eak

ORIGINAL

Decision No. 83170

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY for Authority to Increase Rates Charged by it for Electric Service.	Application No. 53488 (Filed August 1, 1972)

(Appearances are listed in Appendix A)

INTERIM OPINION ON EXPLORATION AND DEVELOPMENT PROGRAM

Nature of Proceeding

By Decision No. 81919 dated September 25, 1973 in Application No. 53488, the Commission authorized Southern California Edison Company (Edison) to increase its rates by $89,138,000 based on estimated 1973 test year results of operations. Near the close of the 50 days of hearings on the rate increase Edison proferred evidence relating to costs of conducting an extensive exploration and development (E&D) program directed towards the acquisition of additional energy resources for electric generation. Because of the indicated likelihood that such matter would involve a number of days of hearing and some additional time for preparation by other participants, the parties stipulated that the treatment of Edison's 1973 E&D expenses, exclusive of those expenses which were included in Administrative and General Expenses, would be the subject of a supplemental hearing to be held after the issuance of the Commission's decision. Presiding Examiner Boneysteele, thus, on April 26, 1973 declared the proceeding on the "general rate case phase" to be submitted and the "exploration and development phase" to be deferred to a later, unspecified time.

Accordingly, Decision No. 81919 states:

> "It is anticipated that, after the issuance of a decision in the general rate case, additional hearings will be held and another decision issued dealing exclusively with exploration and proposals for the funding of the exploration program." (Decision No. 81919, mimeo page 9.)

Additional hearings were held on January 28, 29, and 30 in Los Angeles before Examiner Boneysteele. Three parties actively participated: Edison, the Commission staff, and the California Manufacturers Association (CMA). The matter was submitted upon the filing of opening and closing briefs. The California Farm Bureau Federation (Farm Bureau) was granted permission to file, and did so file, a statement of position.

Edison's Proposal and Request

In the general rate case phase of the proceeding Edison had introduced Exhibit 80, the prepared testimony of W. H. Seaman,[1/] its vice president in charge of fuel supply acquisition activities, and Exhibit 81, the Edison-Mono Fuel Service Agreement which describes the arrangement between Edison and its wholly owned subsidiary, Mono Power Company (Mono), for carrying on an E&D program directed towards the acquisition of additional energy sources for electric generation. Mr. Seaman's prepared testimony and the Edison-Mono Fuel Service Agreement, as well as estimates of the cost of the current E&D program, a comparisen of the Edison-Mono Fuel Service Agreement (including accounting and ratemaking treatment thereof) with the Southern California Gas Company "GEDA"[2/] program, and a table showing the calculation of the proposed E&D adjustment under the Edison-Mono arrangement were considered in the hearings commencing January 28, 1974 as Edison's direct case.

1/ Mr. Seaman is also president of Mono.

2/ GEDA stands for "Gas Exploration and Development Adjustment". See CPUC Decision No. 81898 dated September 25, 1973 in Application No. 53625 of Southern California Gas Company.

While Edison's exhibits suggested it might be seeking authorization of a procedure similar to GEDA, it was explained by counsel that Edison seeks only approval of the concept that reasonable E&D expenses resulting from Edison's arrangement with Mono may be recovered through rates, and that its rates should be increased by $3,449,000 to cover its anticipated 1974 budgeted expenditures. The California jurisdictional portion of such an increase would require an upward rate adjustment of 0.006¢/Kwhr.

It was also pointed out by Edison's counsel that future procedure for such rate treatment could be either through adjustments to base rates initiated as part of a formal rate application or an advice filing, or under the fuel cost adjustment advice filing.

Edison's specific request to the Commission in this proceeding relating to the Edison-Mono E&D arrangement was finally formulated by counsel for Edison on the second day of hearing as follows:

1. Approval in principle and concept of the Edison-Mono fuel service arrangement including:
   (a) Recognition of need for the program.
   (b) Recognition of the ratepayer benefits involved.
   (c) The propriety of reflecting in operating expenses the costs of the ongoing E&D program under the Edison-Mono fuel service arrangement.
   (d) Approval of accounting treatment to be utilized in reflecting such costs in operating expense.

2. Approval of an initial increment of E&D costs under the program as presented in this hearing and reflection of such costs in rates based on the estimated 1974 level of such costs.

