Decision 84-12-069 December 28, 1984

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Joint Application of SOUTHERN CALIFORNIA GAS COMPANY and PACIFIC LIGHTING GAS SUPPLY COMPANY for authority to increase rates charged for gas service; to include an attrition allowance for 1986, and to include in rates the expenditures associated with gas supply and storage projects.	Application 84-02-25 (Filed February 15, 1984)

(Appearances are listed in Appendix A.)

I N D E X

INTERIM OPINION

I. Introduction

In this case, Southern California Gas Company and Pacific Lighting Gas Supply Company (referred hereto as "SoCal", "PLGS", "Applicant(s)" or "Company") have requested an increase in rates of $197.5 million beginning January 1, 1985, and an attrition adjustment of approximately $63 million beginning January 1, 1986. Under the Rate Case Plan as modified by Resolution ALJ-149 and Decisions (D.) 82-12-072 and 83-01-001, Applicant submitted on December 1, 1983, its Notice of Intent (NOI) informing the Commission that Applicant intended to file a general rate increase application based on the Results of Operations for Test Year 1985. The NOI was accepted for filing effective January 9, 1984, and docketed as NOI-112. The application was filed on February 15, 1984, and designated Application (A.) 84-02-25. The late filing was a Commission-ordered deviation from the Rate Case Plan.

A prehearing conference was held on March 26, 1984. Public witness hearings were held on May 14, 1984 in Los Angeles, on May 21, 1984 in San Bernardino, on May 29, 1984 in Santa Ana, on July 23, 1984 in Ventura, and on July 24, 1984 in Bakersfield. Afternoon and evening sessions were held but the public witness hearings were not very well attended. Evidence was taken in Los Angeles and San Francisco during 28 days of hearing commencing May 15, 1984, and concluding on July 20, 1984. The issue of an attrition allowance for years 1986 and 1987 is deferred pending further hearing to be held in mid-1985.

Transcript corrections were submitted by SoCal and staff with no objections raised by any parties. The transcript corrections were adopted. Any motions not previously ruled on are denied.

II. Summary and Decision Outline

Summary of Decision

This decision authorizes an increase in gross revenues of $78,916,000 for 1985 as part of the general rate case application. This decision also provides for the recovery the first year expenses associated with the Liquified Natural Gas (LNG) abandoned project which equal $17,479,000. The total revenue increase for both aspects totals $96,395,000 which represents about a 2.75% increase over present rates. This increase in the revenue requirement results in a new margin for SoCal which is carried over to the consolidated adjustment mechanism (CAM) (A.84-09-022) decision also issued today. At the end of this decision there are two tables which illustrate the Summary of the Results of Operations and compare the SoCal request with the amounts authorized in this decision.

In this application, SoCal requested an attrition allowance for the year 1986. We have decided that SoCal will not file for another general rate increase until 1987 which requires further consideration an appropriate attrition mechanism for the years 1986 and 1987. We will consider such a mechanism in mid-1985.

This decision retains SoCal's rate of return on equity at 15.75%.

This proceeding featured a general agreement on a large array of issues. Even when controversy surrounded a particular dollar figure, the parties were generally able to agree on a methodology. The principal areas of controversy remaining concerned:

Issue		Location in Decision
1.	Rate of return	Rate of Return page 8
2.	Abandoned projects	PLGS page 17
3.	Working cash	PLGS 17 and SoCal rate base page 72
4.	Distribution expenses	SoCal Expenses page 35
5.	Conservation	Market Services page 46
6.	Research and development	Misc. Expenses page 67

Decision Outline

We have included this section to provide a general roadmap of the remaining portion of this decision. We hope that this guide will assist in the understanding of the ultimate result.

The gas utilities in California are given margin treatment for ratemaking purposes. This concept is that the utilities must be allowed the opportunity to earn their authorized rate of return without consideration of the cost of gas or of sales fluctuations. The amount of revenue earned by the utilities without fuel costs is called the "margin". The "margin" is in essence the end product of a general rate case such as this. The cost of gas and sales fluctuation items are considered in separate CAM proceedings twice yearly.

As indicated earlier we directed that this application be filed about 60 days later than usually called for by our rate case processing plan. It was hoped that the parties could agree on many issues and thereby reduce the normal case processing time. We favorably note that many items were stipulated to by the staff and company. This decision will cover all items generally considered in such cases but we will provide very little, if any, discussion of items on which there was general agreement.

A typical decision outline for SoCal would be as follows:

Typical Subject Outline

A. Revenue and sales
B. Expenses
  1. Operating and maintenance expenses
     a. PLGS cost of service
     b. Storage
     c. Transmission
     d. Distribution
     e. Customer service
     f. Customer accounts
     g. Market services
  2. Administrative and general expenses
  3. Taxes
  4. Depreciation espenses
  5. Escalation factors
C. Return
  1. Rate of return
  2. Rate base

However, the relationship of PLGS and SoCal makes it necessary to alter the above outline. Because "escalation factors" and rate of return are common to both companies, and also because these items affect later calculations, it is appropriate to discuss these two items first. PLGS cost of service will next be discussed because this item directly flows through to SoCal as an operating expense. Following operations and maintenance (O&M) expenses, taxes and depreciation we will develop SoCal's rate base. At that point we can calculate a Summary of Earnings and a new margin. This shuffling of subjects is shown on the following outline which will be used for the remainder of this decision.

A. Revenue and sales
B. Escalation factors
C. Rate of Return
D. PLGS cost of service

E. O&M expenses

1. PLGS cost of service (from D. above)
2. Storage
3. Transmission
4. Distribution
5. Customer service
6. Customer accounts
7. Market services

F. Administrative and general expenses

G. Taxes

H. Depreciation

I. Rate Base

III. Present Operations

SoCal is a public utility engaged in purchasing, distributing and selling natural gas to customers located in the Counties of Los Angeles, Fresno, Imperial, Kern, Kings, Orange, Riverside, San Bernardino, San Luis Obispo, Santa Barbara, Tulare, and Ventura. As of December 31, 1983, the Company served 3,941,182 customers of which 3,731,569 were residential customers. The Company sells gas at wholesale to the Municipal Gas Department of the City of Long Beach and San Diego Gas & Electric Company. At December 31, 1983, the Company's serving area contained an estimated population of 12,700,000.

The Company owns underground storage fields at Playa del Rey and Honor Rancho in the Los Angeles area. The Playa del Rey facility has a 12,220 horsepower compressor station, 69 wells, and a working capacity of 2,600,000 cu. ft. (MMcf). The Honor Rancho facility has a 27,500 horsepower compressor station, 39 wells, and a working capacity of 25,000,000 MMcf. The Company under its contract with the Gas Supply Company, operates storage reservoirs at Goleta, Montebello, East Whittier and Alison Canyon.

PLGS purchases its natural gas from Transwestern Pipeline Company (Transwestern), Pacific Interstate Transmission Company, and various producers operating in California and in federal offshore waters. Out-of-state gas purchased from Transwestern is delivered into the system at Needles on the Arizona border.

At December 31, 1983, PLGS owned 903 miles of natural gas transmission pipelines, including 19 miles owned jointly with the distributing company, and 9 miles owned jointly with Pacific Gas and Electric Company (PG&E). There are three compressor stations containing 7 transmission line compressors having an aggregate of 21,720 horsepower.

SoCal owns a total of 2,292 miles of pipelines, including 19 miles owned jointly with the PLGS. There were 9 compressor stations with 56 transmission line compressors having an aggregate of 84,755 horsepower.

As of December 31, 1983, the distribution system of the Company contained 35,686 miles of various size mains. There were 3,126,360 gas services supplying 3,941,182 active meters.

The Company's general office building is located in Los Angeles, California. The Company also owns various divisional and district office buildings, shops and other service buildings, and owns and leases automotive, construction and miscellaneous equipment necessary in the conduct of its business. In addition, the Company operates offices, warehouses, and service buildings of the PLGS as an adjunct to the operations of Company's transmission and storage facilities.

IV. Sales and Revenues

The staff and SoCal stipulated to the sales level gas costs and revenues. The stipulated net operating revenue at present rates is $1,048,702,000. Because we are using the gas margin concept, these items are of minor importance in this case. These items will bear greater significance in the November CAM proceeding.

V. Escalation Rates

For the first time, Company and staff both presented expense amounts on a "constant dollar basis". The adopted Test Year 1985 O&M expenses will first be determined on a "1983 dollar" basis and inflation for 1984 and 1985 will be added to these expenses. SoCal and the staff agree on the proper escalation rates to use for both labor and non-labor O&M expenses for years 1984 and 1985. No other party expressed any views on escalation rates.

The labor inflation rates are in accordance with the agreement signed by the Applicants and the union for a two-year collective bargaining agreement commencing April 1, 1984 through March 31, 1986. That agreement includes a 5.5% wage increase on April 1, 1984 and a further increase of 5.0% on April 1, 1985. To account for the April 1st wage increase dates, labor inflation was calculated at 4.125% for 1984 (5.5% for 9 months) and 9.456% for 1985 (5.5% for the 1984 increase plus 5.0% for 9 months of 1985).

SoCal agreed to use the staff-recommended Modified Producer Price Index (MPPI) to estimate non-labor inflation. These rates are 3.1% and 4.8% for 1984 and 1985, respectively, which when compounded result in 3.1% and 8.049% for 1984 and 1985, respectively.

VI. Rate of Return

Briefs and/or evidence on rate of return has been provided by Applicants, staff, City of Los Angeles, and California Association of Utility Shareholders (CAUS). In addition, Applicants' policy witness provides insights into the related area of risk. Also, Applicants sponsored the testimony of an acknowledged expert in the natural gas industry on the subject of risk.

All parties adopted Applicants' financing plan and capital structure for Test Year 1985. Parties differ, however, as to the cost rates to be assigned the various elements of capital. These differences focus mainly on the embedded cost of long-term debt capital and the required return on common equity. A summary of the positions of the parties follows:

RATE OF RETURN RECOMMENDATIONS
TEST YEAR 1985
(PERCENT)

ITEM	CAPITAL RATIO	APPLICANTS COST RATE	APPLICANTS WEIGHTED COSTS	STAFF COST RATE	STAFF WEIGHTED COSTS	CITY OF L. A. COST RATE	CITY OF L. A. WEIGHTED COSTS
Long-Term Debt	45.0	11.88	5.35	11.60	5.22	11.70	5.265
Commercial Bank Loan	3.4	12.14	.41	12.14	.41	12.50	.425
Total Debt	48.4		5.76		5.63		5.690
Preferred Stock	9.4	6.91	.65	6.90	.65	6.90	.649
Common Equity	42.2	17.50	7.39	15.00-15.40	6.33-6.54	15.40	6.499
Total	100.0%		13.80%		12.61-12.82%		12.838%

A. Long-Term Debt

Applicants propose Test Year 1985 and 1986 average long-term embedded interest costs at 11.88 and 12.2 percent, respectively. Staff estimates these costs to be 11.60 percent for 1985 and 11.82 percent for 1986. City of Los Angeles estimates 1985 debt costs at 11.70 percent.

The determination of embedded interest costs differs between the parties due to differing assumptions as to future long-term interest rates and different treatments of the benefit from the Income from the Discharge of Indebtedness (IDI).

1. Future Long-Term Interest Rates

Applicants estimate future interest costs of long-term debt for SoCal at 13.5 percent in 1984 and 14.0 percent in 1985. Staff uses 12.5 percent and 13.0 percent for 1984 and 1985, respectively, while City of Los Angeles estimates 13.75 percent interest for both years (Exh. 71, p. 33). All parties agree that at the time a decision is reached in this proceeding the Commission should adjust the embedded cost of debt by any known changes in costs and must use its best judgment, based on conditions at the time, as to future cost of long-term debt. During October of this year, Applicants issued $60 million of 12.75% Eurodollar Notes. This financing is reflected in our calculation of the cost of long-term debt. For 1985, we conclude that a long-term interest rate of 13 percent is a reasonable estimate.

2. Income From the IDI

In Applicants' Test Year 1976 general rate case (D.86595) we adopted a policy designed to share the benefits of IDI between ratepayers and shareholders. Until this proceeding, 1976 was the last time that a full record on this issue was developed.

IDI is created when Applicants purchase their bonds in the open market at a discount from face value to satisfy sinking fund requirements. When this happens a gain is realized. It is our stated desire that the benefits from these gains be shared between ratepayers and shareholders.

