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ORIGINAL

Decision No. 85018

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SAN DIEGO GAS & ELECTRIC COMPANY for authority, among other things, to increase its rates and charges for electric service.	Application No. 55627 (Filed April 16, 1975)
In the Matter of the Application of SAN DIEGO GAS & ELECTRIC COMPANY for authority, among other things, to increase its rates and charges for gas service.	Application No. 55628 (Filed April 16, 1975)
In the Matter of the Application of SAN DIEGO GAS & ELECTRIC COMPANY for authority, among other things, to increase its rates and charges for steam service.	Application No. 55629 (Filed April 16, 1975)

(Appearances are listed in Appendix A.)

INTERIM OPINION

By these applications San Diego Gas & Electric Company (SDG&E) requests annual gross revenue increases in the amount of $105,721,100 (38.4 percent - electrical department), $13,664,800 (15.75 percent - gas department), and $78,000 (9.47 percent - steam department), for a total annual revenue increase of $119,463,900 (28.7 percent). This general rate increase request is based upon an estimated 1976 test year.

On April 16, 1975 SDG&E also filed a petition for interim rate relief, requesting annual revenue increases of $71,225,000 (27.25 percent - electrical), $7,241,100 (7.11 percent - gas), and $59,200 (8.19 percent - steam) for an overall annual increase of $78,525,300 based upon 1975 sales. The petition alleged that in order to meet necessary construction and operating commitments SDG&E would be required to sell $40 million in bonds in the latter half of 1975 and $90 million in bonds during 1976. Immediate rate relief was requested because without such interim rate relief SDG&E would be unable to issue proposed 1975 bonds (Series "P" bonds) in the amount of $40 million.

A prehearing conference was held June 2, 1975 before Commissioner Robert Batinovich and Examiner Charles E. Mattson at Chula Vista, California. The three applications were consolidated for hearings on the petition for interim rate relief. Commencing June 25, 1975 through July 25, 1976 16 days of public hearings were held on the petition for interim rate relief at San Diego before Commissioner Batinovich and Examiner Mattson. The matter of the petition for interim rate relief was taken under submission on July 25, 1975 subject to the mailing of written statements on or before August 11, 1975. Late-filed Exhibits Nos. 49, 56, and 57 were received in evidence subsequent to July 25, 1975. The parties were notified of the receipt of the late-filed exhibits by letter dated August 15, 1975.

<u>Related Rate Matters</u>

SDG&E's last general rate increase request was concluded by our Decision No. 84575 (Phase II) dated June 24, 1975 in Applications Nos. 53945, 53946, and 53970. Decision No. 84575 authorized rate increases based upon results of operations of SDG&E for test year 1974.

SDG&E requested rate relief to offset increased fuel cost (resulting from fuel oil price increases and reduced availability of natural gas) by Applications Nos. 55774 and 55775 filed June 30, 1975. A rate increase of $29 million was authorized September 16, 1975 in Decision No. 84905. The fuel cost increases authorized by Decision No. 84905 were based on the fuel oil prices as of July 1, 1975. SDG&E's available gas supply had decreased, and rates were raised, as a result of our Decision No. 84512 (SoCal), the so-called "parity decision".

It should be noted that our Decision No. 84618 dated July 1, 1975 in Application No. 55506 authorized an increase of $2,161,000 in the SDG&E fuel clause adjustment (FCA). The FCA increase was based upon fuel costs as of April 1, 1975.

These related rate matters must obviously be taken into account in estimating SDG&E's 1975 revenues and expenses on an "as expected" basis. Moreover, to the extent that they may reflect rate changes for only a portion of 1975 on an "as expected" basis, we must evaluate their impact on post-1975 operations of SDG&E.

Applicant's Contentions

SDG&E alleged that it requires large commitments of funds to finance its construction program in 1975 and 1976. In order to obtain necessary capital to meet such required construction, SDG&E must be able to sell additional debt in the amount of $40 million in bonds in 1975 (Series "P" bonds) and $90 million in bonds in 1976. These bonds sales are in addition to $40 million in bonds issued by SDG&E on May 6, 1975 (Series "O" bonds).

SDG&E's debenture indentures contain restrictions on the issuance of new funded debt. The requirement is that earnings before taxes and interest, during any consecutive 12 months in the 15 months immediately preceding a new debt issue, must be at least twice the annualized interest expense (including interest on the proposed issue). SDG&E is precluded from issuing proposed mortgage bonds unless and until the historical earnings in the prior 15-month period are sufficient to meet this requirement.

As a result of the debenture indenture provisions, SDG&E is unable to issue mortgage bonds at the present time. SDG&E has necessarily postponed the issuance of mortgage bonds in 1975. SDG&E contends that in order to provide adequate service it must issue additional first mortgage bonds in early 1976. The interest coverage requirement will necessarily include actual earnings in 1975.

SDG&E's estimated 1975 summary of earnings, on an as expected basis, established that earnings available for interest coverage would not support the issuance of additional debt. SDG&E contended that this constituted a financial emergency requiring a sufficient increase in gross revenues (in addition to expected revenues in 1975) in order to obtain a times interest coverage in excess of two after the issuance of $40 million in Series "P" bonds.

Construction Budget - 1975 Capital Requirements

SDG&E's estimated 1975 construction budget was reduced from $193.1 million to $164.3 million as of June, 1975. This was a reduction of approximately $32 million in the initial estimate. The executive vice president of SDG&E presented exhibits setting forth details on 68 percent of the 1975 budget (15 projects in 1975 with estimated expenditures exceeding $2 million each). This witness also presented an exhibit setting forth details of the $32 million reduction.

Included in the large projects in estimated 1975 expenditures are environmental studies and preliminary engineering expenditures for the Sun Desert Nuclear and Kaiparowits (coal) generation projects scheduled for completion in the 1980's. Total expenditures on these two major projects are below $13 million in 1975. A witness on behalf of SDG&E testified that since February, 1973 SDG&E has reduced its projected 1980 peak demand by more than 28 percent. As a result of the reduction in projected peak demand, SDG&E eliminated approximately 840 MW of peaking gas turbine and combined cycle capacity previously scheduled for commercial operations between 1975 and 1980.