Mr. Seaman testified that under the agreement, which became effective as of January 1, 1973, Mono is to explore for, develop, and produce and deliver energy resources for Edison's various generating stations. It is currently involved with oil, gas, oil shale, uranium, coal, and geothermal energy.

The company staff carrying on Mono activities is organized to work with and review the activities of joint venture participants and consulting organizations. It is not intended at this time that Mono will carry out large-scale exploration, development, and production operations on its own, but rather it will enter into such operations in joint venture with others.

According to Mr. Seaman, Mono will finance its activities by obtaining or borrowing from Edison or others, to the extent practicable, the funds necessary to carry out its activities. The agreement provides that Mono will be advanced funds according to the following procedure:

(1) Mono will submit to Edison for its approval projects in which it proposes to engage. If approved by Edison, a work order will be established covering the project with Edison agreeing to advance or loan any necessary funds. The service charges to Mono on any such funds advanced by Edison are not to exceed the rate of return (before taxes on income) consistent with that most recently authorized for Edison by this Commission.

(2) When exploration results in a discovery capable of being developed into a producing operation, the costs for development and production will be amortized or depreciated throughout the useful life of the particular commodity being produced and become part of the fuel service charge along with annual operating and maintenance expenses.

(3) Funds expended on unsuccessful exploration, to the extent not theretofore amortized, will be carried by Mono as a deferred expense until written off on a five-year life basis.

(4) Should Mono market any of the said commodities referred to above to entities other than Edison, the proceeds from such a production and marketing operation would be applied by Mono against the cost of its operations, as contemplated in the Fuel Service Agreement.

(5) Based on annual budgets which can be revised quarterly, Edison will pay to Mono a monthly fuel service charge which Edison will treat as part of its fuel expense.

Need for The Program

Edison's witness, Mr. Seaman, testified at length to the need for an E&D program, stressing the primary concern over the adequacy for the future of the fuel and energy supplies available from traditional sources. He also discussed another concern which has become increasingly critical in recent months, that of having a "yardstick" by which to measure the reasonableness of fuel supply arrangements from those traditional sources and to exert some competitive leverage in dealing with fuel and energy suppliers.

In Mr. Seaman's opinion it is essential that Edison do everything reasonably possible to make more fuel and energy supplies available to California for electric generation, both in terms of having adequate fuel and energy to meet the requirements of the area and also being able to exercise some control over the price that will have to be paid for such fuels.

Staff Analysis

The staff presented two highly qualified witnesses, Kenneth K. Chew, a certified public accountant, employed in the Finance and Accounts Division as a Financial Examiner IV, and Bruno Davis, a registered professional engineer who is the General Division Engineer of the Utility Division with the classification of Principal Utilities Engineer.

Mr. Chew recommended that any approval of the proposed E&D procedure be subject to six accounting requirements, as follows:

1. Full cost accounting for costs related to exploration and development activities on a project to project basis.
2. All income tax credits to be credited to the deferred exploration and development advances.
3. Abandoned leases and associated costs less tax credits to be amortized over five years or as otherwise authorized by the Commission after it is determined that the costs are unrecoverable.
4. Revenues from production on sales to outsiders to be passed back to Edison as a reduction in current fuel service charges.
5. Mono to be required to file an annual report with the Commission setting forth its operating results, financial position and a schedule by E&D projects.
6. Mono to use the same prescribed system of accounts as Edison. The books to be made available for staff review upon request.

Staff witness Davis presented four exhibits in which he analyzed and commented on Edison's development of the requested fuel service charge of 0.006¢/Kwhr. Mr. Davis applied ratemaking adjustments totaling $1,584,000 for the 1973 test year, and concluded that Edison's test year E&D expenses could only support an annual increase of $1,027,000, which amount would require a California jurisdictional fuel service charge of 0.002¢/Kwhr.

A substantial portion of Mr. Davis' adjustment, $1,428,800, is due to the accounting amortization of unsuccessful ventures recommended by Mr. Chew. The remaining $159,300 of Mr. Davis' adjustment is mainly due to Edison not reflecting current year tax credits in its development of cost of funds. This practice results in higher charges by the amount of tax credits multiplied by the cost of funds.

Edison also did not deduct from cost of funds utilized during the year the amortization amounts included in the fuel service charge. According to Mr. Davis this would be inconsistent with the accepted method of calculating cost of service wherein depreciation is deducted from rate base.