SoCal argues at pages 27-28 of its brief that:

> "There are only two benefits which could be "shared": The gain itself and the earnings on the unamortized portion of the gains. By Commission decision, IDI must be amortized over the life of the remaining issues. Thus, earnings on the unamortized IDI is the only benefit left to share (Exh. 78, p. 4)."
>
> "Staff's methodology for calculating cost of debt capital over-adjusts for IDI. It has the effect of double counting the amortization of IDI and, in addition, gives all benefits of the unamortized IDI back to the ratepayer. Accordingly, no benefits are available to the shareholder. Indeed, the shareholder is economically disadvantaged in that he ends up out-of-pocket for the funds that are advanced to purchase the bonds and create the gain. Perpetuating Staff's method of calculating interest costs and over-adjusting for IDI creates the situation where it is in the shareholders best interest not to fund the market purchase of sinking fund bonds, but to simply wait until the sinking fund date and put up face value in cash. Under that scenario, no gains would be created for anybody, but, on the other hand, the shareholder is not out-of-pocket as he is now."

Although the staff argues that there is an additional cash-flow benefit to the shareholders, we agree with SoCal on this adjustment and direct that the SoCal recommended mechanism be adopted which results in an additional 19 basis points increase to the long-term debt cost.

3. Commercial Bank Loan

The PLGS Commercial Bank Loan is an adjustable rate loan keyed to the Prime Rate. Both staff and Applicants used an assumed Prime Rate of 11.5 percent for 1984 through 1986. Subsequent events indicate that these assumptions are accurate, and will be adopted.

Preferred Stock Dividend Costs

Although a very minor monetary item (1 basis point) differences between SoCal and the staff's method of calculating the preferred dividend cost for the $60 million, $10 Series Preferred Stock are clarified by SoCal. The staff reduces the value of the preferred stock by the underwriting fees and commissions; however, it does not consider the expenses associated with the sale. SoCal also persuasively argues that the redemption features of the preferred stock give it the characteristics of debt, as prescribed by the Securities and Exchange Commission, and all expenses associated with the series should be treated as such. The staff has failed to amortize the cost associated with this series of preferred stock. We will adopt SoCal's position which has the effect of increasing the cost of preferred stock from 6.90% to 6.91%.

Return on Equity (ROE)

We have previously stated in D.83-12-068 (PG&E) and D.83-12-065 (SDG&E), respectively, that our "objective is to authorize a return to common equity owners that will be commensurate with market returns on investment having corresponding risks during the test period."

In order to successfully accomplish this objective, we further outlined the three major considerations which guide us. These include: (1) recognition of the validity of risk premiums; (2) consideration of the degree of change in the risk profile of the utility over time; and (3) the judicious application and interpretation of financial models in qualifying risk and the market cost of capital (D.83-12-068).

In this proceeding the quantitative models offered were: 1) Risk Premium, 2) Discounted Cash Flow (DCF), 3) Capital Asset Pricing Model and comparative results.

Risk Premium

The risk premium approach recognizes that there are differences in the risk and return factors for investors holding common stock as compared to bonds. The risk differential between common stocks and bonds is expressed as a premium and is added to the estimated cost of a company's long-term debt to determine the required return on common stock. An average risk premium over an extended time period is usually applied to eliminate the variances in the premium observed over time, however, there may be instances where more recently observed premiums are more appropriate in determining current investor expectations.

The ROE studies developed by this method were presented by SoCal, Staff, and CAUS. The risk premiums developed by each were remarkably consistent and are as follows:

Average Risk Premium

10 years = 4.47

5 years = 4.35

3 years = 2.65

SoCal and CAUS then made a judgment on some averaging technique and added their long-term interest cost to the risk premium to produce a range. The staff chose the 3-year figure of 2.65 to add to its interest estimate of 13.0% to produce 15.6% rate of return on equity.

The average premium for the most recent 3-year period is the most reasonable indication of investors' current expectations and appropriate for risk premium analysis. This premium appears to reflect the change in investors' perceived risk of investments in bonds as compared to equities. The double-digit inflation rates of the 1979 through 1981 period in conjunction with the increased volatility in bond prices that has resulted from financial deregulation and changes in Federal Reserve policy have increased the risk of bond investments. These changes in the risk relationship of bonds versus equities have resulted in a decrease in the equity risk premium over recent years.

Discounted Cash Flow

A second method used both by the staff and SoCal was the DCF method. The DCF model recognizes that the current market price of a share of common stock equals the present value of the expected future stream of dividends and the future sale price of the share of stock, discounted at the investor's discount rate. The discount rate that equates the market price of the stock to the present value of the stream of cash receipts represents the expected rate of return. The DCF model solves for the investor's discount rate as follows:

$$r = D/P + g$$

where the investor's discount rate (r) is the sum of the expected dividend yield at the time of purchase (D/P) and the expected growth rate of dividends in the future (g). The dividend yield can be directly observed in the market place; however, an assumption must be made regarding the period of observation. The dividend growth rate expected by investors is more difficult to determine, as one must make an evaluation of the company's future earnings performance.

SoCal developed a dividend yield of 10% whereas the staff analysis produced a 8.98% yield. The staff method was based on a recent six-month average which is an appropriate time period to reflect current expectations.

The next element to be calculated is the growth rate. SoCal develops a historical growth average in the following table:

1981-1983	9.90%
1979-1983	10.44
1974-1983	6.11
Average	8.82

The staff on the other hand argues in its testimony as follows:

> "Also, I believe that market conditions of recent years have exerted pressure on utilities to increase dividends to maintain adequate market prices for shares of its common stock. I believe as a result of the recently improved market conditions over those of earlier years, investors' expectations regarding dividend growth is more in line with PLC's 10-year historical growth rate and it is my belief that a growth rate of 6.0% to 6.5% is a reasonable indication of investors' expected growth for PLC."

The staff's reasoning appears sound. The growth rate of 6.0% to 6.5% added to the expected yield of 8.98 produces a range of 14.98% to 15.48%.

Capital Asset Pricing Model (CAPM)

The company was the only party which developed an equity return based on this model. The model is described in SoCal's testimony as:

> "The CAPM method of estimating expected return on equity is not unlike the risk premium in theoretical justification. CAPM attempts to relate the return on an enterprise associated with risk of that particular enterprise to returns on risk-free assets. By calculating a return factor above and beyond the return on risk-free securities, the CAPM methodology attempts to isolate the risks of the enterprise. In order to quantify that risk, the CAPM method embraces the statistical concept of "Beta" as:
>
> > "...a complete and sufficient measure of the part of the risk of that asset that requires compensation in the market."(1)
>
> This measure is applied against the expected return on all market securities to determine the appropriate risk-related return on that enterprise."

SoCal develops a range of ROE with this model from 16.7% to 18.1%. Because no other party used the method we cannot compare different applications of the model and will therefore assign very little weight to these results.

Comparative Earnings

The City of Los Angeles offered testimony critical not only of the use of the models discussed above but particularly of the judgments and assumptions used by SoCal. City of Los Angeles uses a compensation earnings test to arrive at a recommendation of 15.4% return on equity which produces an overall rate of return of 12.838% and an after-tax interest coverage of 2.26 times. The staff used a comparative earnings test as a check on its other methods. The staff's recommendation of 15.0-15.5% produces an after-tax interest coverage of 2.3 times which it believes is adequate.

Business Risk

SoCal presented the testimony of an expert on the industry Mr. George Hall to show the increased business risk facing gas distributors. Mr. Hall commented on the steady or declining market demand. The gas market is also characterized as becoming very competitive. Mr. Hall also feels that the risk exposure for gas marketability risk is being shifted to the distributors rather than on the producers where the risk belongs.

Subsequent to Mr. Hall's testimony there have been landmark actions on the federal level which in effect places market risk back up the supply stream toward the producers. We also note that it is the producers and their pricing philosophy that brings the market price up to and competitive with fuel oil.

Conclusion

We have taken into consideration all of the testimony relative to the various models, methods, and risk with the appropriate judgments and conclude that a rate of ROE of 15.75% for 1985 is just and reasonable. This ROE produces an overall rate of return of 13.04% with an interest coverage of 2.3 times.

VII. PLGS Cost of Service

PLGS operates under a Cost of Service Tariff with a fixed rate of return which is the same as that authorized for SoCal. As a result, all differences between the staff and the company in the cost of operations of PLGS also flow through to SoCal as differences between staff and SoCal.

The net difference between SoCal and staff at the close of the hearings was only $7,074,000. This difference was the result of several offsetting issues. The major issues relate to ratemaking treatment of the Ten Section storage field, four allegedly abandoned gas supply projects, and working cash. Working cash will be discussed first followed by the abandoned projects.

A. Working Cash

Working cash is the primary issue outside of abandoned projects resulting in different estimates of the PLGS cost of service. The company originally requested $17,700,000 at proposed rates while the staff estimated $7,330,000, a difference of $10,370,000. Subsequently the company reduced its request to $8,815,000. The significant issues are how to treat gas exchanges in terms of working cash (Accts. 242.20 and 174.10) and payment float.

The staff recommended that the value of gas exchanges between companies be deducted from working cash. The company at first contested this issue but later agreed to the staff treatment.

A second issue concerned the disbursement float associated with Federal and State Income Taxes. This issue has been statutorily resolved with the passage of legislation that no longer allows such a float. The resolution of this issue in favor of SoCal shows up as a change of revenue lag days.

The payment float between PLGS affiliates and their suppliers for gas purchases forms the final working cash issue. The staff wanted to recognize the payment float. The company argues persuasively that the issue is properly the subject of Federal Energy Regulatory Commission (FERC) ratemaking treatment for the affiliates and that this proceeding concerns the relationship of SoCal, PLGS, and their direct suppliers.

With the resolution of these issues, we will adopt a working cash allowance for PLGS of $8,148 million.

B. Abandoned Projects

SoCal/PLGS is requesting to recover in rates the costs of four major gas supply projects and one major gas storage field as abandoned projects. The major gas supply projects are:

1. The Interstate Transmission Associates (ITA)
2. The Interstate Transmission Associates Arctic (ITA(A))
3. The Rocky Mountain Pipeline Project
4. The Alaska Natural Gas Transportation System (ANGTS)

The major gas storage facility to be abandoned is the Ten Section field located in Kern County, approximately 12 miles southwest of Bakersfield, California.

The ITA, ITA(A), and the ANGTS projects relate to SoCal and PLGS's efforts to bring new gas supplies from the Alaskan North Slope, the Canadian arctic regions, and Alberta. SoCal began efforts to bring on new long-term gas supplies in the early 1970's in order to offset the rapidly declining availability of natural gas from traditional and domestic sources. Forecasts by both SoCal, PLGS, and Commission staff showed that new gas supplies would be necessary to avert curtailment of SoCal's high priority gas customers.

In 1969, SoCal and PLGS were notified by their suppliers, El Paso Natural Gas Company (El Paso) and Transwestern, that they were unable to contract for increased volumes of gas required by their market. In 1972, both El Paso and Transwestern actually began curtailment of contract volumes, which meant that they could not provide SoCal and PLGS with contractual minimums of 1.75 billion cu. ft. a day from El Paso and 750 MMcf a day from Transwestern. Gas supply forecasts at that time indicated that domestic gas availability, particularly to interstate markets, would continue to decline and its supplies from traditional sources would be inadequate to meet the requirements of SoCal's and PLGS high priority customers.

During the late 1960's and early 1970's, large quantities of natural gas reserves were discovered in the Arctic regions of Alaska and Canada. Furthermore, Alberta gas supplies were also being offered to U.S. markets. While SoCal and PLGS were experiencing increased curtailment, it was apparent that Canadian and Alaskan supplies could offer a secure source of energy for the Southern California market. At this time, several companies undertook feasibility studies to move these resources to markets in the U.S., including Pacific Interstate Transmission Company (PITCO) and Pacific Light Gas Development Company (PLGD), both SoCal and PLGS affiliates and subsidiaries of Pacific Lighting Corporation (PLC). PITCO and PLGD basically operated on SoCal's and PLGS's behalf to provide them a way to bring gas into their service territory.

With this historical background we can now examine the ratemaking treatment of some projects that were not completed. The first such failed project is the Ten Section storage field.

1. Ten Section

The Commission in D.91856 dated June 3, 1980 granted a certificate of public convenience and necessity to Pacific Lighting Service Company (PLS, renamed PLGS in 1981), SoCal, and PG&E to acquire, construct, operate, and maintain an underground natural gas storage reservoir, together with related facilities, at Ten Section Field (Ten Section). In July 1980, PLGS (successor to PLS) and PG&E acquired the field which was previously owned by Shell Oil Co. and Tenneco West, Inc. Construction then began on facilities for gas storage. Under the PLGS/PG&E partnership agreement, the development of the field was to be accomplished in two stages. During Stage 1, all work that was necessary to allow the storage facility to operate for the primary use of PLGS was to be completed, with additional work necessary, to allow the field to operate for the common use of both PLGS and PG&E, to be completed during Stage 2. PLGS was to pay 99% and PG&E was to pay 1% of the cost of facilities for Stage 1 development. Similarly, during Stage 2, PG&E was to pay 99% and PLGS 1% of the costs until the depreciated investment at Stage 1 and 2 facilities (excluding cushion gas) equalized at 50% each. PLGS and PG&E were each to provide one half of the cushion gas injected into the field. The original 1979 estimate for total Stage 1 was $142 million and $54 million for Stage 2.