Substantial evidence was presented by witnesses on behalf of the San Diego Energy Coalition (SDEC) challenging the necessity of the construction program of SDG&E. A witness on behalf of the SDEC presented estimates that the future peak load of SDG&E will be reduced by the sharply increasing cost of energy in the future (Exhibit 51 Fig. 1). Moreover this witness pointed out that by becoming part of a much larger power pool (by increase of interconnection capacity) SDG&E could achieve greater reliability with a smaller reserve margin than presently required. The witness concluded that the plant construction program of SDG&E will result in reserve capacities that are unreasonably high.

We cannot quarrel with the logic of the proposition that rapidly increasing electrical prices should force a curtailment of customer demand in the future. The difficulty is that we cannot at this time predict with any reasonable certainty the point at which price increases will substantially change the predicted peak demands on SDG&E's system. We agree with the basic proposition of SDEC that there must be substantial conservation in the future. If future requirements prove to be lower than present estimates it may become possible to postpone completion dates of major projects in the future. However, we cannot reasonably conclude on the evidence before us that major construction expenditures presently scheduled by SDG&E in 1975 and 1976 should be terminated or suspended at this time.

SDEC is correct that substantial environmental considerations must necessarily be resolved before approval of proposed future projects of SDG&E. Any required approval of such projects will involve public hearings in certification proceedings before this Commission. The considerations involved in certification of additional generating capacity may involve issues far beyond the question of predicted demands upon the system. Efficiency of generating units, the availability of fuel required for generation, and the cost of various fuels as well as the entire question of the environmental impacts of a proposed project are matters that would necessarily be reviewed in a certification proceeding.

Our conclusion is that the near term capital requirements of SDG&E assumed by both the SDG&E's witnesses and the staff F&A witness are reasonable. The staff did not dispute SDG&E's claim that substantial construction expenditures are required in the near term. Moreover, the staff witness on electric loads, resources, and service concluded that SDG&E will require additional generating capacity in the near future.

Financial Emergency

Having concluded that SDG&E faces immediate capital requirements based upon a construction budget for the year 1975 of $164,329,000 it is apparent that SDG&E requires immediate interim rate relief to support additional external financing (Series "P" bonds). The staff accounting witness presented Exhibit 31, Statement D, which sets forth in detail a comparison of the capital requirements and capital sources for funds available to SDG&E in 1975. The F&A witness assumed $20 million from a proposed sale of common stock in the fourth quarter of 1975 and $25 million from a proposed sale of preferred stock in the third quarter of 1975. The Finance and Accounts witness concluded that even with these assumed sources of capital a substantial debt issue would be required. Since the estimated 1975 earnings available for interest coverage (the required two times interest charges under the debenture indenture) would be inadequate to support the required debt issue, the witness concluded that a financial emergency existed and that substantial rate relief on an interim basis was appropriate.

In support of his conclusion that SDG&E would require additional long-term debt the staff witness reviewed a number of alternatives. SDG&E's short-term borrowing potential totals $105 million. With no long-term debt issue this line of credit would be virtually exhausted by December 31, 1975 and earnings would be insufficient to support a debt issue. Moreover, current income would not meet the common stock dividend requirement and consequently SDG&E would be unable to sell additional stock at any reasonable price. Non-payment of dividends would not alleviate the financial crisis (nor eliminate the need for interim relief) but would make sales of common stock at reasonable prices in the near future virtually impossible.

1975 Results of Operations - As Expected

In the course of the hearing SDG&E accepted certain of the staff estimates and revised its exhibits accordingly. Sheet 6 of Exhibit 55 sets forth a comparison of the revenue and expense estimates of the staff engineer, SDG&E, and the staff accountant for the 12 months ended December 31, 1975. Based upon these estimates, it is apparent that SDG&E is in need of immediate interim rate relief. As we explain in detail at p. 12, infra, the earnings available for interest coverage for the 12 months ended December 31, 1975, without interim rate relief, are too low to support the issuance of any additional long-term debt. Sheet 6 of Exhibit 55 is set forth as Table 1 herein.

The staff witness on behalf of the Finance and Accounts Division recommended that SDG&E be granted immediate interim rate increases to provide adequate bond coverage within four months after the date of such interim rates. The F&A witness concluded that in order to issue necessary long-term debt in early 1976, SDG&E would require additional annual gross revenues of $18.8 million in 1975. The staff witness recommended that rates be increased in order to produce an additional $18.8 million in 1975 and recommended that rates be increased by $56.4 million annually effective September 1, 1975 in order to generate the additional revenue in the succeeding four months. At the end of the four-month period, the F&A witness recommended that the interim rate increase be reduced to an annual increase of $18.8 million.

Applicant accepted the staff recommendation that interim rate relief be in effect for a period of four months at a level that would generate the additional annual gross revenue requirement necessary to meet the times interest coverage and support the issuance of additional debt. Applicant further accepted the staff recommendation that at the end of the four months the interim rate increases be reduced to produce the annual gross revenue amount. The applicant's position is that the staff's recommended revenue increase is inadequate to meet the financial emergency of SDG&E.

TABLE 1

SAN DIEGO GAS & ELECTRIC COMPANY
Comparison of Revenue and Expense Estimates
Staff Engineer, SDG&E, Staff Accountant
12 Months Ended December 31, 1975
(000)

SAN DIEGO GAS & ELECTRIC COMPANY
Calculation of Increase in Gross Revenues Required
To Provide Interest Coverage
(000)