Mr. Davis also presented a comparable analysis for the year 1974, which resulted in an annual increase of $699,000, requiring a California jurisdictional fuel service charge of 0.001¢/Kwhr.

Mr. Davis testified that the Commission staff is not opposed to the Edison-Mono E&D arrangement, although it did have some reservation that competition between California gas and electric companies for natural gas supplies might in effect result in higher costs to California gas customers than would be the case if Edison were not competing for the same fuel.

In order to insure proper review of Edison's projects, Mr. Davis recommended that Edison be required to file the same information as was required of Pacific Gas and Electric Company in Decision No. 80878 dated December 19, 1972 in Application No. 53188.

> "Pacific Gas and Electric Company shall keep the Commission and its staff fully informed of the status of gas and oil development projects, the allocation of suspense funds of Natural Gas Corporation to exploration expense and capital investment, and proposed new ventures under its gas and oil exploration and development program by filing quarterly reports with the Commission on or before the twenty-fifth day succeeding the end of each calendar quarter." (Decision No. 80878, mimeo, p. 54.)

Mr. Davis recommended that, should a fuel service charge be authorized, the charge be applied uniformly on a cents per kilowatt hour basis. He also recommended that the fuel service charge be shown on the rate schedules themselves and not as part of the preliminary statement to the tariff schedules, as suggested by Edison.

Mr. Davis recommended that a fuel service charge be based on the 1973 estimated test year as used in the "results of operation phase", in other words, the general rate case.

As a final recommendation, Mr. Davis observed that his fuel service charge was "somewhat de minimis", and advised the Commission not to increase rates at this time but to wait until Edison should propose some other rate adjustment.

Edison Rebuttal

In rebuttal to Mr. Davis, Edison presented Fred Clisby, an accountant who had had many years' oil and gas accounting experience with a large independent oil company prior to his recent employment by Edison.

Mr. Clisby testified that Mr. Davis had used some incorrect information inadvertently given to him by Edison and had not added back, to the cost of funds utilized, base exploration expense which under his method was not amortized. These factors, when considered, produce an initial increment of 0.002¢/Kwhr based on the 1974 E&D program, reflecting the effect of the staff's recommendation regarding amortization of exploration expenses only after a project is determined to be productive or non-productive.

A problem which came into clearer focus during the cross-examination of Mr. Clisby is the ratemaking treatment of sales of leasehold, mineral rights, or other assets. It was evident that Edison plans to credit to the fuel service charge any revenues received from production and sale of products, with which proposal the staff concurs. The ratemaking treatment planned by Edison for leasehold, mineral rights, or other assets was not as clear; however, Mr. Clisby stated any such transaction would be accounted for as follows:

"My understanding of the transaction, if assets, properties were sold, the proceeds would first be applied against the advance account to the extent that particular property had an unamortized balance.

"The gain would then be treated in the same manner as the sale of product and would be applied to the fuel service charge."

Position of Other Parties

The counsel for the California Manufacturers Association stated that CMA does not oppose the principle of an allowance for E&D expense, with the reservation that there are a number of principles which should be applied in determining what should be allowed.

The Farm Bureau, in its statement, said that it "supports enthusiastically the efforts of Southern California Edison Company to acquire fuel supplies so that it may meet its obligation of providing reliable electric service at reasonable rates to its consumers". The statement goes on to say however that testimony in the case, points raised by the CMA, and questions by the examiner "illustrate the grave concern which the testimony in this proceeding raises". The Farm Bureau suggests that the matter be considered in Cases Nos. 9581 and 9642, our investigations into energy and fuel supplies and requirements of electric and gas companies.

The questions by the examiner, referred to by the Farm Bureau, dealt with two points. The first, directed to Mr. Seaman, was whether or not as a result of a national energy policy, energy sources procured by Edison E&D expenditures might become unavailable to Edison customers. The second, asked to the CMA counsel, dealt with the question of nationwide competition among utilities for fuel supplies financed by ratepayer funds.

The principles that CMA believes should be applied are that E&D money should not be substituted for investor supplied funds in ventures where there appears to be no substantial risk in locating fuel resources. An example which CMA cited was the exploitation of known geothermal reserves. CMA also recommended that no funds from the E&D fuel service charge be expended for carrying costs on capital expenditures made prior to January 1, 1973. CMA also requested a condition that no ratepayers' E&D money be involved in any project, within or without California, in which Edison may have been involved in competitive bidding with another California utility.