During development of Ten Section, cushion gas was injected into the field to prevent subsurface water intrusion into the storage reservoirs, thereby preserving the integrity of the field for future development. Water encroachment would reduce the size of the reservoir and reduce the deliverability of the field. The injection of this cushion gas by PLGS began in July of 1981. PG&E never did provide any cushion gas. In July of 1981, PG&E notified PLGS that it no longer wished to participate in the project, and that it planned to terminate the contract it had with PLGS for the Ten Section. In January of 1982, further development of the project was discontinued, and in the Spring of 1983 the decision was made by PLGS to abandon the project after the cushion gas withdrawal was completed.

PLGS undertook the Ten Section project in the late 1970s to provide additional storage capacity designed to avoid extreme peak-hour and extreme peak-day curtailment of SoCal's highest priority customers and to upgrade the level of service to P-3 and P-4 customers. Other benefits were that Ten Section might (1) mitigate potential adverse impacts to customers in the event of supply interruptions, (2) reinforce the existing storage cycle volume capability to meet seasonal demand, (3) enhance the possibility of acquiring and maintaining additional spot-markets and short-term increments of gas supply which, in the absence of such additional storage capacity might otherwise be lost to California, and (4) provide seasonal peaking storage at minimum cost. In the 1970s, as previously discussed, SoCal had been experiencing a decline in the gas supplies available from traditional sources, consequently, there was less primary supply available to meet extreme peak-hour and extreme-day requirements. At the time the Ten Section project was initiated, traditional gas supplies available to California's gas utilities were forecast to continue their sharp decline, with the estimated extreme peak-day deliveries by winter of 1985 to 1986 being 1031 MMcfd and an extreme peak-hour supply margin without Ten Section of minus 2184 MMcfd.

In addition to escalating costs and withdrawal by PG&E from the project, the level of extreme peak-day gas supply available to SoCal was increasing significantly beyond what had been anticipated by SoCal and the Commission at the time the project was certified in June 1980. Furthermore, at the time of SoCal and PLGS's decision to discontinue development of Ten Section, there were indications that increased utilization could be developed in existing storage fields in the PLGS/SoCal system. Thus the combined effects of gas supply requirements and storage improvements, coupled with PG&E's withdrawal and cost factors, led to the decision by PLGS/SoCal in the Spring of 1983 to abandon the Ten Section project.

SoCal's Position

In order to understand SoCal's position on this issue the effects of D.82-12-054 must be reviewed. That decision, which was SoCal's Test Year 1983 rate case, provided that Ten Section costs would be removed from rate base and placed in balancing accounts for final determination at a later date. As a result, two balancing accounts were established, one for O&M expenses and the other for acquisition and improvement costs.

SoCal requests that it be allowed to recover the total amounts of both interest bearing balancing accounts amortized over four years and also be allowed to continue to earn interest on the unamortized balance as shown in Exhibit 5:

> "SoCal and PLGS propose the continuation of these balancing accounts which have accumulated plant and acquisition costs as well as actual operating expenses associated with the withdrawal of gas and the revenues authorized in Decision No. 82-12-054 for Test Year 1983. In addition to costs currently being accumulated in these balancing accounts, SoCal and PLGS propose inclusion of future abandonment costs net of salvage value from disposition of the field. It is further proposed that these interest bearing balancing accounts be amortized over the four year period 1985 through 1988. The above

> proposed treatment is consistent with Decision No. 82-12-54 and will insure that a full and final accounting for Ten Section costs is maintained while providing a precise means for recovery of all appropriate Ten Section costs."

Revenue Requirements Division (RRD) Position

The RRD looks at the Ten Section project as having three separate costs components which must be kept distinct of ratemaking purposes. These are (1) abandonment of plant in service (2) direct cost of construction work in progress including AFUDC and (3) the operating and maintenance cost associated with cushion gas withdrawal. Relying on extensive Commission precedent RRD recommends that SoCal recover:

1. Cost of abandoned plant in service;
2. Direct costs <u>excluding</u> AFUDC and
3. Balancing account interest earned since January 1, 1983.

RRD also recommends that SoCal amortize this recovery over four years without interest on the unamortized balance, and not recover prospective estimated abandonment costs.

Legal Division

The CPUC Legal Division staff views this project in a different light. While SoCal and RRD view the first injection of cushion gas as the starting points of its "used and useful" nature the Legal Division views this as a preoperational expense. Legal Division compares the estimated 1979 expense of the first stage of $142 million with the $21.9 million amount actually placed in rate base in January 1983 and concludes that this project never was sufficiently operational to be used and useful. Legal Division therefore recommends that the balancing account interest from January 1, 1983 be disallowed.

It is acknowledged that Staff's position is that the Ten Section project was "used and useful" from the first injection of cushion gas and thus SoCal is entitled to earn a return. Legal Division, on the other hand, in briefing, vigorously opposes rate base treatment of this project despite D.92497 which placed Ten Section into rate base. Legal Division argues that injection of cushion gas was merely a preoperational cost and did not render the facility "used and useful", therefore SoCal is not entitled to earn a return on this project.

Discussion

We are persuaded by the Legal Division's arguments. Ten Section has never been "used and useful" as a regular underground storage facility. Cushion gas was injected into the field solely to protect the viability of the future storage project against the intrusion of subsurface water. For us to find that Ten Section was used and useful would be akin to finding used and useful the walls and roof of a powerplant into which the generating equipment had never been installed. The withdrawal and sale of cushion gas amounts to salvaging what remains of SoCal's never-completed facility; it does not amount to regular gas storage operations at Ten Section. SoCal attempts to distinguish this case from our recent treatment of other abandoned projects by pointing to the tangible assets - land, wells, pipelines - associated with Ten Section. We reject this argument for the plain reason that these assets have never provided SoCal's customers with their intended benefits.

In D.92497 in SoCal's TY 1981 rate case, we placed a portion of the Ten Section costs into rate base, on a prospective basis, an action that clearly anticipated that the project would become operational as planned by the project proponents. It is no longer our policy to place major projects into rate base on a prospective basis, before they are operational. But we cannot impose such a policy on what is history; SoCal earned its allowed return on Ten Section in 1981 and 1982. To attempt to undo that fact would be retroactive ratemaking. When the original plans for Ten Section failed to materialize, we removed the facility from rate base in the next SoCal general rate case (D.82-12-054) and placed its costs into two balancing accounts. The final ratemaking treatment for the balances in those accounts remains a live issue to be settled in this case.

Because we have found Ten Section never to have been "used or useful", we will not allow SoCal to earn interest or a return on the balancing accounts established in D.82-12-054, for the period from January 1, 1983, to the completion of cushion gas withdrawal in September 1984. To allow SoCal to recover such a return would amount, in essence, to a violation of our principle of not allowing AFUDC on abandoned projects.

The recovery of the other costs of Ten Section will be in compliance with the recent series of decisions dealing with PG&E, primarily D.83-12-068 and D.84-05-100. SoCal will be allowed to recover that portion of costs and improvements in rate base in January 1983, the January 1, 1983 direct costs not yet in rate base, and the associated O&M expenses. However, SoCal will not be allowed to recover the associated AFUDC, or earn interest on the unamortized portion over the four-year amortization period. Prospective abandonment costs will not be recovered at this time. After such costs actually occur, SoCal may request their recovery in a future rate case.

We also note that in D.84-11-116 issued November 21, 1984 we authorized the sale of the Ten Section project. As noted in that decision, the proceeds of the sale allocable to SoCal will offset the above abandonment costs to be recovered. SoCal is instructed to provide our staff with the details of the sale as soon as the transaction is completed.

The table below shows the difference between SoCal's requested and our authorized recovery amounts.

Table 7

Line No.		Staff Witness Thompson	Staff Witness Groves	Company	Authorized
		(Thousands of Dollars)			
1	Plant in Service	$21948	$21948	$21948	$21948
2	Less Depreciation	(839)	(839)	(839)	(839)
3	Net Plant in Service	$21109	$21109	$21109	$21109
4	Direct costs	7902	7895	8008	7895
5	AFUDC	0	0	2162	0
6	Balancing Interest				
7	Accrued	0	2455	2455	0
8	Estimated 1984	0	2189	2189	0
9	Less PG&E Reimbursement	(10391)	(10391)	(10391)	(1239)
10	Estimated Abandonment Costs	0	0	5948	0
11	*Return on Plant in Service	3146	0	0	0
12	AFUDC disallowance allocable to PG&E	1830	0	0	1830
13	Total to be Amortized in Rates	$23596	$23257	$31480	$20443
14	Less proceeds from sale of Ten Section				(6000)
15	Net to be amortized in Rates				$14443**

* Legal supports staff witness Thompson with exception of return on RB of $3146.

** (4 years ÷ $14,443 = $3,611 per year.)

2. ITA, ITA(A), ANGTS, and Rocky Mountain

ITA and ITA(A)

ITA was a partnership between Northwest Pipeline Corporation, then Northwest Energy Company (Northwest), and PITCO. Northwest and PITCO filed an application in February 1974 with the then Federal Power Commission (FPC) to construct a pipeline from the U.S.-Canandian border near Kingsgate, British Columbia, to a point of connection of Northwest's existing system near Rye Valley, Oregon. The ITA pipeline was proposed to transport 405 MMcfd of Alberta supplies with about 50% intended for the Southern California market. This project terminated in late 1974 when Pan Alberta Ltd., the intended Canadian seller of Alberta Gas, cancelled its agreement with ITA due to an increase in Canadian gas requirements and a lack of regulatory approvals. SoCal's witness Hohne testified that this project was the first of a series of proposed projects to bring Canadian Arctic Gas to Southern California, an effort which culminated in an assured Western leg for Alaskan North Slope Gas. This translated into assurance on the federal level that in the event that a pipeline was constructed from Prudhoe Bay, delivery would be made to the Western area.

In May 1974 ITA(A), a partnership between PITCO and Norhtwest, filed an application with the FPC to build and operate a pipeline extending from a point of connection with the proposed Arctic Gas Pipeline on the U.S.-Canadian border to the Nevada-California border. This project was another predecessor to the Western Leg and was proposed to bring supplies from the Alaskan and Canadian Arctic to Southern California to avert anticipated future curtailment of firm load customers. PLC felt it was necessary to have an investment in both projects because ITA(A) was really an attempt to have a means to bring the Prudhoe Bay gas into Southern California. PLGS had an agreement at that time with Arco which gave PLGS the right to negotiate for a sizeable quantity of Arco's gas in the North Slope. SoCal and PLGS had no way at that time to get the gas down from Prudhoe Bay and were interested in the ITA(A) project because it gave them a way to move the gas and to persuade Arco and all the producers in the North Slope that Southern California needed and was interested in the gas and was willing if necessary to build a new pipeline to bring that gas to market.

In 1976, an agreement was reached between Pacific Gas Transmission Company (PGT), PG&E, and PITCO to combine their efforts to build a single Western Leg of the Arctic Gas Project to serve both Northern and Southern California. This agreement consequently negated the need for a separate pipeline to Southern California, and the ITA(A) project was abandoned.

b. ANGTS

Efforts by SoCal and PLGS to bring Alaskan North Slope gas to Southern California began with their involvement in the Arctic Gas Pipeline Project which was funded through the GEDA procedure. In July 1976, the Alcan Pipeline proposal to transport gas supplies from the Alaskan North Slope emerged as a competitor to the Arctic Gas Pipeline Project as well as El Paso's proposal to transport North Slope Gas to the lower 48 states as LNG. In October 1977, Congress enacted the Alaska Natural Gas Transportation Act, recommending that the Alcan project be used to move North Slope Gas to the lower 48 states. Thus, the Arctic Gas Pipeline Project was terminated. In March 1978, PITCO joined the Alaskan Northwest Natural Gas Transportation Company and formed a partnership responsible for designing, building, and operating the project which had been officially designated as the ANGTS. Hohne testified that PLC was in total support of PITCO's involvement in this project because at that time they felt that they desperately needed additional long-term supplies of natural gas.