Line No.	Item	Staff Engineer Exh. 28 (Col. 1)	SDG&E Exh. 41 (Col. 2)	Staff Accountant Exh. 31 (Col. 3)	SDG&E Exh. 36 Increase	SDG&E Exh. 36 Total	Staff Accountant Exh. 31, Statement E Increase	Staff Accountant Exh. 31, Statement E Total
1	Operating Revenues							
2	Sales Revenues	$ 360674	$ 360332	$ 360674	$ 35046	$ 395378	$ 18754	$ 379428
3	Fuel Adjustment Revenues	31	11349	2161		11349		2161
4	Interdepartmental Revenues	13816	13189	19398	1091	14280	1605	21003
5	Miscellaneous	1820	1820	1820		1820		1820
6	Total Operating Revenues	$ 376341	$ 386690	$ 384053	$ 36137	$ 422827	$ 20359	$ 404412
7	Operating Expenses							
8	Fuel & Purchased Power	$ 202803	$ 235948	$ 216510	$ 1091	$ 237039	$ 1605	$ 218115
9	Other Oper. & Maint.	72862	72897	70799	787	73684	419	71218
10	Taxes Other Than Income	15925	15420	15505		15420		15505
11	Depreciation & Amortization	29223	29226	29209		29226		29209
12	State Franchise Tax	613		259	1888	1888	1530	1789
13	Federal Income Tax	(155)	(9184)		12746	3562	474	474
14	Total Operating Expenses	$ 321271	$ 344307	$ 332282	$ 16512	$ 360819	$ 4028	$ 336310
15	Net Operating Revenues	$ 55070	$ 42383	$ 51771	$ 19625	$ 62008	$ 16331	$ 68102
16	Add Amortization					$ 259		$ 271
17	Income Tax					$ 5450		$ 2263
18	Other Income					$ 7524		$ 5450
19	Earnings Available for Interest							
20	Coverage					$ 75241		$ 76086
21	Times Interest Coverage					2.10		2.15

NOTE:

No interest coverage calculation was made by the staff engineer. Using his revenue and expense estimates, an increase of $15,158,000 in 1975 gross revenues would be required to provide 2.15 times interest coverage.

In evaluating this recommendation we must first resolve the differences set forth on the 1975 estimates of the staff and SDG&E.

1975 - As Expected - Adopted

The revenue projections of the staff engineer, SDG&E, and the staff accountant are essentially based upon the staff engineer's estimated sales. The differences in total operating revenues may be traced to different estimates of fuel adjustment revenues in 1975, and to different assumptions regarding the availability of natural gas for sale by the gas department to the electric department (interdepartmental revenues).

Other than the major differences resulting from different fuel adjustment revenues (related to fossil fuel price and mix) only one major difference exists among the three expense estimates. Other Operation and Maintenance expenses were estimated by SDG&E and the staff engineer at $72.9 million. The staff accountant arrived an estimate of $70.8 million, approximately $2.1 million lower.

The staff accountant arrived at his estimate by using actual expenses for the first five months of 1975 and adjusted recorded expenses for the last seven months of 1974. The staff accountant annualized the known wage increases in his expense estimate. The staff engineer reviewed the company's 1975 estimates and accepted them as reasonable in the Other Operation and Maintenance expenses.

The F&A witness testified that he had included all wage increases in his expense estimate. However, he was of the opinion that SDG&E's other O&M expense should reflect the company's effort to curtail all controllable expenses.

We next consider the question of fuel expense and fuel adjustment revenues anticipated in 1975. We recognize that the actual earnings available for interest coverage in 1975 are reduced by the amount that total operating revenues (including fuel adjustment revenues) do not offset actual fuel expenses incurred. The staff engineer used the base fuel price established by our Decision No. 83675 dated October 29, 1974 in Applications Nos. 53945, 53946, and 53970. The staff engineer assumed that all fuel price increases above the base price, as well as changes in gas supply resulting in higher fuel costs in 1975, would be recovered by offset rate increases. As we will discuss in detail in reviewing the staff accountant's recommendation, this did not happen. It follows that the net operating revenues the staff engineer sets forth for the 12 months ended December 31, 1975 are overstated by the amount that fuel cost increases in 1975 were not offset by matching revenue increases.

The staff accountant's 1975 electric department fuel cost is based upon recorded fuel costs for the first five months of 1975 plus a projection for the remaining seven months. The staff accountant used the fuel mix in effect during the last seven months of 1974 and fuel prices as of the latest available date (May, 1975) to obtain his estimate. As the staff accounting witness stated, the 1975 fuel cost estimate will be understated to the extent that SDG&E does not receive immediate rate increases to offset cost increases from reduced gas supply (the parity decision) and increases in fuel prices.

It is apparent that the staff accountant's 1975 revenue requirement of $18.8 million is understated for increased fuel costs for electrical generation have not been immediately matched by offset rate increases in 1975. Applications Nos. 55774 and 55775 requested offset rate increases to meet increased fossil fuel prices and reduced gas supply to the electric department of SDG&E in the amount of approximately $29 million. Rate increases were necessary to meet increased costs commencing July 1, 1975. Since those rate increases did not go into effect until September 21, 1975 it is apparent that SDG&E's fuel adjustment revenue in 1975 will not offset 1975 fuel expense. The result is a major revenue shortfall in the fuel expense revenues in 1975 that is not reflected in the staff accountant's estimate. The shortfall occurs, as the staff accountant explained, because SDG&E did not obtain immediate rate increases to offset increased fuel costs.

The SDG&E revenue estimates include estimated fuel adjustment revenue for 1975 on an as expected basis. SDG&E recognized $2,161,000 of fuel adjustment revenues resulting from our Decision No. 84618 dated July 1, 1975. The staff accountant also included that $2,161,000 in his estimates for 1975. However, SDG&E estimated additional fuel adjustment revenues of $9,188,000 based upon the assumption that SDG&E would obtain offset rate relief to compensate for the SoCal parity decision and July 1, 1975 fuel price increases. Additional offset revenues were granted upon our determinations in Decision No. 84905 in Applications Nos. 55774 and 55775. The offset rate relief to the electrical department of SDG&E granted by Decision No. 84905 will generate additional revenue in 1975. SDG&E estimated its 1975 fuel expense at known prices, with the result that fuel expenses exceed fuel adjustment revenues for 1975 as expected. SDG&E assumes that any subsequent fuel adjustment will exactly offset any change in fuel expense.

We find that SDG&E's estimates of its fuel offset revenues and known fuel expenses as expected in 1975 are reasonable for purposes of estimating the actual net operating revenues available to SDG&E for the 12 months ending December 31, 1975.

1975 Expected Earnings - Interest Coverages

The debenture indenture provides that earnings available for interest coverage for a recorded 12-month period must be twice the annualized interest on all funded debt. The staff accounting witness assumed annual interest costs of $31.3 million (with no additional debt) and annual interest of $35.3 million if $40,000,000 in additional debt is issued in 1975. (Exhibit 31, Statement B.) The staff accountant assumed that $40,000,000 in additional debt would be issued at a cost of 10 percent.

