost of service, Gas Transmission Northwest's current rates were approved by the FERC in 1996 and would not include amounts related to the SrERP.

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Specifically, this section addresses the costs of the 17 senior executives who received the retention grants in early 2001. The 17 senior executives were employed by three separate entities:

- 1) PG&E Corporation, the Holding Company (PG&E's parent company);
- 2) PG&E, the Utility; and
- 3) NEGT, a subsidiary of PG&E Corporation.

In the 2003 GRC, PG&E addressed the costs of these three entities separately, so they are addressed separately in this section.

A. Retention Grants for Holding Company (PG&E Corporation) Executives

As described earlier, under the SrERP, retention grants were issued in January and February 2001. Under the terms of the Program, the retention grants were to vest no earlier than December 31, 2003, and no payments were to be made until 2004. However, as required under Generally Accepted Accounting Principles, expenses associated with the Program were booked beginning in 2001. The Program expenses related to Holding Company senior executives were charged on the Holding Company financial books to Provider Cost Center (PCC) 20000, "Holding Company Corporate Items."

Generally, the 2003 GRC estimates of Holding Company department costs were prepared using recorded data from the Holding Company's financial books for 2000 and 2001, then adjusting the recorded data for expected increases or decreases in costs to derive the 2003 forecasts.⁷ However, PG&E did not use recorded 2001 costs to forecast the costs of PCC 20000 in the GRC. Instead, PG&E used the 2002 budget, which excluded the retention grants, as the basis for the PCC 20000 forecast.⁸ The 2001 recorded expenses related to the retention grant accrual were not included in the 2003 revenue requirement in the GRC.

The Commission's Office of Ratepayer Advocates (ORA) confirmed this in its review of PG&E's 2003 GRC showing on A&G expense. In its report on PCC 20000, ORA found that: "PG&E excluded the cost of stock options and deferred compensation from its forecast."⁹ ORA accepted PG&E's 2003 forecast for Holding Company PCC 20000, although it disagreed with PG&E's allocation of these costs to the Utility.¹⁰

⁷ Holding Company recorded and forecast costs were described in Chapter 7 of Exhibit 4 and supporting workpapers (Exhibits 4-7-W1 and 4-7-W2). Additional support was provided in Chapters 8 through 15 of Exhibit 22.

⁸ See PG&E's response to Data Request ORA_OC0054, Attachment 2.

⁹ Exhibit 306, p.9-33. PG&E provided information on the components of the forecast for PCC 20000 in response to Data Requests ORA_OC0054 and ORA_OC0272. These responses show that retention grants were not included in the forecast of Corporate Items.

¹⁰ Exhibit 306, p.9-34.

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Senior Executive Retention Program Compliance Report

B. Retention Grants for PG&E (Utility) Executives

When PG&E Corporation booked the accrual in 2001 to recognize the future expenditure for the retention grants, it charged PG&E for the portion of the expenses related to Utility executives. This charge was included in the 2001 invoices sent by the Holding Company to the Utility. On PG&E's financial books, these invoiced costs from the Holding Company are charged to PCC 10940, "Affiliate Costs," to Account 923, Outside Services.¹¹ Hence, the accrued expenses related to Utility executive grants were charged to PCC 10940 in Account 923.

Generally, the 2003 GRC forecast of Account 923 was prepared using recorded data from PG&E's financial books for 2000 and 2001, then adjusting the recorded data for expected increases or decreases in costs to derive the 2003 forecasts.¹² However, PG&E did not use recorded PCC 10940 costs in developing its Account 923 forecast in the GRC. Instead, PG&E removed the PCC 10940 costs from the recorded Account 923 data used to develop Utility Corporate Services costs.¹³ PG&E then prepared the forecast of Holding Company charges to the Utility using the method described in Section A, above. As noted above, ORA's audit confirmed that PG&E excluded the cost of stock options and deferred compensation from its forecast.

C. Retention Grants for National Energy Group Executives

The 2003 GRC did not include any costs related to NEG. As stated in Exhibit 4, "Administrative and Support Costs," at page 7-3:

The costs that are incurred by the Holding Company specifically for the benefit of non-Utility endeavors are not allocated to the Utility...*[F]unctional areas that are not Utility-related, such as the Chief Executive Officer (CEO) of PG&E's National Energy Group (NEG), are not included as part of services allocated to the Utility...* These costs are not charged to the Utility.
[emphasis added]

¹¹ This can be verified by extracting data for PCC 10940 from PG&E's response to Data Request ORA_AUD043, Attachment 1, and reconciling PCC 10940 costs to the Holding Company invoices provided in response to Data Request ORA_OC0012.