In May 1982, partners in the ANGTS project announced that the planned start-up date had been delayed until 1989 due to changed market conditions and the lack of definitive gas contracts and financing. Hohne testified that the partners on the ANGTS project made the decision in May of 1982 that the project was lagging but that it wasn't until December of 1982 that they presented a vastly curtailed budget for operations. As a result of that budget, PITCO was convinced that the project was going to be postponed longer than they had anticipated in May of 1982. Consequently, PLGS stopped recording any AFUDC and stopped further funding of PITCO's costs effective December 1982.

Hohne testified that at the time they joined the ANGTS project, it was forecast that by 1985 supplies from traditional sources would be inadequate to satisfy high priority customers. According to Hohne, the passage of the Natural Gas Policy Act (NGPA) in 1978 caused increased wellhead price ceilings for natural gas and encouraged accelerated development of natural gas. At the same time gas demand was decreasing.

Hohne further testified that the project at this time is not really dead. Some partners are still funding the project, but the level of financial support for the project is very low with very little money being expended. The project has been postponed indefinitely by its sponsors. Generally, SoCal believes that because of the size cost and national scope, the ultimate destiny of ANGTS is beyond its control.

c. Rocky Mountain Pipeline

Several major natural gas discoveries were made in the Overthrust Belt during 1977 to 1980. Reports issued by the Potential Gas Committee estimated that the Rocky Mountain Region had in excess of 40 TCF of probable reserves supporting a potential reserve life of over 50 years, which is considerably higher than any other region.

Thus, the Rocky Mountain area had the potential of becoming an increasingly important domestic gas producing region. Various interstate pipelines announced plans to secure these supplies. One project was the Trailblazer pipeline project, involving five major interstate pipelines aiming at securing these new supplies for Eastern markets. Two other Midwest pipeline companies announced plans for pipeline extensions to bring these new supplies to their markets. The Rocky Mountain Pipeline was proposed by PGT to compete for these same supplies. The Rocky Mountain Pipeline Project had plans to construct and operate a pipeline system, with an initial capacity of 413 MMcfd, to transport natural gas to California from reserves developed in the Overthrust Belt in Southwestern Wyoming, Northern Utah, and other producing basins in the Rocky Mountain area. PITCO joined the projects in May of 1980 and PLGS funded PITCO to insure that Southern California would benefit from the development of this key domestic region. Though supply forecasts had become much more favorable by 1980, Hohne testified that things were still very uncertain, and everyone was touting the Rocky Mountains as a new supply area. SoCal and PLGS entered into this project to meet long-term supply needs.

In early 1982, reserves in the Rocky Mountain region were not being developed at an adequate pace to supply both the Trailblazer Pipeline, which was currently under construction at that time and the proposed Rocky Mountain Pipeline. This, and the improved supply situation at the time, resulted in the project being indefinitely postponed by its sponsors. ~~In February 1983,~~ FERC dismissed the Rocky Mountain Project application without prejudice. PLGS stopped recording AFUDC for the Rocky Mountain Project as of February 16, 1983, which was the date of the FERC dismissal of the sponsors' application.

<u>Position of SoCal</u>

Applicants request authority to amortize over a four-year period $19,599,000 consisting of, (1) all advances, net of income tax credits, made to the gas supply project entities ($14.1 million) and (2) all AFUDC accrued on those advances ($5.5 million), with the unamortized balance during that period included in rate base. SoCal's witness Morningstar, testified that PLGS's advances to the gas supply project entities, net of actual and estimated tax credits, together with accumulated AFUDC, totaled $19.6 million. Those advances funded each project company's share of the cash requirements necessary to receive final regulatory approvals which would permit permanent financing to be obtained and PLGS to be reimbursed. The ITA and ITA(A) projects, however, have been abandoned and the Rocky Mountain Pipeline application has been dismissed, so no reimbursement is expected. The ANGTS project has been postponed indefinitely and PLGS is no longer funding its affiliate's involvement in that project. If the ANGTS is ultimately constructed and PLGS's affiliate remains a partner, PLGS would be reimbursed for its advances and AFUDC to the extent such amounts are included by the FERC in the project's rate base. PLGS would then flow through in rates any amount it had previously been allowed to recoup by this Commission.

The company's argument is summarized in the following excerpt from its opening brief on page 147:

> "PLGS cannot recoup disallowed costs of abandoned projects by increasing rates associated with successful projects (Tr. 12/1384). Furthermore, no one (including Staff) has alleged that any of PLGS' advances were imprudent or should be disallowed (Exh. 51, p. 5-3). Applicant has diligently and prudently pursued new sources of supply during a period when the need for such supplies was widely acknowledged. When such projects are unsuccessful for reasons that could not be foreseen or controlled by management, the Applicants should not be penalized by the disallowance of prudently incurred costs (Tr. 12/1386). Thus, Applicant should be permitted to amortize the $5.5 million of AFUDC accrued on the gas supply project advances, along with those advances."

Position of Toward Utility Rate Normalization (TURN)

TURN's conclusions concerning the ITA and ITA(A) projects are different from that of SoCal. TURN believes that PLGS's actions were preliminary preconstruction expenditures on two alternative means to bring arctic gas to the continental United States. The risk was that PLGS's alternative would not prevail. This is certainly not an exceptional risk; rather, it is a normal risk of doing business. Accordingly, TURN recommends that the Commission apply traditional "used and useful" analysis, as was recently done with respect to PG&E's Mendocino plant, and deny all recovery.

TURN further asserts that the ANGTS and Rocky Mountain projects have not yet been abandoned. Therefore, TURN recommends that abandoned project treatment be denied until the projects are totally abandoned.

Discussion

We will adopt the recommendation of staff that SoCal recover the direct costs of these projects (with the exception of ANGTS) without AFUDC and without a return during the four-year amortization period.

We agree that ITA, ITA(A), and Rocky Mountain Project all fall within the exception to the used and useful principle enunciated in D.84-05-100. At the time that all of these projects were entered into by SoCal/PLGS, it was a period of dramatic and unanticipated change and uncertainty in the natural gas industry. Both industry and government were forecasting serious supply shortages that would result in curtailment. Nationally, natural gas utilities, natural gas pipelines, gas producers, and the federal government were involved in many different efforts and projects aimed at securing long-term natural gas supplies to meet anticipated demand. Particularly, all of SoCal/PLGS's forecasts showed the necessity of new supplies in order to avert the curtailment of SoCal's high-priority gas customers. Given the uncertainty of this period, we find that SoCal acted reasonably in its effort to obtain long-term supplies in view of the threat of continued supply shortages and curtailment of its firm customers. Furthermore, SoCal/PLGS's decisions to abandon these projects timely were prudent managerial decisions based on the improved outlook for gas supply, increased success with the Commission's mandated conservation programs, and SoCal/PLGS's Tailored Storage program.

These projects do meet our exception to the "used and useful" principle as enunciated D.84-05-100. Under that exception, only the recovery of direct costs is appropriate. None of these projects ever reached fruition, they never provided direct and ongoing benefits, nor were they "used and useful" in providing adequate and useful service to ratepayers. Therefore, any recovery of AFUDC would be totally contrary to Commission precedent.

During the proceeding the concern was raised that SoCal is seeking recovery for ANGTS as an abandoned project, while at the same time, SoCal is not officially abandoning it nor is SoCal abandoning it for tax or accounting purposes. As previously discussed, PLGS is no longer advancing any additional funds for the ANGTS project and has stopped recording AFUDC as of December 1982. We agree with our accounting staff that, prior to the authorization of any rate recovery for ANGTS, SoCal should demonstrate conclusively that the need for this project no longer exists and that it has not merely been deferred, but has been permanently abandoned. This record lacks such a conclusive demonstration. Based on the current state of the record, we will decline to treat ANGTS as an abandoned project. However, should SoCal subsequently declare the project to be abandoned and conform its accounting and tax treatment to such a declaration, we will entertain a Petition to Modify this decision or an appropriate Application seeking relief. In this way, SoCal will suffer no disadvantage due to the three-year rate case cycle.

Table 2

Summary of Abandonment Cost for the Gas Supply Projects to be Amortized in Rates (Thousands of Dollars)

LN No.	Item	Company	Authorized
1	Total Advances for Abandoned Projects	$28,986	$3,226*
2	AFUDC	5,510	0
3	Tax Credits	(4,259)	0
4	Subtotal	$30,237	$3,226
5	Estimated Federal and State taxes	(10,638)	0
6	Amount to be Amortized	$19,599	$3,226
7	Annual Amortization Amount for test year 1985 (4-year amortization period)	$ 4,900	$ 806

(Red Figures)

*($28,986 less $25,760 ANGTS = $3,226)

The company uses a net of taxes method versus the gross of taxes used by staff shown on line 5 above. To arrive at the revenue requirement for this item the company figure would have to be grossed up. (19599 x 2.01 = 39394)
(39394 ÷ 4 = 9848)
The annual revenue requirement of SoCal = $9848 whereas the staff's method results in a revenue requirement of $806.

C. PLGS Results of Operation

With the resolution of the contested issues discussed above, the following table illustrates the PLGS revenue requirement, which becomes an expense item for SoCal.

Table 3

Pacific Lighting Gas Supply Company
Summary of Earnings
Test Year 1985 Estimated at Authorized Rate of Return
(Thousands of Dollars)

LN No.	Item	Authorized
1	Operating Revenues	
2	Gas Sales	$112,898
3	Total Operating Revenues	112,898
4	Operating Expenses	
5	Wesco Amortization	(32.0)
6	Amort. of Gas Sup. Proj.	12,945
7	Administrative and General	5,978
8	Subtotal	18,891
9	Labor Inflation	292
10	Non-Labor Inflation	145
11	Subtotal After Wage Adj.	19,328
12	Depreciation	17,303
13	Taxes Other Than On Income	6,745
14	California Franchise Tax	6,366
15	Federal Income Tax	26,871
16	Total Operating Expenses	76,613
17	Net Operating Revenues Adjusted	36,285
18	Rate Base	$278,261
19	Rate of Return	13.04%

(Red Figure)

VIII. Operating and Maintenance Expenses

The next step in determining our test year revenue requirement as shown in our outline on page 5 is to derive a reasonable level of operating expenses. We will follow our prior outline of issues raised in the following order:

1. PLGS Cost of Service
2. Storage
3. Transmission
4. Distribution
5. Customer Service
6. Customer Accounts
7. Market Services
8. Administrative and General
9. Clearing Accounts

Within this set of topics most controversy was in the area of Distribution expenses, Market Services (Conservation) and Administrative and General (Research and Development).

A. PLGS Cost of Service

The PLGS cost of service was resolved in the previous section to be $112,898,000.

B. Storage Expenses

Underground storage expenses comprise expenses for operating and maintaining both SoCal and PLGS underground storage reservoirs at Alison Canyon, Playa del Rey, Montebello, Goleta, East Whittier and Honor Rancho. These expenses include wells, pipelines, compressor stations, and applicable supervision and engineering.

Staff and SoCal have reached agreement on an estimate of $20,742,000 for underground storage for test year 1985. At the outset of the hearing the only differences between staff and the company were in the areas of gas losses (Account 823) and wells

(Account 832). SoCal's estimate of 248 MMcf of losses is an actual annual gas loss based on a three-year average (1980, 1981, and 1982). Staff registered no objection to the use of this three-year average. The initial difference between staff and Company in the area of gas losses was due solely to the use of different estimates for the cost of gas. SoCal has stipulated to staff's cost of gas estimate of $4.5436/MMcf as developed by staff witness Geoffrey W. Meloche which brought SoCal and staff into agreement on an estimate for gas migration losses.

C. Transmission Expenses

There have been no recent significant additions or changes to Applicant's transmission plant. This is consistent with the fact that total residential, commercial/industrial and resale gas volume was at its highest in 1972. The plant (as well as its O&M personnel) has historically handled larger volumes than are currently expected.

The staff estimates for transmission O&M expenses showed an initial difference between staff and company of $548,000. Later the company agreed with the staff estimate. The total agreed-upon expenses for this item are $18,621,000 which is adopted.

D. Distribution Expenses

The Company and staff are in wide disagreement on this expense item. The Company based its estimates on 1983 recorded costs plus recent planned activities. The staff on the other hand used a four-year averaging technique based on a ratio of labor hours to number of customers. Two important facts to note are that the distribution system is growing at rate of slightly less than 2% per year and that distribution expenses increased by 21% from 1982 to 1983. The table below shows the 1983 recorded figures as well as RRD staff and SoCal estimates for Test Year 1985. This table also shows the $10,495,000 difference between the Company and the staff.