The applicant calculated the annual interest on December 31, 1975 on funded debt as $35.829 million after issuance of $40,000,000 in new debt at a cost of 11 percent. If no additional debt were issued, the applicant's assumed cost of all outstanding debt at the end of 1975 would be $31.429 million. (Exhibit 36)

Without rate relief the staff accountant's initial calculations show that interest coverage at present rates on December 31, 1975 would be 1.61 times if no additional debt were issued and 1.43 times if $40,000,000 of additional debt were issued. As the staff accountant points out, earnings at present rates would be inadequate to enable SDG&E to meet its indenture requirement of two times interest coverage in order to issue long-term debt (Exhibit 31, Statement B, Sheet 1 of 2). The figures set forth in Exhibit 31 were later revised by the staff accountant in order to reflect additional operating revenues based upon the staff engineer's estimates of sales. However, as page 6 of Exhibit 55 shows, income required to support additional debt of $40,000,000 cannot be achieved without substantial interim rate relief.

It is apparent that the amount required to meet the interest coverage requirement of both SDG&E and the staff accountant is substantially identical for 1975. The staff annual interest cost with no additional debt for 1975 is $31.389 million, and the SDG&E annual interest requirement on funded debt without additional debt is 31.429 million (Exhibit 36, Column A). Both the staff accountant and SDG&E concluded that without substantial interim rate relief no new debt could be issued by SDG&E in 1975.

1975 Expected Earnings - Rate of Return

SDG&E's showing of financial emergency and the related revenue requirement is not based upon or directly related to the last rate of return authorized this utility. Decision No. 83675 dated October 29, 1974 found that 8.75 percent was a reasonable rate of return for SDG&E. Based upon the capital costs reviewed in that decision, we concluded that a rate of return of 8.75 percent would meet the interest coverage requirement of the SDG&E debenture indentures. As we have seen, the 1975 anticipated earnings of SDG&E will not meet the debenture indenture requirements. As we would expect, the earnings anticipated for 1975 are substantially below the 8.75 percent rate of return.

The staff engineer estimated that the SDG&E rate base as expected for 1975 would be $759,492,700. Using the staff engineer's rate base, the net operating revenues anticipated by December 31, 1975 by the staff engineer would produce a 7.24 percent rate of return, SDG&E's net operating revenues would produce a 5.57 percent rate of return (on the staff engineer's rate base), and the staff accountant's net operating revenues would produce a rate of return of 6.8 percent.

The president of SDG&E testified that in the interim case SDG&E does not seek to exceed its last authorized 8.75 percent rate of return. A witness on behalf of SDG&E presented Exhibit 41, setting forth net operating revenues of $61,922,000 for the 12 months ending December 31, 1975 including additional revenues of $35,046,000 from interim rate relief. The estimated net operating revenues would produce a rate of return of 8.14 percent on the staff engineer's rate base.

In authorizing increased rates to allow SDG&E to achieve the net operating revenues required to issue securities we are not determining a reasonable return on rate base.

The staff brief suggests that any rate increase authorized to meet the financial emergency should be limited to an annual increase of $12.4 million as this is the estimated amount of revenue required on an average year basis to achieve an 8.75 percent rate of return.

The difficulty with adopting this staff limitation on interim rate relief is that it would fail to meet the existing financial emergency facing SDG&E. It is undisputed that SDG&E must necessarily issue securities in 1976. SDG&E is presently unable to issue debt because its interest coverage is below the two times fixed charges without the issuance of any additional debt. If we do not grant emergency interim rate relief, SDG&E will be unable to finance necessary utility operations in any reasonable fashion. The capital requirements of SDG&E's near term construction requirements could not be met and the result would be inadequate service.

The staff accounting witness assumed that capital sources in 1975 would include sale of additional common stock in the fourth quarter of 1975 (in the amount of $20,000,000) and the sale of additional preferred stock in the third quarter of 1975 (in the amount of $25,000,000). (See Exhibit 31, Statement D, Sheet 1 of 2.) The F&A witness stated that if common stock dividends cannot be paid from current earnings, the company would be unable to sell additional stock at any reasonable price. The staff estimated that current net income would be $16 million short of meeting the estimated 1975 common stock dividend. Failure to achieve the authorized rate of return has resulted in a situation which threatens to destroy SDG&E's ability to attract capital.

Short-Term Surcharge - Problems With Approach

This combination of circumstances presents this Commission with a difficult decision. We are convinced that the record demonstrates that SDG&E is entitled to substantial interim relief. And we are satisfied that the record supports the recommendation of the staff accounting witness that an extraordinary short-term rate increase would be required to allow SDG&E to issue debt at the earliest opportunity. We decline to accept that recommendation with the understanding that the result may be some short-term financing problems for the utility.

The record shows that a rate increase sufficient to generate additional revenue in the approximate amount of $35 million in the next four months would be required to bring SDG&E's interest coverage up to the level necessary to issue additional debt by February 1976. We rely upon compelling policy and legal considerations in reaching the conclusion that such an increase is not in the best interests of the utility or its ratepayers.

The greater part of the $35 million would be to compensate the utility for fuel oil expense already incurred during 1975. The effect of such a rate increase would be to make the utility whole for fuel expense for the entire year 1975. This result would be inconsistent with respect to recent Commission policy with regard to fuel expense.

We are referring specifically to the matter of overcollection under the utility's fuel adjustment clause during 1974, and the corresponding reduction in that overcollection balance during the first six months of 1975. It is particularly the undercompensation for fuel expense during the first part of this year that resulted in the interest coverage situation now before us, and so long as a substantial number of those months are included in the coverage calculation, the utility's interest coverage ratio will be depressed. The problem is compounded further by this Commission's action in Decision No. 84618 reducing SDG&E's fuel clause factor by an amount calculated to offset the utility's gain from the sale of surplus fuel oil during 1974, a decision now under reconsideration.

Under these circumstances we would have to condition such an increase upon our ultimate determination in Case No. 9886 (the fuel clause) and reconsideration of Decision No. 84618. The strong probability that this Commission would require that such funds be returned to the ratepayers over a period of time might undermine investors' confidence in such a solution with the result that the bonds intended to be issued would be unmarketable. We cannot attempt such a departure from existing policy on such a speculative basis.