¹² The costs of PG&E Corporate Services departments were described in Chapter 2 of Exhibit 4 and supporting workpapers (Exhibits 4-2-W1 through 4-2-W5). Additional support was provided in Chapter 5 of Exhibit 22.

¹³ See Exhibit 6-6W2, page 52, which lists the Utility PCCs included in PG&E's 2003 estimate for Account 923; the list does not include PCC 10940.

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Senior Executive Retention Program Compliance Report

The only area in the GRC showing where NEG costs are discussed is in the context of Holding Company costs. Under Commission guidelines, PG&E must demonstrate that Holding Company costs are properly allocated between the Utility and NEG.¹⁴

The estimate of Holding Company costs is shown by department on Table 7-1 on pages 7-46 and 7-47 of Exhibit 4. The only NEG organization included on Table 7-1 is Provider Cost Center 20002, President, NEG (see Line 7). The total 2003 forecast for this NEG organization is shown in the column titled "Total Cost" as \$579,000. The amount allocated to the Utility is zero, as shown in the column titled "Utility Common." The entire cost of this NEG organization is allocated to the "Affiliates/Below-the-Line" column; that is, it is excluded from the forecast in the GRC.

Because the 2003 GRC did not include any costs related to NEG, by definition, no costs related to retention grants made to NEG executives were included in the 2003 GRC revenue requirement.

5. Commission Staff Audit of This Report

Ordering Paragraph 11b of Decision 04-05-055 requires, in part:

The Executive Director shall direct Commission staff to audit the accounting and treatment of the \$84.5 million as reported in the advice letter or supplemental advice letter. PG&E and PG&E Corporation shall fully cooperate with the Commission staff audit. (p. 142)

PG&E is prepared to provide supporting documentation for all the information provided in this Attachment 3 and will provide full cooperation to the Commission Staff in compliance with Ordering Paragraph 11b.

¹⁴ The exclusion of NEG costs and the resulting estimate of Holding Company costs are described in Chapter 7 in Exhibit 4 and supported in workpapers (Exhibits 4-7W1 and 4-7W2).

PACIFIC GAS AND ELECTRIC COMPANY
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Senior Executive Retention Program Compliance Report

Table 1

SENIOR EXECUTIVE RETENTION ELIGIBILITY LIST

Last Name	First Name	Title	Band	Retention Amount	Stock Units ¹	Final Retention Payments ²
INITIAL LIST						
Corporation and Pacific Gas & Electric Company Participants						
Glynn, Jr.	Robert D.	CHAIRMAN, C.E.O. & PRESIDENT	1	\$6,000,000	615,385	\$17,089,241
Smith	Gordon R.	SR. V.P./PRES. & CEO PACIFIC GAS AND ELECTRIC CO.	2A	\$3,500,000	358,975	\$9,968,736
Darbee	Peter A.	SR. V.P. and CFO	2	\$2,250,000	230,770	\$6,408,483
Worthington	Bruce R.	SR. V.P. & General Counsel	2	\$1,250,000	128,205	\$3,560,253
Stanley	G. Brent	SR. V.P.-Human Resources	3	\$1,250,000	128,205	\$3,560,253
Richard	Daniel D.	SR. V.P.-Public Affairs, PACIFIC GAS AND ELECTRIC CO./Sr.V.P. Govt. Relations of PG&E CORP.	3	\$1,250,000	128,205	\$3,560,253
TOTAL				\$15,500,000	1,589,745	\$44,147,219
SUPPLEMENTAL LIST						
Corporation and Pacific Gas & Electric Company Participants						
Randolph	James K.	SR. V.P. & Chief of Utility Operations	3	\$1,250,000	95,715	\$2,658,006
Rueger	Gregory M.	SR. V.P. - Generation and Chief Nuclear Officer	3	\$1,250,000	95,715	\$2,658,006
Harvey	Kent M.	SR. V.P. C.F.O. & Treasurer	3	\$1,250,000	95,715	\$2,658,006
Peters	Roger	SR. V.P. & General Counsel	3	\$1,250,000	95,715	\$2,658,006
PG&E National Energy Group Participants						
Boren	Thomas G.	EVP/PRES. & CEO OF PG&E NATIONAL ENERGY GROUP	2A	\$3,500,000	267,995	\$7,442,221
Maddox	Lyn E.	SR. V.P./PRES. & COO, TRADING, PG&E NEG	2	\$2,250,000	172,285	\$4,784,354
Iribe	P. Chrisman	SR. V.P./PRES. & COO, EAST REGION, PG&E NEG	2	\$2,250,000	172,285	\$4,784,354
King	Thomas B.	SR. V.P./PRES. & COO, WEST REGION, PG&E NEG	2	\$2,250,000	172,285	\$4,784,354
Herman	Steve	Sr. V.P. General Counsel	4	\$1,250,000	95,715	\$2,658,006
Cooper	John Robert	Sr. V.P. Finance & CFO	4	\$1,250,000	95,715	\$2,658,006
Barpoulis	Sarah	Sr. V.P. Power	4s	\$1,250,000	95,715	\$2,658,006
TOTAL				\$19,000,000	1,454,855	\$40,401,323
GRAND TOTAL				\$34,500,000	3,044,600	\$84,548,542

Notes:

- 1 For Initial Group, stock units priced at close on 1/22/01: \$9.75. Supplemental Group at close on 2/21/01: \$13.06.
2 Stock price of \$27.77, closing price on 12/31/03.