Table 5

Distribution Expenses
(Exclusive of Customer Service Expense)
Test Year
(Thousands of Dollars)

Account Number	Item	1983 Recorded	Test Year 1985 RRD (A)	Test Year 1985 Utility (B)	Util. Exceeds RRD Amount (C)
	Operation				
870.00	Supv. & Engr.	$28609	$28483	$32323	$3840
874.00	Mains & Serv. Exp.	48	65	74	9
875.00	Meas. & Reg. Sta. Exp.-Gen.	759	736	836	100
878.00	Meter + House Reg. Exp.	1396	1288	1463	175
879.00	Cust. Insp. Exp.	19	14	16	2
880.00	Other Expenses	11121	10329	11726	1397
881.00	Rents	191	205	205	0
	Subtotal Dist. Oper. Exp.	42143	41120	46643	5523
	Maintenance				
885.00	Supv. & Engr.	0	0	0	
886.00	Struc. & Improve.	1106	1033	1484	451
887.00	Mains	12786	12593	14224	1631
889.00	Meas. & Reg. Sta. Equip. Gen.	786	722	820	98
892.00	Services	16566	14991	16997	2006
893.00	Meters	6114	5841	6627	786
894.00	Other Equip.	472	432	432	0
	Subtotal Dist. Maint. Exp.	37830	35612	40584	4972
	Total Dist. Expenses	$79973	$76732	$87227	$10495

SoCal's response to the staff technique is reflected in the following quotations from SoCal's brief at pages 52 and 54:

> "SoCalGas vehemently disagrees with Ms. Hytonen's methodology and believes it was chosen to confirm her conclusions. Staff's sole reliance on the labor hours to customer ratio fails to consider such highly relevant factors as survey footage, number of leak repairs, age of the system and newly authorized, safety-related activities."
>
> "Ms. Hytonen should not rely on an arbitrarily chosen, simplistic mathematical formula to arrive at expense estimates. Ms. Hytonen should articulate, at least to a certain degree, the aspects of the Company's operations she disagrees with. Ms. Hytonen relied solely on her mathematical formula and failed to present an explicit assessment as to why SoCalGas distribution expense estimates are not reasonable."

While we agree with SoCal that any estimate of distribution expenses must include "newly authorized" or mandated activities, we also believe that staff witness Hytonen's averaging technique is appropriate to bring the growth in distribution expenses back toward the rate of growth of the distribution system. We will therefore not adopt either the staff's nor the Company's estimates in total. We will rather adopt those estimates supplied by the staff except for certain accounts where new or mandated programs indicate that SoCal's estimate is more appropriate.

1. Distribution Sub-accounts

Account 870. Supervision and Engineering

The greatest difference between the staff and Company in this area. The staff averaging methodology which results in a reduction from 1983 is not appropriate for this account but the growth (13%) embedded in the Company's estimate appears excessive. We will adopt as a compromise a figure about 7% over 1983 expense levels which produces a number of $30,612,000.

Accounts 874, 875, 878, 879, 880, and 881

The accounts in this section constitute the remaining operating accounts. In this area, the staff's methodology is most appropriate and staff's estimates will be adopted.

Account 886. Structure and Improvements

The staff's averaging techniques failed to consider the additional maintenance associated with six new distribution bases and four new division headquarters. The SoCal estimate is adopted ($1,484,000).

Accounts 887 (Mains) and 892 (Services)

These accounts are the primary accounts that house the newly-mandated safety-related activities. The staff did not fully consider these programs separately. SoCal made a convincing showing regarding its expanded safety program and the Company's estimates will be adopted ($14,224,000 and $16,997,000).

Accounts 889, 893, and 894

These three accounts are the remaining accounts in the maintenance area of distribution expenses. The staff's method is appropriate for these expense categories and will be adopted.

Authorized Distribution Expenses

The table below contains the results of the above discussion.

Table 5

Southern California Gas Company
Distribution Expenses
Test Year 1985

Account	Item	RRD	Utility	Authorized
		(Thousands of Dollars)		
870	Supv. & Engr.	$28483	$32323	$30612
874	Mains & Serv. Exp.	65	74	65
875	Meas. & Reg. Station Gen.	736	836	736
878	Meter & House Reg. Exp.	1288	1463	1288
879	Customer Install Exp.	14	16	14
880	Other Exp's.	10329	11726	10329
881	Rents	205	205	205
	Total Operation Exp's.	41120	46643	43249
885	Supv. & Engr.	0	0	0
886	Struct's. & Improvements	1033	1484	1484
887	Mains	12593	14224	14224
889	Meas. & Reg. Sta. Equip.-Gen.	722	820	722
892	Services	14991	16997	16997
893	Meters	5841	6627	5841
894	Other Equip.	432	432	432
	Total Mainten. Exp.	35612	40584	39700
	Total Dist. Exp.	$76732	$87227	$82949

2. PCB Balancing Account

The last subject to be addressed in this section concerns a balancing account which was authorized previously to facilitate recovery of expenses associated with replacement of equipment contaminated with environmentally hazardous Polychlorinated Biphenyls (PCBs). The current balance is overcollected by about $2.1 million. The staff recommends that the balancing account treatment be continued and that the current overcollection be refunded. Since the current rates have resulted in the overcollection, staff recommends that any future overcollections be resolved in the next general rate case. The Company concurs. We will adopt the staff recommendation. The $2.1 million current overcollection will be returned to the ratepayers over the next 12 month period.

E. Customer Service Expenses

Customer Service expenses include the cost of field service calls to establish service, disconnect service, adjust appliances, investigate leakage and bill complaints, and other related available services normally offered to natural gas customers. In addition, field service employees change meters and regulators in accordance with the Company's and Commission's agreed-upon plan.

SoCal is requesting $68,158,000 for this item while the staff estimate of $66,629,000 is about 3% lower. The staff performed a thorough analysis of these expenses based on later data than that available to SoCal. The authorized figure is $66,429,000, which essentially adopts staff's recommendations. The one exception is staff's recommendation for an additional $200,000 in advertising for SoCal's pilot light program. This program will be funded at the level of SoCal's request, $1,166,000.

F. Customer Accounts Expenses

This expense item includes meter reading, billing, mailing, maintaining customer records, and uncollectibles. The major items contested involve postage and uncollectibles. The table at the end of this discussion will show the company, staff, and authorized amounts by account.

Account 903 and Customer Records and Collection Expenses

The major item causing the large difference between the Company and the staff is the estimate of postage expense. Both staff and SoCal agree that if a postage increase is implemented before this decision is signed, then we should recognize the increase. The Postal Commission decision has been issued. This decision recognizes the postal expense increase effective February 1985.

Account 904, Uncollectible Rate

The uncollectible factor for the residential and commercial sectors is the difference causing the 56% difference between the Company and the staff. The staff expense estimate is $3,679,000 while the SoCal estimate is $5,738,000.

Staff estimated an uncollectible factor using a 5-year average for Residential and Commercial of .5021% while SoCal estimated .85%. We believe that the best estimate is neither the Company's nor the staff's but rather the most current experienced factor. Thus far in 1984, SoCal is experiencing a residential and commercial uncollectible rate of .80%. With SoCal's estimated improvement, this will be reduced to .65%. This results in an expense level for this account of $4,402,000.

SOUTHERN CALIFORNIA GAS COMPANY
Test Year 1985

Development of Uncollectible Expense
($000)

		SOCAL	STAFF	ADOPTED
1.	Uncollectible Rate	0.85%	0.5021%	0.65%
2.	Operating Revenue	$1,048,702	$1,048,702	$1,048,702
3.	Residential & Commercial Revenue Factor	46.576%	46.576%	46.576%
4.	Residential & Commercial Revenue (2)x(3)	$ 488,443	$ 488,443	$ 488,443
5.	Residential & Commercial Uncollectible Exp. (4)x(1)	$ 4,152	$ 2,452	$ 3,175
6.	Industrial Uncollectible Expense	$ 1,586 1/	$ 1,227 2/	$ 1,227
7.	Total Uncollectible Factor (8)÷(2)	0.55%	0.35%	0.42%
8.	TOTAL UNCOLLECTIBLE	$ 5,738	$ 3,679	$ 4,402

1/ SoCal estimated its test year 1985 industrial uncollectible by using estimated 1983. (0.15%)

2/ Staff developed its test year 1985 industrial uncollectible by using 1983 recorded uncollectibles. (0.12%)

Accounts 901, Supervision, 905 Miscellaneous Expenses

These accounts contained relatively minor differences between Company and staff. The staff recommended disallowing such programs as a minority hotline, consultant review of the bill format, and other minor programs because a positive cost-benefit relationship was not shown. These types of programs do not easily lend themselves to cost-benefit analysis and seem to be reasonable programs within management responsibility. We will not adopt the staff adjustments. The following table contains the results.

Table 6
Customers Accounts
(Thousands of Dollars)

Account	RRD	SoCal	Authorized
901	$ 4219	$ 4649	$ 4649
902	15437	15437	15437
903	50166	51811	50624*
904	3679	5738	4402
905	0	0	0
Cost Savings	(326)	0	0
	$73175	$77635	$75112

(Red Figure)

* To allow for the increase in postal rates which occurred after exhibits were filed.

G. Market Services Expenses

Market Services contain the following program elements, with expense requests and staff recommendations:

$000's

	SoCal	Staff	Authorized
1. New Customer Service and Information	$ 4086.0	$ 4086.0	$ 4086.0
2. Cogeneration	2214.0	2214.0	2214.0
3. Conservation	17506.4	14712.7	10196.5
4. Master Meter Conversion	392.6	2689.0	392.6
5. Development and Analysis	2735.4	3156.7	1813.9
6. Support and Administration	2514.9	1600.3	1472.3
7. AGA Advertising	365.0	0	0
	$29814.3	$28458.4	$20175.3

Of these seven programs only two were not contested to some degree: Cogeneration and New Customer Service and Information.

1. New Customer Service and Information

This program, in conformance with applicable regulations, provides service to new customers with information on installation costs, rate schedules, and requirements for service. This program also obtains new construction data for use in planning gas distribution facilities.

SoCal's estimate includes labor costs equivalent to a workforce of 79.39 persons for test year 1985. This compares favorably to workforce equivalents of 101.28, 97.06, and 94.14 for 1981, 1982, and 1983, respectively.

CPUC staff reviewed the related workforce requirement estimated for New Customer Service and Information Program by SoCal and found it reasonable; $4,086,000 will therefore be authorized.

2. Cogeneration

The SoCal cogeneration program is consistent with the policy and related directives that stem from the Commission's OII-26 and the OIR-2 proceedings. In D.82-01-013, OIR-2's purpose was stated to be "to establish standards governing the prices, terms and conditions of electric utility purchases of electric power from cogeneration and small power production."

SoCal enters the OIR-2 cogeneration picture for at least two reasons: (1) It is the supplier of natural gas to cogeneration projects in the service territories of ten electric utilities (including Southern California Edison) and (2) SoCal is well aware of potential cogenerators through its gas usage records. The gas company then is a logical, reasonable source of information and assistance to potential cogenerators.

SoCal's program of offering to provide information and assistance to potential cogenerators is cost-effective and successful. It has provided assistance (feasibility studies, design evaluation, etc.) to over 350 projects. Of these, 37 projects totaling 216.5 megawatts (MW) of capacity, are either operating or are under construction and another 30 projects are in the design phase. SoCal's personnel work with each project from its inception (as invited), reviewing designs and advising on the best way to meet the efficiency standards required by FERC and Section 218.5 of the California Public Utilities Code.

There is substantial societal benefit. The dependence of this state and its ratepayers on foreign oil and gas are lessened because the gas used in the cogeneration process is used much more efficiently (50 to 100 percent more efficiently) than if it were used to produce process steam and electricity separately through conventional thermal power plants. SoCal estimates that 250 MW of cogeneration installed by 1985 will, over the subsequent 15-year period, save on the order of 1,125,000,000 therms, valued at over a billion dollars ($1,275,375,000). However, in the future we expect a showing from staff and SoCal that assures us of no double counting of benefits of SoCal's program with those of the electric utilities.

In view of these and other long-range benefits to the ratepayer, we will authorize SoCal's proposed, estimated rate of expenditure for these cogeneration assistance programs of $2,214,300 for 1985 and 1986.

3. Conservation

The Company in this proceeding is requesting $17,506,000, the staff recommends $14,712,000 while TURN recommends $8,559,200 (in 1983 dollars). Staff has also developed an alternate "bare bones" conservation proposal totaling $13,378,000.

In concept, both staff and SoCal support our current stay-the-course policy on conservation funding, which was enunciated in PG&E's and SDG&E's last general rate cases. TURN recommends a policy of severe cutbacks in conservation. TURN would reduce spending substantially for programs designed to influence behavior rather than install hardware. This translates into cuts in all advertising. TURN also recommends cuts in programs that fail the non-participant ratepayer cost-effectiveness test, particularly non-residential programs.

