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Decision No. 84577

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of SOUTHERN CALIFORNIA EDISON COMPANY for an order of the Public Utilities Commission of the State of California authorizing Applicant to make effective a special adjustment to billings for electric service to offset costs associated with increased fuel oil inventories.	Application No. 55198 (Filed September 17, 1974)

(Appearances listed in Appendix A)

O P I N I O N

Southern California Edison Company (Edison) seeks authority to make effective a special adjustment to billings of 0.035 cents per kilowatt-hour for retail electric service provided pursuant to its filed tariffs and special contracts to increase annual revenues for California jurisdictional sales approximately $16,900,000 to offset costs associated with increased fuel oil inventories.

After notice, public hearings on this matter were held before Examiner Johnson in Los Angeles on December 23, 1974 and on January 9, 10, 16, and 17, 1975, and the matter was submitted on February 3, 1975 upon receipt of concurrent briefs. Testimony was presented on behalf of Edison by its manager of fuel contracts, by a senior plant appraiser in its valuation department, by its chief regulatory cost engineer, and by a rate structure engineer. Testimony was presented on behalf of the Commission staff by a financial examiner and a utilities engineer. Other parties to the proceeding participated through extensive cross-examination of Edison and Commission staff witnesses.

Advice Letter Filing

This Commission, by Decision No. 79838 dated March 21, 1972, authorized Edison to file revised tariff schedules establishing a fuel cost adjustment billing factor which provided an adjustment amount per kilowatt-hour sold to reflect increases or decreases in the cost of fossil fuel. The unit amount of the adjustment is equal to the estimated fossil fuel expense for the 12-month period commencing with the expected effective date of each adjustment amount, minus the corresponding cost of the same quantity of heat energy utilizing the price levels and relative availability of fuels forming the basis for the base rates, divided by the estimated kilowatt-hour sales for that period.

Decision No. 79838 further provided that the fuel cost adjustment billing factor not be revised more often than once every three months, that the derivation of the billing factor be filed with the Commission on or before the 30th day preceding its effective date, that the filing be reviewed by the Commission staff, and that the billing factor become effective only after approval by the Commission.

In accordance with this procedure, Edison, by Advice Letter No. 394-E filed July 2, 1974, requested that effective August 1, 1974, the fuel cost adjustment billing factor be increased from 0.707 to 0.941 cents per kilowatt-hour to increase the estimated annual revenues for California retail sales by $113,100,000 for the 12-month period ending July 31, 1975. The requested increase of $113,100,000 for California jurisdictional retail sales was comprised of $83,600,000 increased fuel prices, $10,600,000 increased costs due to changes in mix, and $18,900,000 for return and income tax on oil inventory costs in excess of such costs allowed in the material and supplies component of rate base by Decision No. 81919 dated September 25, 1973 on Edison's Application No. 53488 for a general rate increase. Resolution No. E-1402 authorized Edison to increase its fuel cost adjustment billing factor from 0.707 to 0.818 cents per kilowatt-hour to yield an annual increase in revenues from California jurisdictional sales of approximately $53,100,000. Included in the $60,000,000 differential between the requested and authorized billing adjustment revenues was the $18,900,000 return and income tax associated with increased fuel inventory costs. Edison was authorized, however, to file a separate application for this amount, together with its justification for the regulatory treatment proposed by it. This application was filed pursuant to the authorization granted by Resolution No. E-1402.

Increased Fuel Oil Inventory

Edison alleges that in order to reduce the risk of future inadequate fuel in times of critically tight supplies, it has substantially increased its fuel oil inventory since the issuance of Decision No. 81919. The record shows that the oil storage capacity has increased from 14,700,000 barrels in January, 1973 to an estimated 22,600,000 barrels at year-end 1975 and the oil inventory has increased from 8,100,000 barrels in January, 1973 to an estimated 14,600,000 barrels at year-end 1975. Edison's manager of fuel contracts testified that the average year fuel oil inventory of approximately 12,500,000 barrels included as an element in rate base in Decision No. 81919 was increased to the current average level of approximately 16,000,000 barrels to maintain a 90-day supply at today's limited supply of natural gas and increased consumption of fuel oil.

This witness further testified that in late August of 1974 the inventory level as of year-end 1974 was estimated to be 17,500,000 barrels at a cost of approximately $274,000,000 and that in early December, 1974 this estimate was revised upward to approximately 19,700,000 barrels at a cost of about $296,000,000.