PG&E Gas and Electric Advice
Filing List
General Order 96-A, Section III(G)

ABAG Power Pool
Accent Energy
Aglet Consumer Alliance
Agnews Developmental Center
Ahmed, Ali
Alcantar & Elsesser
Anderson Donovan & Poole P.C.
Applied Power Technologies
APS Energy Services Co Inc
Arter & Hadden LLP
Avista Corp
Barkovich & Yap, Inc.
BART
Bartle Wells Associates
Blue Ridge Gas
Bohannon Development Co
BP Energy Company
Braun & Associates
C & H Sugar Co.
CA Bldg Industry Association
CA Cotton Ginners & Growers Assoc.
CA League of Food Processors
CA Water Service Group
California Energy Commission
California Farm Bureau Federation
California Gas Acquisition Svcs
California ISO
Calpine
Calpine Corp
Calpine Gilroy Cogen
Cambridge Energy Research Assoc
Cameron McKenna
Cardinal Cogen
Cellnet Data Systems
Chevron Texaco
Chevron USA Production Co.
Childress, David A.
City of Glendale
City of Healdsburg
City of Palo Alto
City of Redding
CLECA Law Office
Constellation New Energy
CPUC
Creative Technology
Cross Border Inc
Crossborder Inc
CSC Energy Services
Davis, Wright Tremaine LLP
Davis, Wright, Tremaine, LLP
Defense Fuel Support Center
Department of the Army
Department of Water & Power City
Dept of the Air Force
DGS Natural Gas Services
DMM Customer Services
Downey, Brand, Seymour & Rohwer
Duke Energy
Duke Energy North America
Duncan, Virgil E.
Dutcher, John
Dynergy Inc.
Ellison Schneider
Energy Law Group LLP
Enron Energy Services
Exelon Energy Ohio, Inc
Exeter Associates
Foster Farms
Foster, Wheeler, Martinez
Franciscan Mobilehome
Future Resources Associates, Inc
G. A. Krause & Assoc
GLJ Energy Publications
Goodin, MacBride, Squeri, Schlotz &
Grueneich Resource Advocates
Hanna & Morton
Heeg, Peggy A.
Hogan Manufacturing, Inc
House, Lon
Imperial Irrigation District
Integrated Utility Consulting Group
International Power Technology
Interstate Gas Services, Inc.
J. R. Wood, Inc
JTM, Inc
Kaiser Cement Corp
Korea Elec Power Corp
Luce, Forward, Hamilton & Scripps
Marcus, David
Masonite Corporation
Matthew V. Brady & Associates
Maynor, Donald H.
McKenzie & Assoc
McKenzie & Associates
Meek, Daniel W.
Mirant California, LLC
Modesto Irrigation Dist
Morrison & Foerster
Morse Richard Weisenmiller & Assoc.
Navigant Consulting
New United Motor Mfg, Inc
Norris & Wong Associates
North Coast Solar Resources
Northern California Power Agency
Office of Energy Assessments
Palo Alto Muni Utilities
PG&E National Energy Group
Pinnacle CNG Company
PITCO
Plurimi, Inc.
PPL EnergyPlus, LLC
Price, Roy
Product Development Dept
Provost Pritchard
R. M. Hairston & Company
R. W. Beck & Associates
Recon Research
Regional Cogeneration Service
RMC Lonestar
Sacramento Municipal Utility District
SCD Energy Solutions
Seattle City Light
Sempra
Sempra Energy
Sequoia Union HS Dist
SESCO
Sierra Pacific Power Company
Silicon Valley Power
Simpson Paper Company
Smurfit Stone Container Corp
Southern California Edison
SPURR
St. Paul Assoc
Stanford University
Sutherland, Asbill & Brennan
Tabors Caramanis & Associates
Tansev and Associates
Tecogen, Inc
TFS Energy
TJ Cross Engineers
Transwestern Pipeline Co
Turlock Irrigation District
U S Borax, Inc
United Cogen Inc.
URM Groups
Utility Cost Management LLC
Utility Resource Network
Wellhead Electric Company
Western Hub Properties, LLC
White & Case
WMA