Adopted Approach

With these considerations in mind we adopt instead an approach that will yield to the utility a substantial annualized increase based entirely on prospective data. We believe that this approach, combined with prompt Commission action on future fuel offsets and the pending general rate case, will resolve this company's financial problems for 1976 and beyond.

The amount of the rate increase, $27,200,000, is based on the test year 1975, and the calculation of the amount required to restore the utility's last authorized return on equity of 12.38 percent. We make no finding with respect to what is a reasonable rate of return for purposes of the pending general rate case. We do observe that high interest rates are impairing this utility's ability to secure equity capital and in this interim order we seek to at least halt this erosion.

While the relief that we grant today does not seem sufficient to enable this utility to soon issue additional debt, we do believe that it will substantially strengthen the utility's position in the equity market so that additional funds might be generated by stock offerings at reasonable prices. We find it incumbent upon management to attempt to ease the situation by exploring alternative means of financing. We are particularly interested in the possible application of the Employee Stock Ownership Plan (ESOP, the so-called "Kelso Plan") and the prudency for this particular utility, in its unique situation, of the practice of leveraged leasing for new construction. In the ordering paragraphs we shall direct the company to report to the Commission on the adaptability of these financing methods to its situation and the relative cost of these methods compared to traditional financing. We are concerned about the accounting practices that resulted in the 1974 overcollection being treated as 1974 income, and the 1975 undercollection being treated as 1975 expenses. We believe that this approach unfortunately misstates the true revenue picture of the utility, in view of the original intention of the fuel clause that over and undercollections would balance over years. From our experience we suggest that it would have been more appropriate for the utility to have amortized the overcollection over the subsequent period of undercollection, and we now request the utility to make such accounting adjustments to restate earnings, if, it may do so consistently with generally accepted accounting principles. The effect of such adjustments would be to increase 1975 earnings, while reducing 1974 earnings. We note that we do not expect this situation to be repeated for this utility, even though we have granted and will continue to grant it further offsets, as we have ordered it to account separately for the revenues collected, and we expect to soon modify the fuel clause itself so as to preclude a reoccurrence. Thus, earnings should no longer be affected by fuel clause revenues. And perhaps there is an accounting method by which SDG&E could adjust its accounting for the gain from the sale of surplus fuel oil and the later imposed offsetting reduction so that revenues and expenses would be matched and the current 12-month period not adversely affected.

The increased revenues granted herein will be allocated to each department in the manner requested by applicant using the percentage utilized in the general rate case. However, the increase will not include the steam department, but will be allocated entirely between gas and electric departments.

<u>Subsidiary Relationships - New Albion Resources Company</u>

SDEC's brief raises several issues in connection with the relationship of SDG&E to its subsidiaries, especially New Albion Resources Company (NARCO), a subsidiary which is involved in the sale of coal to SDG&E at the proposed Kaiparowits power plant. SDG&E argues that the question of its relationships with subsidiaries may properly be considered in the general rate proceeding. We share the concern of SDEC regarding the contemplated sale of coal to SDG&E. As applicant is well aware, subsidiary relationships are frequently of substantial concern to this Commission.

Transactions with affiliates are normally reviewed in detail in general rate proceedings before this Commission. However, it appears from our record that SDG&E's subsidiary is presently entering into contracts which may materially affect the prices of coal fuel in the future. In view of the fact that a controlling interest in the coal (based on our record) appears to be held by Southern California Edison Company and SDG&E's subsidiaries, we admonish SDG&E that any contract for the purchase of coal by the parent utility must provide reasonable prices.

We do not intend to prejudge the question of the reasonableness of the terms of any future contract involving coal purchases, but there are certain facts that are apparent on our limited record. The utility's subsidiaries are hardly in the position of small independent companies involved in a highly speculative operations entitled to extremely high returns regardless of the cost to SDG&E and its ratepayers. As SDEC points out in its brief, NARCO has obtained loans from SDG&E at favorable rates. NARCO is in the position, as a subsidiary of SDG&E, of seeking a coal supply as part of SDG&E's Kaiparowits project. We direct SDG&E at this time that it is to advise the Commission staff in these continuing applications of the current status of contract negotiations. We are particularly concerned that the staff be informed of any agreements establishing prices for coal in the Kaiparowits project. Based upon the evidence in our record, we would expect that the price of coal could be extremely advantageous in the future, as contrasted with other fossil fuels on a Btu basis.

Revenue Requirements - Rate Spread

A substantial number of SDG&E's customers appeared before the Commission and expressed their objection to further rate increases. The SDEC witnesses strongly urged that the historical rate pattern of declining blocks, resulting in lower units cost to larger units, is no longer appropriate. We agree. Moreover, we accept the judgment of the SDEC witnesses that the consumption of minimal quantities of electricity and gas by domestic users becomes relatively price inelastic. Rising prices may lower demand and assist the goal of conservation after recognition that appropriate quantities of electricity and gas in the domestic rate classes represent minimum necessary amounts which are relatively price inelastic. In short, a minimum quantity of energy is required by all domestic customers.

SDG&E submitted exhibits setting forth rate increases required when domestic customers using less than 300 kilowatt-hours of electricity monthly and 50 therms of gas monthly are excluded from any emergency interim rate increases authorized. The staff by late-filed Exhibit 57, set forth alternative rate schedules with exclusions for less than 200 kilowatt-hours of electricity. The staff's alternative is designed so as not to result in an inordinately low rate between 200 and 300 kilowatt-hours of electricity at which usage level conservation is practicable.

The staff's alternative gas rate design proposed the elimination of the tail block of the general service schedules and a uniform rate for all interruptible schedules.

The average usage for domestic customers on the SDG&E system is approximately 500 kilowatt-hours per month. The company analyzed a group of 8,000 customers: 700 single-family-residential customers whose homes were valued at less than $20,000 used 376 kilowatt-hours monthly on the average; 1,600 single-family residences whose occupants had an average age of 65 or older used 436 kilowatt-hours per month.

Selection of the appropriate level for our first step toward the lifeline concept is necessarily a matter of judgment. Subsequently, we will develop more refined lifeline rates.