Fuel Inventory Rate Base Amounts

An exhibit setting forth Edison's estimated weighted average rate base associated with fuel inventory for the period October, 1974 through October, 1975 was presented into evidence by one of Edison's senior plant appraisers. The fuel stock rate base amount was set forth as $186,100,000 and equals the weighted average balance of fuel oil inventory for that period of $264,800,000 minus estimated weighted unpaid invoice balances of $83,500,000 plus weighted average coal stock and other fuel items of $4,800,000. This witness further testified that the $186,100,000 rate base item represented an increase in fuel oil inventory cost of $119,100,000 over the estimated average fuel stock cost of $67,000,000 included as a rate base item in Decision No. 81919. He also stated that the estimated base for carrying charges for a combination of Edison and trust[1/] ownership, assuming a weighted average fuel oil under trust balance of $53,300,000, was $65,800,000.

The Commission staff engineer presented testimony and an exhibit indicating that the total fuel stock rate base element should be $158,900,000 or $27,200,000 less than the $186,100,000 testified to by the Edison witness. The record shows the basis for the difference derives from the pricing of 2,695,000 barrels of fuel oil storage classified as nonusable. This oil was classified as nonusable because it was either stored at the bottom of tanks and could not be withdrawn because of pump suction limitation or, in the case of crude oil storage, could not be withdrawn below the level of the floating roof without causing a hazardous condition. According to the testimony of the staff engineer, this nonusable oil should be carried in inventory at its original cost of $15,600,000 rather than at the present FIFO cost of $42,800,000 used by Edison. The record is quite clear that under the FIFO method of accounting, the first-in unit price is applied to an amount of oil equal to

1/ Edison entered into a trust agreement with Union Bank under which the trust purchases oil for Edison. This arrangement allows more flexibility to Edison in financing.

the entire first-in quantity before subsequent prices are applied to other quantities of oil. Consequently, the so-called nonusable portion of oil, or its equivalent, has long since been priced out at its original price and been replaced by a more recently priced oil. The staff engineer's postion in this matter is, therefore, invalid.

Increased Revenue Requirement

Edison's chief regulatory cost engineer presented exhibits and testimony deriving the alleged amount of increase in revenue requirements necessary to compensate Edison for the costs associated with the increased fuel oil inventory. His cost-of-ownership computations for Edison ownership of the fuel stock were based on a weighted cost of long-term debt of 2.82 percent and of equity of 5.38 percent for a total authorized return of 8.20 percent as set forth in Decision No. 81919. The weighted cost of debt plus the product of the derived net-to-gross multiplier of 2.1364 times the weighted cost of equity of 5.38 percent equals 14.3 percent. This percentage figure was utilized by Edison as the cost of ownership for Edison owned fuel. The carrying charge applied to trust-owned fuel was set forth as 13.5 percent and equals the sum of 12-1/4 percent banker's acceptance rate at the time the trust was negotiated, one percent bank commission, and one-quarter percent trustee fee.

As previously discussed the increase in rate base associated with fuel inventory increases since Decision No. 81919 is estimated to be $119,100,000 with full Edison ownership and $65,800,000 with a trust ownership of $53,300,000. For total Edison ownership of the fuel oil the increased revenue requirement is set forth on the record as the product of $119,100,000 times 14.3 percent cost of ownership charges plus increased ad valorem taxes of $2,440,000, a total of $19,470,000 a year. The increased revenue requirement for a combination trust and Edison ownership was set forth as the sum of the product of $65,800,000 times 14.3 percent, plus the product of $53,300,000 times 13.5 percent, plus the increased ad valorem taxes of $2,440,000 a total of $19,050,000 a year.

The Commission staff's financial examiner accepted Edison's computations on the carrying charge for trust-owned oil but utilized the then effective prime interest rate of 10-1/4 percent for computing the cost of ownership of the Edison owned portion of the fuel stock. As previously stated, the staff engineer's fuel stock rate base element was computed to be $158,900,000. The staff's financial examiner deducted the $67,000,000 fuel stock rate base element included in Decision No. 81919 from the $158,900,000 total and assumed the same trust owned balance of $53,300,000 used by Edison to yield an Edison owned portion of the fuel stock of $38,600,000. The increased ad valorem taxes associated with the increased oil inventory were computed by the staff engineer to be $1,882,800. The staff's financial examiner applied the 13.5 percent trust carrying charge to the $53,300,000 trust owned balance and the 10-1/4 percent prime interest rate to the Edison owned fuel stock of $38,600,000 and added the increased ad valorem taxes of $1,882,800 to derive an added revenue requirement associated with the increased fuel inventory of $13,034,800. The staff recommends that should a special billing adjustment be authorized as a result of this proceeding the resultant increased revenues not exceed this amount. Under cross-examination the staff witness further testified that if he were preparing his exhibit at that time that due to the substantial decline in banker's acceptance rates, he would use the same 10-1/4 percent for trust ownership of the fuel oil as for the Edison owned fuel oil. The sum of this 10-1/4 percent times the increase in fuel oil inventory of $91,900,000 and the increased ad valorem tax of $1,882,800 equals $11,302,300.