To put these recommendations in perspective, it is useful to note that, in 1983 dollars, 1983 authorizations equalled $14.5 million and 1984 authorizations equalled $16.1 million (including carryforward of unspent 1983 funds). *

It should also be noted that other conservation expenses recovered through SoCal's Conservation and Load Management Adjustment Clause (CLMAC) will total approximately $80 million in 1984 (in 1983 dollars). The attached table presents an overview of funding levels for SoCal's total conservation programs, including those at issue in this proceeding.

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* These figures do not include expenses funded in other departments, such as the pilot light program, development and analysis, support and administration and AGA advertising.

Table 7

Southern California Gas Company
Conservation Programs
Test Year 1985

Item	Utility	ECB Staff	Adopted
	(1983 Dollars in Thousands)		
Residential			
Energy Training Center	$ 449.7	$ 449.7	$ 449.7
Manufactured Housing	796.7	754.7	0
Cold Weather Conservation	1,178.6	1,178.6	554.0
Energy Education	749.2	749.2	400.0
Product Testing	290.9	150.9	0
Home Energy Audits	568.4	568.4	568.4
Committed Energy Needs	2,491.9	1,550.0	0
Subtotal	6,525.4	5,401.5	1,972.1
Non-residential			
Energy Efficient Audits	6,356.7	6,856.7	6,356.7
Food Industry	336.8	336.8	0
Heat Recovery	1,133.9	1,383.9	1,133.9
CACS-Audits	733.8	733.8	733.8
Energy Options	2,419.8	0	0
Subtotal	10,981.0	9,311.2	8,224.4
TOTAL	17,506.4	14,712.7	10,196.5

Table 7a

Southern California Gas Company
Energy Management and
Conservation Expenditures

Line No.	Program	1983 Authorized	1983 1/ Recorded	1984 2/ Planned	1985 3/ Proposed
		(Dollars in Thousands)			
1.	Residential Conservation Services	$12,716	$ 8,755	$ 8,029	$ 1,000
2.	Weatherization Financing and Credits Program	50,564	57,115	56,866	54,000
3.	Demonstration Solar Financing Program	12,964	12,507	15,086	16,000
4.	Weatherization Training Center	468	437	657	450
5.	Manufactured Housing	717	613	718	797
6.	Conservation Education	674	401	485	750
7.	Energy Efficiency Audits	7,365	6,006	7,233	6,357
8.	Food Industry	350	236	297	337
9.	Heat Recovery	1,096	335	1,055	1,734
10.	Cold Weather Conservation	1,099	1,257	1,139	1,178
11.	Master Meter Conversion	183	100	194	393
12.	Cogeneration	1,224	823	1,454	2,214
13.	Pilot Light Program	1,342	1,354	461	1,166
14.	Accelerated Equipment Modernization	15	2	131	291
15.	Support and Administration Activities	2,278	2,344	4,565	4,065
16.	Committed Energy Needs	-	-	-	2,492
17.	Energy Options	-	-	-	2,420
18.	AGA-Advertising	-	-	-	365
19.	CACS-Audits	-	-	-	734
20.	Home Energy Audits	-	-	-	568
21.	Expenses other Depts. (A&G)	2,000	3,000	4,000	5,000
22.	TOTAL	95,055	95,258	102,370	101,711
23.	At 1983 $	95,055	95,258	97,033	101,711

1/ From SoCal's 1983 Preliminary Energy Efficiency Report.

2/ From SoCal's 1984 Preliminary Energy Efficiency Plan.

3/ 1983 constant dollars.

The SoCal request is to continue the following ongoing programs:

1. Energy Training Center
2. Manufactured Housing
3. Cold Weather Conservation
4. Energy Education
5. Energy Efficient Audits
6. Food Industry
7. Heat Recovery

In addition to the current programs, SoCal proposes four new programs: (1) Home Energy Audits, (2) CACS Audits, (3) Committed Energy Needs, and (4) Energy Options.

Conservation Policy

The Commission's recent policy has been to maintain current authorized expenditure levels for conservation/load management programs rather than dramatically increase or decrease the authorizations from prior years. While some factors indicate that a less aggressive approach to conservation is appropriate, the Commission had declined to dismantle the existing program infrastructure in the recognition that the energy scene may change quickly and dramatically. Beginning with PG&E's and SDG&E's TY1984 general rate cases, the Commission had adopted a level of funding approximately equal to prior authorization levels (in nominal dollars). This has become known as the "stay the course" funding policy.

In particular, the Commission has articulated the following set of general guidelines in its recent Test Year rate case decisions for SDG&E (D.83-12-065), PG&E (D.83-12-068) and Pacific Power and Light (D.84-07-150):

- Maintain programs mandated or required by law
- Review programs required by past Commission decisions to determine whether they should be continued.
- Implement only those new programs clearly cost-effective

- Phase out/reject programs that require incentive payments borne by all ratepayers, but only cost-effective to participants and, because of potential for reduced billings, would probably be undertaken without incentives.
- Maintain/initiate programs which, although they may not meet some of the above objectives, are worthwhile based on considerations of equity and externalities.

Since significant funding increases have occurred in offset proceedings, it is important to consider the sum total of all conservation and load management programs, regardless of the proceeding in which they are funded.

The Commission has also given greater weight to the issue of program cost-effectiveness in recent Commission decisions. With relatively stable energy prices and average rates close to (if not above) marginal costs, many utility programs are not cost-effective to the non-participant. As we have previously discussed in Decision 82-12-054 (SoCal Gas' TY1983 general rate case) and more recently in Decisions 83-12-065, 83-12-068 and 84-07-150, the nonparticipant test is essentially a test of equity. Generally, we hesitate to reqquire nonparticipants to fund new or expanded conservation programs which increase rates to a greater extent than would incremental supply. As indicated in Tables V-A and V-B, none of SoCal's conservation programs pass the nonparticipant test, even under a wide range of sensitivity analysis. All programs, except the Master Meter Conversion Program pass the societal test.

Our evaluation of SoCal's, staff's and TURN's funding recommendations in this case will follow the guidelines reiterated above, taking into explicit consideration the cost-effectiveness of specific programs.

Energy Training Center

	SoCal	Staff	TURN	Authorized
Request $ in 000's	449.7	449.7	0	449.7

The staff and SoCal agree on a spending level significantly below 1983 andd 1984 authorizations, but comparable to recorded expenditures in those years. TURN recommends that all ratepayer support for the program be phased out. TURN's position is that the stated goal of training 300-400 people does not justify its expense.

We will adopt the requested $450,000, because we have encouraged all our utilities' conservation efforts to try to penetrate the low-income groups. We believe this training center helps in this regard.

Manufactured Housing

	SoCal	Staff	TURN	Authorized
Request				
$ in 000's	796.7	754.7	537	0

The objective of this program is to motivate manufacturers and dealers of mobile homes to build and sell homes which incorporate energy conservation techniques and efficient gas appliances. In 1983, SoCal was authorized $718,000 for the Manufactured Housing Program, and spent $613,000. Concern Awards were given to 3,486 mobile homes and $194,000 in incentives were paid to dealers. For 1985, SoCal is requesting $797,000 to operate the program, with a target goal of reaching 13,200 concern mobile homes and 6,615 other mobile homes with conservation features. The staff recommends a $42,000 adjustment for Solar Demonstration and Displays and Exhibits. We note that this program fails the nonparticipant test by a wide margin. Furthermore, it provides incentives to manufacturers and dealers, rather than end-users. We deny funding for this program.

Cold Weather Conservation

	SoCal	Staff	TURN	Authorized
Request				
$ in 000's	1178.6	1178.6	554	554

This program encourages customers through newspaper and television to install specific conservation devices, institute conservation practices that assist them in keeping their gas bills low in winter. The benefits of energy efficient appliances for replacment and new construction are also commercialized through this program.

TURN's response to this program is in its brief at page 34 as follows:

> "Surely consumer awareness has reached the point where expenditures on this very basic information can be scaled back. Surely the very large advertising budgets associated with more specific utility and nonutility activities serve these basic needs."

We agree with TURN that such advertising can be scaled back significantly and authorize $554,000 for the program.

Energy Education

	SoCal	Staff	TURN	Authorized
Request $ in 000's	749.2	749.2	0	400

The objective of the Energy Education Program is to promote efficient use of energy by informing and educating a wide variety of consumer groups by distribution of materials to schools and through group presentations to adult audiences about the efficient use of natural gas and conservation in general.

SoCal was authorized $485,000 for this program in 1983 but spent only $401,000. Although staff recommends the full requested funding based on its cost-effectiveness, TURN questions these results and recommends either no funding or a freeze at 1983 expenditure levels. We agree with TURN. We are uncomfortable with the cost-effectiveness results of programs that are designed to influence behavior. We would like to see more empirical results before authorizing such large program increases as proposed here. We will allow $400,000.

Product Testing

	Socal	Staff	TURN	Authorized
Request $ in 000's	290.9	150.9	0	0

The goal of this program is to assist manufacturers in testing their products in order to encourage continued research, production of additional innovations, and product efficiency improvements.

A new item proposed in this program is to assist manufacturers in the introduction of their energy efficient gas appliance and products to retailers and distributors. The utility claims that approximately $140,000 of appliance introduction assistance to manufacturers of high efficiency gas appliances is needed during test year 1985 so that the residential gas appliance industry remains competitive with its electric counterparts.

The staff recommends disallowance of $140,000 for product introduction. TURN recommends that this program be eliminated. Staff's review of the last four years of new residential construction activities indicate that, instead of erosion, the percent of gas appliance saturation is increasing on SoCal's service territory (Exhibit 69 page VI-14). Moreover, we do not believe that ratepayers should fund conservation programs for the purpose of maintaining one industry's competitive position vis-a-vis its electric counterparts. We deny funding for the program.

Home Energy Audit Service

	SoCal	Staff	TURN	Authorized
Request $ in 000's	568.4	568.4	568.4	568.4

The objective of this program is to comply with the requirements of D.83-12-061 dated December 20, 1983 in A.83-09-23 and A.83-09-26. The home energy audits provided by this program encourage customers to make their homes more energy efficient. The audit is also a requirement for income tax credits available from conservation measures. D.83-12-061 also authorized termination of te Residential Conservation Service (RCS) program by the end of 1984 but required SoCal to continue offering do-it-yourself audits to its customers.

This expense item was not contested and will be adopted at the requested level.

Committed Energy Needs

	SoCal	Staff	TURN	Authorized
Request $ in 000's	2491.9	1550	0	0

This is a new program whose basic purpose is to retain or increase the market share of gas versus electric appliances for (1) space heating, (2) water heating, (3) cooking, and (4) clothes drying. The basic strategy of SoCal is industry contacts, promotions, incentives, and advertising. SoCal asserts that it needs this program because it sees a trend of customer preference away from all gas appliances and thus a newly evident trend of market erosion.

The staff is not so concerned with market erosion as it is with the efficiency of end-use gas usage for the four functions discussed above. The following quote from the staff exhibit illustrates the staff's concerns:

> "It is perfectly clear that these end uses can be served by gas or electricity but when they are served by electricity we simply burn the gas to do so at the generating plant and with all the boiler, generation, transmission and distribution losses it takes <u>more</u> natural gas to make the electricity to serve these uses than to distribute the gas to do it directly. Also, at some point, when these uses are served by electricity we either have to cycle or otherwise interrupt these appliances at the time of system peak or we have to build more power plants to meet the capacity requirements."

The staff believes that SoCal's goals can be achieved with substantially less money than SoCal is requesting. The staff recommends $1 million for the new construction industry contacts and promotions and $550,000 for new gas appliance rebates when gas appliances replace similar electric appliances.

TURN recommends that this program not be financed at all. TURN's criticism has two thrusts. The first is that the program as structured by SoCal consists almost totally of intangible advertising, promotion, and contacts. The second is that ratepayers should not fund any inter-energy competition. TURN believes that the competition between electricity and gas should be conducted in the market place without ratepayer financing.

We share TURN's concerns. In SoCal's last general rate case proceeding, SoCal proposed a similar program as part of "Conservation Support Activities". In Decision 82-12-054, the Commission stated:

> "In SoCal's last general rate case, this Commission questioned the value of the New Construction program and stated that SoCal must be able to demonstrate that 'savings can be directly attributable to its efforts.' Nonetheless, SoCal projects no energy savings as a direct result of this program. Exhibit 31 reveals that SoCal seeks to use these program funds to encourage the installation of gas, rather than electric, home appliances. While the choice of gas, as opposed to electric appliances may be a prudent end-use decision, we do not agree with SoCal that ratepayers should underwrite an effort to influence that choice. We will disallow SoCal's funding in this category because of the program's uncertain benefits to its own ratepayers." (D.82-12-054, page 44-45)

More recently, in Advice Letter No. 1423, SoCal requested funding for this new program with unspent, carryover 1983 funds. Resolution No. EC-33 issued May 16, 1984, denied this request. The Commission determined that new programs were to be fully analyzed in this rate case proceeding.