The following tabulation indicates the rate structure we are adopting for domestic service:

	Per Meter Per Month			
Rates	D-1	D-2	D-3	D-4
Customer Charge	$1.86	$2.02	$2.18	$2.35
Energy Charge:				
First 300 Kwhr, per Kwhr	0.03527			
First 400 Kwhr, per Kwhr		0.03619	0.03636	
First 500 Kwhr, per Kwhr				0.03695
All Excess, per Kwhr	0.03210	0.03210	0.03210	0.03210

The following tabulation compares our adopted domestic rates with the rates in effect at the date of this decision including a 0.405¢/Kwhr fuel cost adjustment:

Usage Kwhr	Present Rates 9/21/75	Adopted Rates	% Increase	Present Rates 9/21/75	Adopted Rates	% Increase
	D-1			D-2		
40	$ 3.28	$ 3.43	4.6	$ 3.53	$ 3.63	2.8
100	6.07	5.79	(4.6)	6.39	6.04	(5.5)
200	10.47	9.72	(7.2)	10.80	10.07	(6.8)
300	13.75	13.66	(0.7)	14.08	14.09	0.1
400	17.04	17.27	1.3	17.36	18.12	4.4
500	20.32	20.87	2.7	20.65	21.73	5.2
1,000	36.74	38.96	6.0	37.07	39.81	7.4
1,500	53.15	57.04	7.3	53.48	57.88	8.2
2,000	69.51	75.11	8.0	69.90	75.96	8.7
	D-3			D-4		
40	$ 3.85	$ 3.80	(1.3)	$ 4.22	$ 3.99	(5.5)
100	6.84	6.22	(9.1)	7.33	6.45	(12.0)
200	11.24	10.26	(8.7)	11.74	10.55	(10.1)
300	14.52	14.30	(1.5)	15.02	14.65	(2.5)
400	17.81	18.34	3.0	18.30	18.75	2.5
500	21.09	21.96	4.1	21.59	22.85	5.8
1,000	37.51	40.03	6.7	38.01	40.93	7.7
1,500	53.92	58.11	7.8	54.42	59.00	8.4
2,000	70.34	76.18	8.3	70.84	77.08	8.8

(Decrease)

As our first step toward the lifeline concept in gas rates we will authorize increases to the large customers only. We consider such rate structure necessary to encourage conservation.

There is substantial evidence that energy costs will continue to increase in the future. A witness on behalf of SDEC reviewed the projected capital expenditures of SDG&E and concluded that the requested rate increases, if granted in full in the general rate cases, would not support the proposed construction program through 1979. No evidence was presented to controvert the SDEC contention that under existing economic conditions the only feasible alternative to future rate increases would be conservation and development of alternative renewable energy sources (assuming such alternative sources would be available at a lower cost than the presently available energy). The SDEC evidence supports the conclusion that the capital costs of SDG&E's construction program will result in substantially increased energy costs in the future. The evidence is that SDG&E is facing increased energy demands. Conservation is absolutely imperative.[1/] Under the present circumstances, we will make every attempt to minimize the economic dislocations and hardships of rate increases.

Customers of SDG&E have urged that rates and charges should be increased for meter account activity fees. Rate increases are suggested to meet the cost of sending servicemen to customer locations. Substantial charges are recommended to connect new service.

Counsel for SDG&E stated that these changes recommended for new hookups and service calls should be considered in the general rate case, and that SDG&E agrees in principle with these recommendations. The city of San Diego also urges that such rates and charges be increased and adopted. Such rate reform cannot reasonably be established on a four-month interval, the period of the initial interim rate relief when substantial rate increases will temporarily be in effect to meet the fiscal emergency of SDG&E.

Staff counsel advised all parties on the record that the staff intends to present substantial rate reform in this proceeding. Although we do not, and cannot, on the record for the interim rate

1/ See our comments on conservation in Re Pacific Gas & Electric Company, Decision No. 84902 dated September 16, 1975.

relief, adopt all recommendations for rate reform that have been made at this time we advise SDG&E that comprehensive proposals for such rate reform must be explored in the general rate case proceedings. In the interim however we are adopting rates to enhance conservation and reduction in maximum demands. In addition to exclusion of increases to the lifeline domestic customer, and resulting large increases to other classes of customers, we are providing greater than average increases in demand charges for demand metered customers. This should be the first step toward proposals by SDG&E and others for peak load pricing rates and other tariffs which promote curtailment of load during peak periods. It is clear that the rate reform recommendations have substantial merit and an adequate record, including specific proposals, must be developed in order to implement such reforms.

SUBJECTS FOR GENERAL RATE CASE

There are a number of subjects that relate to the operation of this utility that we intend to explore in the general rate case, in addition to those matters necessarily included.

Conservation

In Decision No. 84902 involving PG&E this Commission announced that "We intend to make the vigor, imagination, and effectiveness of a utility's conservation efforts a key question in future rate proceedings and decisions on supply authorization." In the hearings to follow we expect the applicant to make a showing with regard to its accomplishments and intentions with respect to conservation and related matters, such as alternative energy sources. This is a matter of the utmost importance and grave concern to this Commission.

Intertie and Mutual Assistance

In view of both the economic advantage of maintaining reasonable rate levels and financial constraints on raising capital for construction, it is essential that SDG&E restricts new facilities to the minimum necessary to provide adequate service. Reduction in reserve margins can prudently be made if SDG&E and the other California electric utilities will expand on mutual assistance arrangements and further utilize interties to maximize the efficiency of the combined systems.

The diversity in system loads should permit overall reduction in capacity expansion which will reduce the environmental impact on the state of electric facilities in addition to providing economic benefits.

Hookup or Connection Charges

The cost of adding additional customers to the utility network continues to escalate. There is a substantial question whether this Commission should depart from traditional regulation and impose a hookup or connection charge in proportion to the actual cost to the utility, and if so, whether the charge should apply to all new construction or whether urban renewal should be excluded.

Peak Load Pricing

The subject of peak load pricing is part of our investigation into electric rate structures. In this proceeding we would like to explore the possibility of offering ratepayers a discount in their rates based upon the installation of special metering at the ratepayers' own expense. The record must be developed with respect to possible customers for such an offering, the effect of peak load pricing on the utility's revenues, and the effect on its plant projects.

Gas Heating for Swimming Pools

The future availability of gas supplies sufficient for firm utility customers is a matter of grave concern to this Commission. Based on our current knowledge of gas supplies, we believe that this Commission may have to impose a moratorium on the connection of new gas heaters for swimming pools. In this regard we propose that no new gas heating connections be allowed. We hope to explore this issue further in the hearings to follow. We encourage new building construction to rely on solar heating for this purpose.