CMA also recommends that the procedure authorized for Edison's E&D should be similar to the requirements for advance approval set out in Finding 17 of our GEDA Decision No. 81898.

Petition to Set Aside Submission

On June 21, 1974, Edison filed a document entitled "Motion to Amend Application and Petition to Set Aside Submission". Attached to the motion was a revision of the Edison-Mono Fuel Service Agreement which incorporated some of the suggestions of the Commission staff. A comparison of the revised agreement with the GEDA program was also attached. By the motion Edison requested that the proceeding be reopened to receive the revised evidence and any additional information deemed necessary by the Commission to enable it to dispose promptly of the matter.

Discussion

In analyzing the record in this phase of the proceeding we are troubled by the vagueness of the proposals before us. For example, it was only after the noon recess of the second day of hearing that counsel for Edison crystalized its request.

The staff argues that before the staff can analyze, or the Commission consider, the magnitude of Edison's E&D program, or whether a time limitation should be established, or whether preauthorization should be required for all future projects, it is incumbent upon Edison to present far more than it has in this proceeding.

On the other hand, the staff in turn is vague in its recommendations and in its discussion of the problem of the competition between California utilities for energy sources, particularly gas, which could be generated by Commission recognition of E&D programs. The staff, in its opening brief, found this problem to be troubling. It said that at some stage, the Commission may well have to consider proscribing or limiting competition among California utilities. The problem, to the staff, is obvious. If, through competitive bidding, a California utility (or affiliate) is required to put up more money than it would without such competition, how has the California ratepayer benefitted? The staff went on to declare that at this early stage in E&D programs, the utilities and ratepayers alike would be well served by the Commission's consideration of guidelines or a statement of policy. In conclusion the staff brief urged "...that the Commission give attention to the problem of competitive E&D activities by California utilities".

Although the military approach to analyzing situations and recommending courses of action is not, at present, the most popular one, there is still some merit to the submission of complex proposals according to the doctrine of completed staff work.[3/] The above quotation from the staff's opening brief is admittedly taken out of context, and the staff did make definitive recommendations concerning the level of the E&D fuel service charge and accounting procedures.

3/ "A staff study report should represent completed staff work. This means that the staff officer has solved a problem and presented a complete solution to his superior. The solution should be complete enough that all the commander or chief has to do is approve or disapprove". (AFM 10-4 Guide for Air Force Writing, Washington, D.C.; Department of the Air Force, 1 April 1960, p. 122.)

We find that reasonable E&D expenditures arising out of Edison's agreement with Mono may be recovered from customers as a legitimate part of the cost of service. We agree with the staff recommendations concerning accounting and availability of books and records of Edison and Mono. We also concur with the staff that the year 1973 is the proper test period. This is consistent with Decision No. 81919 (mimeo. pages 33 and 34) and with the California Supreme Court's discussion of the test year principle (City of Los Angeles v PUC (1972) 7 Cal 3d 331 at p. 346).

It follows from our agreement with the other staff recommendations concerning test period and accounting treatment that we also concur with the staff's determination that the proper E&D fuel service charge should be 0.002¢/Kwhr. Again we agree that, because of the many increases over the last year and the recent large general rate increase and even larger fuel clause increases granted Edison, it is unwise to increase the rates once again for such a small amount. We concur with the staff's conclusion that any fuel service charge justified on this record would be de minimis and we will not authorize such charge at this time.

In this instance we are not inclined to promulgate guidelines or statements of policy. The issues are so novel and the details so complex that we prefer to have proposals submitted by the parties for our consideration. It is to this end, as a source of impartial advice, that we employ a large and capable staff.

Edison's petition to set aside submission was received during our deliberation of this decision. Its objectives do not appear inconsistent with action that we will take in this decision. In the order that follows, we shall make as many findings as the record will permit, and base our order on such findings. The remaining inchoate issues and those raised by Edison's petition will be considered in further hearings in this proceeding. At that time we expect to have more definitive proposals for our consideration.

Findings

1. There is a need for an exploration and development program similar in principle and concept to the Edison-Mono Fuel Service Agreement.