Despite a clear directive in prior decisions, SoCal did not present any cost-effectiveness analysis of this program in their application. Their workpapers did provide some figures which indicate that this program on the whole fails the non-participant test for both SoCal Gas ratepayers, as well as electric ratepayers. Only the replacement program marginally passed the non-participant test for SoCal gas ratepayers.

We are not persuaded by SoCal's showing in this case that our prior policies should be reversed. We will not authorize funding for this new program. Overhead costs associated with this program will also be commensurately reduced.

Energy Efficiency Audits

	SoCal	Staff	TURN	Authorized
Request $ in 000's	6356.7	6856.7	5000	6356.7

The objective of this program is to identify areas where energy efficiency can be improved in commercial or industrial facilities and assist customers in implementing energy management programs.

Under this program, SoCal personnel survey customers' facilities to identify practices and equipment or process changes which promote more efficient uses of natural gas. Customers are encouraged to implement innovative techniques and invest in energy efficient systems. Audits are also performed when new customers come on line or when a significant change in plant operation occurs.

In 1983, SoCal was authorized $7,233,000 and spent $6,006,000, completing 15,277 audits and 15,105 post audits in the commercial sector and 1,138 audits and 5,444 post audits in the industrial sector, for a total of 30,332 audit/post audits, as well as 2,540 equipment modernization projects.

For 1985, SoCal is requesting $6,357,000 with a goal of 26,570 audit/post audits for commercial and industrial facilities, 2,328 equipment modernization projects, annual savings of 77,147 Mtherm, and life cycle savings of 240,505 therms. The ECB staff's review indicates that this program is cost-effective and there are still large and cheap opportunities for commercial and industrial customers to conserve natural gas by making gas furnaces and boilers more efficient. The ECB staff believes that this program should be expanded to allow $500,000 in additional incentives.

TURN feels that the target customers of this program all have access to the relevant information and financing to perform the obviously cost-effective work. Thus, TURN recommends phasing out the program particularly as it applies to the larger industrial customers.

We believe that if TURN's arguments were correct, then the potential for so much conservation would have evaporated. It still exists. We will continue this program as proposed by SoCal and authorize $6,356,700.

Food Industry

	SoCal	Staff	TURN	Authorized
Request $ in 000's	336.8	336.8	0	0

The objective of the Food Industry program is to conserve energy by increasing the sale and installation of energy efficient gas equipment in food service establishments. This program has three components:

1. Equipment Introduction
2. Equipment Demonstration
3. Efficiency Equipment Sales

The equipment introduction component assists manufacturers in developing markets for innovative energy-efficient food service appliances and equipment through shared advertising costs.

The equipment demonstration component tests food service equipment for energy efficiency, and gives the manufacturer of a prototype piece of equipment independent test data.

Efficiency Equipment Sales or the Dealer Support component motivates dealers to sell energy-efficient equipment by offering them incentives for such sales.

Staff recommends full funding of this program because it encourages conservation of natural gas by promoting the use of high-efficiency appliances.

TURN opposes this program on the general principle that the utility should not subsidize the development of new products where there is a significant manufacturing industry already in place.

We believe that TURN's arguments justify curtailing this program, and deny funding for it.

Heat Recovery Program

	SoCal	Staff	TURN	Authorized
Request $ in 000's	1338.9	1338.9		1338.9

The Heat Recovery program seeks to encourage commercial and industrial customers to make the necessary investment to reclaim considerable portions of the waste energy generated by their operations. This reclaimed energy can then be used in a number of applications, such as the preheating of combustion air, boiler feedwater or the raw material in production.

This is the most cost-effective program of SoCal with 1983 life cycle savings achieved at a cost of only $.007 per therm. Staff therefore recommends an increase of $250,000 over the requested amount.

TURN opposes the program on the general principle discussed in the Food Industry section.

We adopt the reasoning of our staff and will authorize the full amount requested by SoCal. We are very reluctant to authorize more than the utility requests particularly when this amount is substantially greater than the 1983 expenditure level.

Commercial and Apartment Conservation Service

	SoCal	Staff	TURN	Authorized
Request $ in 000's	733.8	733.8	733.8	733.8

The CACS audit program is mandated by Title VII of the National Energy Conservation Policy Act. The targeted group for this audit program is small commercial buildings built prior to June 30, 1980 with natural gas consumption of 1,000 therms per month or less, and apartments and condominiums of five units or more which were built prior to June 30, 1980 and are centrally heated and/or cooled.

This is a mandated new program which was not contested. We will authorize the requested amount.

Energy Options

	SoCal	Staff	TURN	Authorized
Request $ in 000's	2419.8	0	0	0

This is a new program designed to maintain or increase gas sales. It pays a ratepayer-funded incentive directly to the appliance salesperson. The program budget shows that about 80% of the costs would be in the form of advertising and incentives. PG&E had a similar program in 1979 and 1980, but later discontinued it because it was difficult to manage and ineffective. We will not authorize any funding for this new program.

4. Master Meter Conversion

In this proceeding, SoCal proposed a budget for this item of $392,600 as compared to 1983 expenditures of $100,000. The staff, on the other hand, seeks a much more ambitious program of converting all eligible master meters by the year 2000. The staff-proposed spending level is $2,688,600.

Without a more detailed showing regarding the cost-effectiveness of the program, we are reluctant to ask SoCal to embark on such an ambitious program. This is the one program that does not appear cost-effective to society. We are therefore reluctant to ask SoCal to embark on the ambitious program recommended by staff. We will authorize the program at the level of SoCal's request, due to the potential program benefits for lower-income renters.

5. Development and Analysis Support and Administration

These two Marketing Service programs consist of the following elements:

Strategic Planning

Marketing Research

Forecasting and Analysis

Consumer Communication Services

Market Services Training

Administration

For these programs, SoCal is requesting $5,250,300. The staff has recommended a reduction of $493,000 commensurate with other program adjustments. The staff's argument is that these "support or overhead" type items are directly related to the size of the program which they support. We have adopted funding levels in some programs below staff's recommendations. Hence, we believe that adopting staff's "bare bones" funding alternate for these two marketing service programs is reasonable, and responsive to SoCal's arguments at the same time.

SoCal argues that these costs are not directly related to the size of the other Marketing Service Programs and should not be proportionately cut. TURN argues just the opposite. We believe that the adopted staff adjustment is the minimum that could be made and that SoCal should have no problems staying within this authorized amount.

6. <u>American Gas Association (AGA) Advertising</u>

SoCal is requesting $365,000 for AGA advertising. Both SoCal and particularly the AGA witness made a convincing showing that this national advertising is effective. We agree, however, that this type of generic advertising is more appropriately funded by shareholders. We will therefore continue our current policy and not authorize any amount for AGA advertising.

7. <u>Miscellaneous Marketing Service Issues</u>

a. <u>Unexpended Conservation Funds</u>

In accordance with Resolution EC-33 dated June 1984, SoCal has provided us with an estimate of total unspent and unencumbered conservation funds from 1981 through the end of 1984 including interest. The estimated total amount is $5.6 million.

Our staff has reviewed this filing and concurs with the amounts stated. Staff also recommends that this amount be used to reduce the revenue requirement in this case. The staff also finds that the underexpenditures were reasonable.

We concur with staff. We will treat this amount in the same fashion as the PCB overcollection which is to return this money to the ratepayer over the next 12 month period.

b. <u>Discretionary Reallocations</u>

In the past, we have provided that unspent conservation funds would be carried forward and ultimately refunded with interest. We will continue this same practice. Also, we have in the past provided management with the flexibility to reallocate up to $1 million among conservation programs. The staff recommends that this be reduced to $250,000. We will maintain the current amounts and authorize SoCal to reallocate up to $1 million between programs without an advice letter filing provided that no funds are reallocated from Residential to Nonresidential programs and vice versa.

H. Administrative and General

The administrative and general expenses include salaries, wages, supplies, and expenses of officers and general office employees of SoCal properly chargeable to operations but not chargeable to a particular operating expense. Also included are the fees and expenses of consultants; cost of insurance and reserve provisions; employee pensions and benefits; franchise requirements; rents; research, development and demonstration (RD&D); and maintenance of general plant.

SoCal traditionally uses its budget process to estimate test year expenditures. Test year 1985 estimates were developed from forecasts of expenses by functional accounts prepared by each division and/or department, as appropriate. These functional account totals were then combined into the individual PUC accounts as shown on Table 8. This process specifically includes increases resulting from changes in federal regulations, safety standards, and operational requirements.

RRD reviewed workpapers provided by SoCal and analyzed historical data and 1983 actual expense. This was done on a functional as well as PUC account basis. The results of RRD's review and analyses are also contained in Table 8.

Table 8

Administrative and General Expenses
(Thousands of Dollars)

Line No.	Acct. No.	Acct. Description	Company (1)	Staff (2)	Amount of Difference Cols. (1-2)
1		OPERATION			
2	920	Administrative & general salaries	$51,408	$ 50,927	$ 481
3	921	Office supplies & expenses	27,510	27,029	481
4	922	Administrative expenses transferred - credit	-	-	-
5	923	Outside services employed	10,811	10,811	-
6	924	Property insurance	1,767	1,767	-
7	925	Injuries and damages	7,085	6,749	336
8	926	Employee pensions and benefits	74,618	71,988	2,630
9	927	Franchise requirements	15,749	15,694	55
10	928	Regulatory Commission expenses	350	350	-
11	930	Miscellaneous general expenses	26,408	23,456	2,952
12	931	Rents	4,330	4,084	246
13		Total Operating Expenses	220,036	212,855	7,181
14		MAINTENANCE			
15	932	General Plant	2,819	2,819	-
16		TOTAL ADMINISTRATIVE AND GENERAL EXPENSES	$222,855	$215,674	$7,181

The table above shows a difference between the staff and SoCal of about $7,181,000. This difference is misleading. The method of computing Acct. 926 has been agreed to. The $2.6 million difference flows from other expense items. The same is true for Acct. 927 (Franchise requirements) and Acct. 931 (Rents). The real difference is contained in Acct. 930 (Miscellaneous general).

Account 920 and 921 Administrative & General Salaries Office Supplies & Expenses

In 1982, SoCal began a Quality Circle program in which voluntary non-management groups, or circles, meet regularly to investigate and resolve business-related problems. Typical problems include mechanical or administrative procedures and the design and use of new methods and equipment. These Quality Circles have proven so successful that senior management has approved the expansion of the program. RRD believes that the Quality Circle program will improve productivity and employee morale and will benefit both SoCal and its ratepayers.

The issue relating to this program was best outlined in the SoCal's brief at page 106 in the following excerpt:

> Staff calculated the cost savings from the Company's Quality Circle program as a function of costs to be incurred in both 1984 and 1985 (Exh. 53, p. 12-7). The Company agreed with Staff that the savings flowing from 1985 expenditures should be used to reduce Test Year revenue requirements; however, the Company objected to similar treatment for the 1984 expenditures because they were not paid for by the ratepayer (Tr. 9/1024-1025). The Company believes, as stated by witness Ballew, that "the shareholder should reap the benefits of the costs that he incurred, and the ratepayer should do likewise."

The question becomes whether the costs of the Quality Circle Program should be borne by the ratepayer or shareholder. SoCal argues that the cost of the program were not reflected in the last general rate case decision, therefore, the costs were borne by the shareholders. Simply because a particular program or item is not included in a general rate case decision does not mean that any expenditures on such a program were provided by shareholders. Our decisions are not the operating budgets of the utilities. The costs of this program were a normal utility expense which could not be affirmatively shown to be a shareholder contribution. We will adopt the staff adjustment.

2. Account 925 Injuries and Damages

The 1983 actual expense of $673,000 was $287,000 less than SoCal's estimate of $960,000. SoCal developed its estimates for years 1983-1985 based on specific case payments it had forecasted. RRD staff does not believe that estimating test year 1985 expenses by forecasting specific case payments is appropriate. The expenses for this account in the last five years, based on a normalized 1983 dollar year estimate, range from $491,000 to $943,000 (1979 = $943,000; 1980 = $491,000; 1981 = $619,000; 1982 = $776,000; 1983 = $673,000). RRD believes that a five-year average of $700,000 more is appropriate as an estimate of test year 1985 expenses for this functional account.

We agree with the staff's reasoning particularly when we are facing a three-year rate cycle for SoCal. We will adopt the staff adjustment.