Employees' Discounts

Obviously employees' discounts are a fringe benefit and this Commission cannot expect that such discounts will terminate without some corresponding increase in some other kind of benefit. But discounts in electric and gas rates are so plainly inconsistent with conservation efforts that we must place on notice the utility and its employees that discounts must be eliminated. We suggest that one possible substitute might be the so-called "Kelso Plan" employee stock option proposal.

Attorneys' Fees

We believe that the relationship between the utility and a law firm with a partner on the company's board of directors requires that this Commission have in the record evidence that supports the reasonableness of the relationship and of the fees charged the utility by that law firm.

Salaries

In Decision No. 84902 involving PG&E this Commission determined that executive salary amounts in excess of $100,000 annually should not be borne by the ratepayers. We shall undertake to make a determination as to the appropriate amount for this utility.

Advertising

The matter of advertising is a subject of substantial interest to many ratepayers. In recent years this Commission has instituted guidelines with respect to the kinds of advertising expense that is allowable for ratemaking purposes. In the proceeding to follow we intend to consider whether this utility is complying with such guidelines and whether such guidelines ought to be modified.

Legislative Advocacy

In Decision No. 84902 we also determined that the lobbying expenses should be borne by the company's shareholders not ratepayers. The same subject is obviously also an issue in this proceeding.

Board of Directors

The makeup of the utility's board of directors is a matter over which this Commission exercises no control. Consequently, we do not propose to undertake any action in that regard. We do suggest that there may be ways that the company could, by opening up its board of directors, reduce the public sentiment in opposition to further rate increases. Though that is a matter ultimately for the utility's shareholders to decide, we do invite comment in this regard.

Multi-family Dwellings and Mobile Homes

These residential dwelling units raise serious ratemaking problems with respect to treating the residence fairly and uniformly with other residences, while not discriminating against the suppliers caught in the middle. We direct the utility to come forward with some solution to this problem.

Expenses

The matter of controlling expenses is a subject of great concern to this Commission, particularly, in the face of the financial problems confronting this utility. We expect that the applicant will be able to show actual economies and controls implemented in an effort to ease the problem and to demonstrate to the ratepayers that they and their utility share a common interest in this regard.

Findings

1. SDG&E, by Applications Nos. 55627, 55628, and 55629, requests authority to increase its rates and charges in the annual amount of $119,463,900 (28.7 percent). SDG&E's request is based on a 1976 test year.

2. SDG&E filed a petition for interim rate increases in these matters on April 16, 1975, based on SDG&E's expected results of operations for 1975. The petition sought $71,225,000 electric, $7,241,100 gas. The company's request was modified in August to seek $35,000,000 for four months.

3. Decision No. 83675 dated October 29, 1974 in Applications Nos. 53945, 53946, and 53970 found the reasonable return on equity to be 12.38 percent and the reasonable rate of return for SDG&E to be 8.75 percent, based on 1974 operations of SDG&E.

4. SDG&E's return on rate base on 1975 anticipated actual earnings will be below seven percent without emergency rate relief.

5. SDG&E requires additional capital in 1976 to finance its construction program. A reasonable estimate of the amount required to finance the construction program is $164.3 million. Without such program SDG&E's ability to provide adequate service may be impaired.

6. In order to issue and sell stock on a reasonable basis, SDG&E must have adequate earnings. Anticipated 1975 earnings, without interim rate relief, will be inadequate.

7. SDG&E's available short-term credit from bank loans and commercial paper totals $105 million. Such short-term borrowings must be reduced to zero every 12 months and held at zero for 30 days.

8. SDG&E's outstanding debenture indentures require that earnings available for interest coverage (for a 12-month period in the prior 15 months) must be two times annual interest on all funded debt at the time further debt is issued.

9. SDG&E's estimated results of operations for 1975 are set forth in Table 1 in this decision. SDG&E's estimates of revenues and expenses on an "as expected" basis, Table 1, Col. 2, include reasonable estimates of anticipated fuel expenses and revenues.

10. SDG&E's net operating revenues for 1975, without interim rate increases, will be too low to meet the two times annual interest requirement of the outstanding debenture indentures. SDG&E cannot issue mortgage bonds at the present time.

11. SDG&E's inability to issue securities in order to meet its present financial requirements constitutes a financial emergency requiring immediate interim rate relief.

12. Until SDG&E's earnings are sufficient to allow SDG&E to issue additional securities, SDG&E's present financial emergency will continue.

13. Undercollection of fuel expense for the first half of 1975 is the primary reason for this utility's financial problem.

14. High interest expense continues to erode SDG&E's ability to secure equity capital.

15. Based on a 1975 prospective test year, a rate increase of $3.1 million for gas and $24.1 million for electric is required to maintain a 12.38 percent return on equity.

16. Increasing energy demand on the SDG&E system imposes substantial capital construction requirements on the utility. Increased capital requirements result in increasing energy costs to SDG&E. Conservation of energy will lessen SDG&E's capital requirements. Decreasing rate blocks to larger consumers of energy does not encourage conservation.

17. Present energy sources are limited and total ultimate energy supplies are limited. Future energy sources are available only at increased costs. Under such circumstances, authorized rates should encourage maximum conservation.

18. Energy use in smaller quantities by domestic customers is less price elastic than the energy used in the tail blocks by large domestic consumers of energy. Rates should be designed to encourage maximum conservation by large energy consumers.

19. Interim rate relief is justified and required in the annual amount of $27.2 million.

Conclusion

The petition for interim rate relief should be granted to the extent set forth in the following order. Final rates will be authorized after full hearings on all issues involved in the general rate increases.

INTERIM ORDER

IT IS ORDERED that San Diego Gas & Electric Company is authorized to file with this Commission on or after the effective date of this order, in conformity with the provisions of General Order No. 96-Series, revised tariff schedules with rates as set forth in Appendix B.

IT IS FURTHER ORDERED that San Diego Gas & Electric Company shall report to the Commission in writing within thirty days as to the possible applicability and prudency of the Employee Stock Ownership Plan and leveraged leasing in its financial situation.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 15th day of OCTOBER, 1975.

I will file a concurring opinion.
William Symons Jr.