2. Such an E&D program would benefit the ratepayer.

3. Reasonable E&D costs would be a proper charge to operating expense.

4. A proper E&D fuel service charge based on this record would be 0.002¢/Kwhr.

5. An increase of 0.002¢/Kwhr would be de minimis and will not be authorized at this time.

6. In accounting for E&D arrangements, Edison should follow the six accounting recommendations of the staff set forth in the foregoing opinion.

7. Complete authorization of Edison's E&D program will require a record containing more definitive proposals of guidelines and statements of policy.

Conclusions

1. The proposal of Southern California Edison Company should be granted to the extent set forth in the following order.

2. The proceeding should be reopened for further hearings to complete the record.

INTERIM ORDER ON EXPLORATION AND DEVELOPMENT PROGRAM

IT IS ORDERED that:

1. The exploration and development arrangement pursuant to the Southern California Edison Company-Mono Power Company agreement, as described herein is approved in principle and concept.

2. Reasonable exploration and development costs incurred under the Edison-Mono agreement may be included in Edison's operating expenses, pending a final decision in this proceeding.

3. Edison is directed to account for exploration and development charges according to the six accounting recommendations of the staff as set forth in the foregoing opinion.

4. No adjustment to rates is authorized at this time.

5. The proceeding shall be reopened for further hearings for the purpose of receiving more definitive proposals for guidelines and statements of policy upon which to base a final order establishing appropriate exploration and development program procedures.

The effective date of this order shall be ten days after the date hereof.

Dated at San Francisco, California, this 23rd day of JULY, 1974.

I abstain:

Commissioner

President

Commissioners

APPENDIX A

LIST OF APPEARANCES

Applicant: Rollin E. Woodbury, Robert J. Cahall, William E. Marx, and H. Robert Barnes, by William E. Marx, and Philip Walsh, Attorneys at Law, for Southern California Edison Company.

Protestants: Laurence J. Thompson, for the Cities of West Covina, Inglewood, Manhattan Beach, Hermosa Beach, and Torrance; Kennard R. Smart and Furman B. Roberts, Attorneys at Law, for the City of Orange; George Wakefield and L. J. Thompson, by John Lippitt, for the City of West Covina; Louis Possner, for the City of Long Beach; Daniel Collins, for the City of Torrance; and James F. Sorensen, for Friant Water Users Association.

Intervenors: Curtis L. Wagner, Jr., and Frank J. Dorsey, Attorneys at Law, for the Executive Agencies of the United States; and John R. Phillips, Attorney at Law, Larry E. Moss, Daniel L. Dawes, and Walter C. Bond, for The Sierra Club.

Interested Parties: William L. Knecht, Attorney at Law, and Ralph Hubbard, for California Farm Bureau Federation; R. C. Arnold, for Shell Oil Company; Robert F. Smith and Walter C. Leist, for Union Carbide Corporation; Robert W. Russell, by Kenneth E. Cude, for the City of Los Angeles; Eugene R. Rhodes and O. T. Jones, for Monolith Portland Cement Company; Kenneth M. Robinson, Attorney at Law, and George B. Scheer, for Kaiser Steel Corporation; Brobeck, Phleger & Harrison, by Robert N. Lowry, Gordon Davis, and Larry Hultquist, Attorneys at Law, for California Manufacturers Association; John H. Lauten, by H. Kenneth Hutchinson, Attorney at Law, for The Metropolitan Water District of Southern California; Carl Alan Wulfestieg, for the Los Angeles Department of Water and Power; Arthur Kugel, for the Public Utilities Department, City of Riverside; Paul Hendricks, for the City of Vernon; Lawler, Felix & Hall, by Richard D. De Luce, Attorney at Law, E. V. Sherry, and Baker, Hostetler & Patterson, by Alan G. Rorick, Attorney at Law, for Air Products and Chemicals, Inc.; Stephens, Jones, La Fever & Smith, by Maurice Jones, Jr., Attorney at Law, for Revere Copper and Brass, Inc.; and E. A. Tharpe III, Attorney at Law, for Southern California Gas Company.

Commission Staff: Rufus G. Thayer and Janice E. Kerr, Attorneys at Law, Norman R. Johnson, T. F. Marvin, Robert C. Moeck, Bruno A. Davis, and Kenneth K. Chew.