Edison's chief regulatory cost engineer also presented an exhibit comparing the summary of earnings for the years 1973, 1974, and 1975 under average year conditions taken from Edison's current general rate increase Application No. 54946 with and without the proposed special billing adjustment added to the 1974 and 1975 revenues. This exhibit shows the proposed billing adjustment increased the rate of return for average year 1974 from 7.93 to 7.97 percent and for the average year 1975 from 7.29 to 7.51 percent. Late-filed Exhibit 7-A, presented by the Commission staff, shows, as a preliminary figure, a recorded rate of return of 8.54 percent and an adjusted rate of return of 7.29 percent for the year 1974.

Proposed Rate Adjustment

One of Edison's rate structure engineers presented testimoney and exhibits setting forth Edison's proposed rate changes.

The previously discussed increased revenue requirement, assuming joint trust and Edison ownership of the fuel oil, of $19,050,000 was first allocated among off system, resale, and California jurisdictional sales. The allocated California jurisdictional amounts were computed to be $16,900,000 which, when divided by the California jurisdictional sales of 48,454 million kilowatt-hours for the 12-month period ended October 31, 1975, produced a special billing adjustment of 0.035 cents per kilowatt-hour. Edison proposes to implement this adjustment by adding paragraph 4, Special Billing Adjustment to the Preliminary Statement and by adding a special condition providing for the inclusion of this billing adjustment to each of the California jurisdictional rate schedules.

The Commission staff's engineer utilized similar procedures applied to the staff computed increased annual revenue requirement of $13,034,800 to derive a special billing adjustment factor of 0.024 cents per kilowatt-hour which he recommended be used should a special billing adjustment be authorized as a result of this proceeding.

Rate Making Considerations

The staff's financial examiner, while offering no opinion regarding the approval of this application, recommended that the Commission carefully weigh a desire for equitable treatment of Edison in the form of prompt rate relief to offset additional costs incurred to assure customers of an adequate fuel inventory against the undesirable results that might occur if other utilities seek to use the special circumstances of Edison's fuel situation as a precedent for interim rate relief based on other types of rate base adjustments. He testified that, in his opinion, this application reflects a radical departure from this Commission's rate making practices in that it seeks interim relief on a projected increase in rate base between the last adjudicated rates and a rate base to be established by our decision on Application No. 54946, Edison's currently pending general rate increase application. This witness further testified that should we grant the requested rate relief it could be argued that any utility that installs nonrevenue producing plant without AFC should be granted immediate rate relief without the necessity of a full scale rate proceeding. He also stated that one of the more persuasive bases for granting interim relief, that of financial emergency, is entirely lacking in this pending matter.

To fully inform the Commission this staff witness also presented testimony that would support granting what he considered a reasonable portion of the requested increase. This testimony indicated that the expenditures for increased fuel oil inventories are clearly in the public interest and were made at our urging in order to assure Edison's customers of an adequate fuel supply in the event of another oil embargo; that a departure from accepted ratemaking procedures is in itself no barrier for providing rate relief where the need is clearly established; and that swift action in granting justified rate increases is clearly in the interests of both utilities and their customers. The Commission urging referred to in his testimony is contained in Decision No. 81931[2], dated September 25, 1973 on Case No. 9581, an investigation into the adequacy and reliability of the energy, and fuel requirements, and supply of the electric utilities. It will be noted from the foot-noted excerpt that the decision did not establish a new procedure nor order specific measures but merely emphasized and highlighted the necessity for continued efforts to fulfill the utilities' long established and fully recognized responsibility to take all necessary steps to insure adequate service to its customers. Consequently, this ordering paragraph cannot be construed as a mandate to provide the special rate treatment herein requested. In this respect, the Commission staff witness testified in response to the examiner's question that absent this decision, it would be his recommendation that the application be denied.

Edison alleges that this application is for rate relief to offset increased costs and is not a request for interim relief. The application differs from the usual request for interim relief in that it is not an integral part of a general rate increase matter but is a separate application limited specifically to increased costs related to an increased fuel oil inventory. It differs from the usual offset proceeding in that the increased costs relate to an increased rate base rather than specific increased operating costs. It is Edison's position that rate relief has been granted to offset increased rate base related costs and the rate relief requested by this application is similar to that granted Southern California Gas Company (SoCal) by Decision No. 83881 dated December 17, 1974 in Application No. 55117. Therefore, according

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2/ Decision No. 81931 (Mimeo p. 39)
"(d) Take all other appropriate actions to contract for natural gas, fuel oil, and other appropriate fuels."