President
William Symons Jr.
Leonard Ross
Robert Batinovich
Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

LIST OF APPEARANCES

Applicant: Chickering & Gregory, by Sherman Chickering, C. Hayden Ames, Allan Thompson, Attorneys at Law; Gordon Pearce, Attorney at Law; and John H. Woy.

Protestants: Robert S. Giovannucci, for Real Estate Servicing Company; Zoe Weinberg (in lieu of Elaine Liebbrandt) and Arthur Deutsch, for the Gray Panthers; Madeline Marini, for Consumer Power and S.D. Energy Coalition; and Jack Walsh, Attorney at Law, for himself.

Interested Parties: Ronald L. Johnson, Deputy City Attorney; M. W. Edwards, Utility Rate Consultant, for the City of San Diego; Charles J. Mackres, for the Department of Defense and other Executive Agencies of the United States Government; Mark B. W. Murray, for Southern California Edison Company; Frank J. Dorsey, for The Consumer Interest of the Executive Agencies of the United States; Elroy F. Wiehl, for the City of Escondido; Debra A. Greenfield, for the City of Vista; Madeline Marini, for Consumer Power and S.D. Energy Coalition; Herbert B. Shore and Francis Halpern, for San Diego Energy Coalition and New American Movement; James Jacobson, for Solar Advocates of San Diego; and Clem J. Nevitt for himself and other retired employees.

Commission Staff: Elinore C. Morgan, Attorney at Law; Jack Gibbons, B.A. Davis, and John D. Reader.

APPENDIX B

RATES - SAN DIEGO GAS & ELECTRIC COMPANY - ELECTRIC AND GAS DEPARTMENTS

Applicant's electric and gas rates, charges, and conditions are changed to the level or extent set forth in this appendix.

SCHEDULES NOS. D-1 THROUGH D-4

RATES

	Per Meter Per Month			
	D-1	D-2	D-3	D-4
Customer Charge	$1.86	$2.02	$2.18	$2.35
Energy Charge				
First 300 Kwhr, per Kwhr	$0.03527			
First 400 Kwhr, per Kwhr		$0.03619	$0.03636	
First 500 Kwhr, per Kwhr				$0.03695
All Excess, per Kwhr	0.03210	0.03210	0.0321	0.03210

SCHEDULES NOS. A-1 THROUGH A-4

RATES

	Per Meter Per Month			
	A-1	A-2	A-3	A-4
Customer Charge	$0.86	$1.02	$1.18	$1.35
Energy Charge				
First 100 Kwhr, per Kwhr	0.05753	0.06023	0.06413	0.06893
Next 400 Kwhr, per Kwhr	0.04893	0.05023	0.05223	0.05503
Next 1,000 Kwhr, per Kwhr	0.04343	0.04433	0.04583	0.04863
Next 1,500 Kwhr, per Kwhr	0.03943	0.03943	0.03943	0.03943
Next 2,000 Kwhr, per Kwhr	0.03869	0.03869	0.03869	0.03869
All Energy in Excess of 5,000 Kwhr per month:				
First 100 Kwhr/Kw, per Kwhr	0.03869	0.03869	0.03869	0.03869
Next 100 Kwhr/Kw, per Kwhr	0.03469	0.03469	0.03469	0.03469
Next 100 Kwhr/Kw, per Kwhr	0.03169	0.03169	0.03169	0.03169
All Excess Kwhr, per Kwhr	0.02969	0.02969	0.02969	0.02969

RATES - SAN DIEGO GAS & ELECTRIC COMPANY - ELECTRIC AND GAS DEPARTMENTS

SCHEDULE NO. A-5

RATES

	Per Meter Per Month
Energy Charge	
First 6,000 Kwhr or less	$320.45
All Energy in Excess of 6,000 Kwhr per month	
First 100 Kwhr/Kw, per Kwhr	0.04112
Next 100 Kwhr/Kw, per Kwhr	0.03592
Next 100 Kwhr/Kw, per Kwhr	0.02318
All Excess Kwhr, per Kwhr	0.02118

Minimum Charge: The monthly minimum charge shall be $320.45 but not less than $1.40 per Kw of billing demand.

SCHEDULE NO. A-6

RATES

	Per Meter Per Month
Energy Charge	
First 100 Kwhr/Kw, per Kwhr	0.04132
Next 100 Kwhr/Kw, per Kwhr	0.03582
Next 100 Kwhr/Kw, per Kwhr	0.02197
All Excess Kwhr, per Kwhr	0.01907

Minimum Charge: The monthly minimum charge shall be $7,000.00 but not less than $1.40 per Kw of billing demand.

SCHEDULES NOS. A-ME2, H, P, P-ME, and PDC

All sales of electric energy sold under the above schedules are increased by 0.389 cents per kilowatt-hour.

SCHEDULES NOS. LS-1, LS-2, LS-3, LS-4, DWL, PA, OL-1, and OL-ME

All sales of electric energy sold under the above schedules are increased by 0.332 cents per kilowatt-hour.

APPENDIX B

SCHEDULE		RATES Per Meter Per Month
G-40	All usage per therm	$.12816
G-50	" " " "	"
G-51	" " " "	"
G-54	All usage per million BTU	¢128.16

A. 55627)
A. 55628) D. 85018
A. 55629)

COMMISSIONER WILLIAM SYMONS, JR., CONCURRING

San Diego Gas and Electric's customers and the economy of the area the Company serves surely need adequate rate relief to keep their major utility company operating on an even keel. I concur with the increase as far as it provides part of the necessary financial relief, but the majority, in rejecting the hearing examiner's more adequately designed relief, makes a serious error. The decision does not meet the realities of financing the immediate future's construction requirements so that the ability to meet the people's energy needs will not suffer tomorrow. It is of small value to toss in "lifeline rates" when the decision fails to meet the principal need justifying interim relief. (I believe the lifeline issue should be decided in Case 9804, our General Investigation in electric rate structure where the evidence has been entered.)

Today's decision is reminiscent of finding a patient who needs 2 pints of blood, but transfusing him with 1 pint and adding a warm wish that he lives until tomorrow. Unfortunately, the customers, not the Commission, stand the long watch.

San Francisco, California
October 15, 1975

William Symons Jr.
WILLIAM SYMONS, JR.
Commissioner