to Edison, granting the rate relief requested in this matter would not establish a precedent. The offset grants for increased costs associated with increased rate base authorized by Decision No. 83881 are for the increased costs associated with the investment in the Aliso Canyon gas storage project and the amortization, over a five-year period, of the synthetic natural gas project including costs associated with the inclusion of the unamortized balance of the amount of such write-off in rate base. It is true that these offset grants involved rate base related expenses. It should be noted, however, that Decision No. 83160 dated July 16, 1974 on SoCal's Application No. 53797 for a general rate increase allowed Aliso Canyon Storage Field expenses on an as-expected basis and indicated that SoCal should request "authorization to amortize unsuccessful project expenditures." (Mimeo p. 35.) Consequently, the authorization of offset allowances for these two items granted by Decision No. 83881 is merely an updating of anticipated cost increases considered in SoCal's last general rate increase proceeding. Similar consideration of anticipated fuel inventory cost increases were not included in Edison's general rate proceeding and, the matters being dissimilar in this respect, the offset allowances authorized for SoCal cannot be considered as a precedent for this matter.

The establishment of a reasonable rate base upon which to predicate a specified rate of return and related return on equity must, of necessity, result from a thorough analysis of the various elements comprising this rate base. To grant an offset increase based on increased investment of a single element of rate base, particularly when there is currently pending an application for a general rate increase where the matter will be fully considered would be contrary to our long established policy of authorizing rate increases. Before authorizing increased rates to offset increased rate base related expenses we need to carefully consider all the factors relating to average year revenues and expenses. Absent such consideration, the granting of increased rates could result in an imbalance of consumer and investor interests to the overall detriment of the investors and ratepayers alike. The record contains no compelling reason to run the risk of creating such an imbalance by an imprudent rate increase authorization without adequate review of all ratemaking factors. Consequently, the application will be denied.

Findings

1. Edison's fuel oil storage capacity has increased from 14,700,000 barrels in January, 1973 to an estimated 22,600,000 barrels at year-end 1975 and its fuel oil inventory increased from 8,100,000 barrels in January, 1973 to an estimated 14,600,000 barrels at year-end 1975.

2. This fuel oil storage capacity represents approximately 90 days supply and is necessary to protect Edison against interruption in supply.

3. The weighted average fuel oil inventory costs for the period October, 1974 through October, 1975 is estimated to be $264,800,000.

4. Under the FIFO method of accounting the equivalent of any nonusable oil is priced out at its FIFO cost and no basis exists for its inclusion in inventory at original cost.

5. The carrying charge rate derived for application to trust owned fuel is equal to the sum of banker's acceptance at 12-1/4 percent at the time of negotiation, one percent bank commission and one-fourth percent trustee fee, a total of 13.5 percent. It would be inappropriate at this time to use this rate because of the substantial decline in banker's acceptance rates.

6. Decision No. 81931 in Case No. 9581, an investigation into the adequacy and reliability of the energy and fuel requirements and supply of the electric utilities, emphasized the necessity for continued efforts to insure reliable service rather than ordered specific measures and, therefore, does not compel the authorization of the special adjustment to billings requested in this application.

7. Rate adjustments relating to elements of rate base should only be considered together with overall test year earnings to avoid the risk of unbalancing customer and investor interests.

8. The requested special adjustment to billings for electric service to offset costs associated with increased fuel oil inventories should not be granted.

The Commission concludes that the relief requested should be denied.

O R D E R

IT IS ORDERED that the relief requested in Application No. 55198 is denied.

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

Dated at San Francisco, California, this 24th day of JUNE, 1975.

Vernon L. Sturgeon
President

Commissioners

Commissioner William Symons, Jr., being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

LIST OF APPEARANCES

Applicant: Rollin E. Woodbury, Robert J. Cahall, William E. Marx, Richard K. Durant, Attorneys at Law, for Southern California Edison Company.

Protestant: Sylvia M. Siegel, for TURN, Consumer Federation of California, Fight Inflation Together and Energy Reform Group.

Interested Parties: Best, Best & Krieger by Michael D. Harris, Attorney at Law, for Desert Water Agency, City of Palm Springs, Desert Hospital District, Palm Springs Unified School District and Desert Hot Springs County Water District; Enright, Elliot & Betz by Norman Elliott, Attorney at Law, for Monolith Portland Cement Co. and Committee to Preserve California Industry; Joe Westmoreland, for Department of Public Utilities, City of Riverside; Robert P. Will and R. D. Twomey, Jr., Attorneys at Law, for Metropolitan Water District of Southern California; David B. Follett, Attorney at Law, for Southern California Gas Co.

Commission Staff: Timothy E. Treacy, Attorney at Law, and Robert C. Moeck.