3. Account 930 Miscellaneous General Expenses

The heart of the controversy between the SoCal, the staff and TURN is in this account. The two issues are (1) RD&D and (2) American Gas Association (AGA) dues. We will first discuss the AGA issue then the RD&D issue.

a. AGA Dues

The first major issue to be decided is whether or not AGA membership constitutes a benefit to the ratepayers such that AGA dues should be considered a reasonable operating expense.

Mr. Kolodziej testified for the AGA that:

> "A.G.A. is a national trade association comprising approximately 300 natural gas distribution and transmission companies. As such, it was established and exists to fulfill the needs of the regulated gas industry and thereby improve the industry's ability to better serve its customers."

"A.G.A serves SoCalGas and its customers in two general ways: the first is by helping them improve their local programs, practices, and procedures in all areas of their operation. In this regard, AGA provides hundreds of forums and other vehicles through which SoCalGas employees can exchange information with their peers in other companies in order to better serve its California customers. These face-to-face exchanges include committee meetings, workshops, seminars, and other forums. In addition, A.G.A. provides program Clearinghouse services in a number of areas including customer relations, educational services, and training and development. Through such clearinghouses, A.G.A. maintains information on successful programs conducted by member companies and makes this information available to other companies upon request.

"The second way A.G.A. serves SoCalGas and its customers is by doing things collectively or at the national level that the utility could not do or could not do cost-effectively on its own.

"All of these activities are directed at the same goal -- to improve the efficiency and effectiveness of member companies in all areas of operation without having them incur unnecessary 'learning curve' costs. If A.G.A. did not exist, solid business practice would call for creation of such an organization."

Mr. Kolodziej then went on to describe several specific examples of activities that benefit SoCal and its ratepayers.

SoCal's annual membership dues excluding advertising discussed earlier are $465,000 which includes $4,000 for lobbying and about $46,500 for other government activities. In this proceeding SoCal seeks recovery of $461,000 ($465,000 - 4,000).

The staff recommends a 25% reduction of the total non-advertising dues. The staff recommendation is based on our last PG&E decision dealing with this subject where we reduced PG&E recovery of dues for similar organizations by 25% representing lobbying expenses.

TURN views most of the AGA activities as either advertising or lobbying and recommends a two-thirds cut to $153,000.

We find that SoCal's membership in AGA provides substantial benefits to the SoCal ratepayer so that membership dues not including advertising can be considered a reasonable operating expense. However, we will continue our long-standing policy of not allowing ratepayers to pay for lobbying activities and will only allow recovery of the $461,000 as requested by SoCal.

b. Research, Development and Demonstration

Request	1983(Rec)	1984(Est)	SoCal	Staff	TURN	Authorized
$ 000's	6939	6618	9205	6364.9	3987	7456

In D.82-12-005, issued December [illegible] 1982 in OII 82-08-01, we established guidelines for evaluating utility RD&D projects. These guidelines form the cornerstone of our RD&D policy. D.82-12-005 emphasized that RD&D projects should support one or more of the following objectives:

- There should be a reasonable probability of providing benefits to the ratepayers (minimize expenditures on concepts with a low probability of success).

- Projects should be consistent with the utility's resource plan.

- Projects should not duplicate research currently, previously, or imminently undertaken by another utility or research organization.

- Projects should lead to environmental improvement.

- Projects should enhance public or employee safety.

- Projects should support the Commission's conservatin objectives and promote conservation by efficient resource use or by reducing and/or shifting system load.

- Projects should develop new resources, particularly those resources which are renewable, and/or processes or otherwise further supply technology. The project should reduce reliance on finite, nonrenewable resources.

- Projects should improve operating efficiency and/or reliability or otherwise reduce operating costs.

The broad nature of these guidelines leaves room for interpretation and judgment. This has led to a considerable amount of controversy in this proceeding.

Staff recommended $2.8 million of downward adjustments to SoCal's $9.2 million request primarily because in the staff's view certain projects are duplicative of Gas Research Institute (G.R.I.) projects and others are more appropriately funded by industry.

TURN recommends approximately 50% of the requested amount for the following reasons:

1. Utility RD&D should not subsidize third party compliance with regulatory requirements.
2. RD&D should not subsidize commercialization and marketing efforts by manufacturers.
3. The utility should not engage in RD&D which offers no unique benefits to California.

We have arrived at our authorized amount of $7,456,000 based upon reasons other than those put forth by either our staff or TURN. Because of the lack of agreement by all parties, we have elected to apply our stay-the-course policy to RD&D in addition to conservation expenses. We thus took the 1983 and 1984 average RD&D expense and allowed 10% growth ($6,778,000 x 1.10 = $7,456,000). It should be emphasized that this $6.3 million RD&D budget is in addition to ratepayer support for the GRI as mandated by the Federal Energy Regulatory Commission. This support will amount to about $10.2 million during 1984. We will discuss, if not resolve, some of the important issues raised primarily by TURN.

TURN and staff did an excellent job analyzing SoCal's RD&D projects and discussing several problems confronting a regulatory agency in deciding how to treat RD&D for ratemaking purposes. While we take a different view, staff's and TURN's effort helped us crystalize certain issues. Some of the more important issues raised are research duplication, co-funding, and attrition year programs.

Research Duplication

We have previously stated our intent to avoid duplicative research projects. In this proceeding, the staff put forth the following definition of research duplication:

> "a research project is duplicative when the objectives and/or goals are the same regardless of the technology used and the time frame involved. This is because ratepayers would be paying twice, once to the research organization and the other to the utility to perform research to achieve the same goals or objectives." (R.T. Vol. 17, pp. 1824-1825.)

According to staff, the following projects have a duplication problem:

1. Pre-Combustion NOx Elimination
2. Improved Piping and Venting Systems for Gas-Fired Appliances
3. Improved Glass Melter
4. High Temperature Contaminated Heat Recovery
5. Excavation Techniques
6. Field Test of Hand-held Proximity
7. Proximity Device for Excavation Equipment
8. Operation Safety - only the $200,000 for corrosion detection locator research
9. Passive Solar
10. High Efficiency Water Heater

SoCal, on the other hand, prefers a broader definition which would not find projects with similar goals duplicative if the projects used different methods and techniques.

We find staff's argument persuasive and will not approve funding for these projects. However, within the amount approved by this order, we will allow SoCal to file an advice letter for approval of these projects if they can resolve the duplication problem with the staff. We will also be considering the duplication issue in coordination with the California Energy Commission at our annual RD&D meeting scheduled for late January, 1985. For future proceedings, we instruct SoCal to make a more detailed showing regarding possible duplication of research projects. This subject naturally leads to another broader issue raised by TURN.

Regulatory Treatment of RD&D

The possible duplication discussed above led TURN to recommend that the regulatory agency provide prior approval of all research projects as shown in its brief at pages 7 and 8:

"Because RD&D is discretionary, the Commission must take particular care that the utility's RD&D budget is spent in the ways anticipated by the Commission. Two general types of abuses must be avoided. First, RD&D money must not become an open pocket that can be raided to cover overspending in other areas. Second, RD&D money must not become a slush fund for SoCal's research managers to shift among projects without outside review.

"The open pocket issue appears not to have been a problem in recent years for SoCal, since the utility claims to have overspent its authorized RD&D budget in 1981 and 1983 (Id. at 1441). However, the Commission should still provide that any future underspent funds would either be rolled over or refunded to ratepayers, as has been the Commission's practice for energy conservation funds. TURN recommends this revision.

"There is an immediate need for the Commission to restrict SoCal's authority to transfer funds among projects, and add or drop projects. Depending on the limit and use of such discretion, existing flexibility could either maintain effectiveness or become a slush fund to finance pet projects or subsidize favored customers. The Commission must be able to prevent the latter."

It has been our goal to establish guidelines and standards generally agreed-upon by all parties that would govern the research efforts of the utilities. Thus we see the regulatory role as overseeing the compliance of the utilities to the standards rather than detailed project review. Some project by project review is unavoidable, especially during general rate cases. However, our major focus is to see that the utility has an appropriate method of evaluating projects. Also we would want to see that the utility has a process that it uses to determine if its research is duplicative of the work of others (not just G.R.I.). We need to be assured that the utility's cost-benefit analysis is correctly done.

After we undertake the review discussed above we can then make a finding of the funding level for the research program. Once we have approved the funding level and utility selection process we can then leave management the discretion of managing its program. It is this path that we choose in this proceeding. The staff confirms that SoCal has complied with our guidelines and definitions. Also, SoCal is actively involved with G.R.I. and has attended PUC statewide workshops on RD&D and should therefore be aware of potentially duplicative research. We will therefore not impose tighter regulatory controls on SoCal at this time. There is one area however on which we would like to see recommendations. That is, what minimum ranking should a project have to obtain in order to be considered reasonable. Hypothetically, one could say that if a project did not attain a score of 20 points in the staff's rating scheme or 300 in SoCal's scheme, it should not be conducted. If we could make such a determination, it would go a long way toward addressing TURN's valid criticisms.

A last subject in the area of both regulatory treatment and duplication involves the selection of projects by who the potential beneficiaries are. TURN's brief once again treated the subject in a cogent manner in the excerpt below:

"Many of SoCal's proposed RD&D projects have very broad potential applications, so that their success would benefit gas consumers or industries far beyond the utility's service territory. (see RT13/1574-84; 17/1872-75). These projects should be evaluated carefully to see that the potential benefits to SoCal customers justify the expenditure of SoCal funds.

"TURN certainly does not oppose the idea that RD&D might produce broad benefits. However, we note that GRI already spends over $150 million on RD&D of broad interest, including $10.2 million involuntarily extracted from SoCal's ratepayers. We urge the Commission to be very leery of authorizing further extractions.

"The best model for such research is the use of research organizations or consortia of utilities where each participant's contribution is consistent with its potential benefit. GRI claims to be an example. This rationale is also used to justify programs such as SoCal's Fuel Cell Program, under which SoCal seeks to contribute $200,000 per year to a much larger effort.

"TURN recommends that the Commission require substantial cofunding of general-application RD&D. The test is a simple one: if the project is so promising, SoCal should be able to attract other participants. The Commission should make use of the vast pool of technical knowledge in the industry to supplement its own efforts to screen proposals."

We agree with the general thrust of TURN's recommendation for future proceedings. We direct staff and SoCal to propose such a standard which should govern research whose potential beneficiaries are broader in scope than simply the ratepayers in SoCal's service territory. Particularly, we want suggestions on how to cooperate on or avoid duplicative research. We note that the broader the research, the more likely it is that some other utility or institution is engaged in similar research.

In a similar vein, TURN recommended that we not approve funding of projects which subsidize commercialization and marketing efforts by manufacturers, or RD&D projects by industrial consumers. Similarly, staff recommended that we deny funding various product development projects and targeted industry projects which staff felt should be funded by the industry directly benefiting from the research. We are also concerned about ratepayers funding projects whose benefits accrue to a single customer or class of customers. In such instances, we expect to see co-funding by the entity(s) directly benefiting from the RD&D research. However, we decline to take the strong action recommended by staff and TURN in this proceeding. We note that industrial customers are ratepayers and therefore entitled to benefits resulting from a fair allocation of RD&D funds. Our responsibility is to see that RD&D funds are spent wisely and that potential benefits accruing from RD&D projects are balanced fairly among all ratepayers. We will be considering this issue as we work with the California Energy Commission, California utilities, and other interested parties during RD&D meetings scheduled for the coming year to implement D.82-12-005 of OII 82-08-01, Senate Bill 2155, and Assembly Bill 3897.

The last issue we will discuss involves the related problems of co-funding, refund of underspent RD&D funds, and attrition year budget levels. The problems arise from the following hypothetical series of events:

1. Utility requests RD&D funding level which has a certain amount of known co-funding.
2. We adopt a certain spending level based on the utility requests.
3. Subsequently the utility either acquires much more co-funding, underspends its RD&D budget, or concludes research on certain projects.

SoCal would spend any additional co-funding and retain any unspent funds to be used as it sees fit. TURN would do the opposite. TURN recommends that the utility not be allowed to spend in excess of the authorized level as a result of additional co-funding and that any resulting underexpenditures be returned to the ratepayers. TURN also recommends that the utility be required to obtain prior approval of RD&D projects, including its attrition year(s) RD&D programs. This is consistent with TURN's view favoring more direct regulatory management of RD&D because TURN sees RD&D as being total discretionary.

We will adopt TURN's recommendation in part. We will continue to allow the utility to manage its own RD&D program during the test year subject to constraints articulated in this decision and the guidelines adopted in D.82-12-005. However, we will require SoCal to file for approval of its attrition year(s) RD&D programs. This is necessary because, as TURN points out, relatively few test year programs are scheduled to continue into 1986 (only $3.2 million worth according to TURN). We are hesitant to give SoCal complete freedom to embark on such a large proporition of new RD&D projects without review and input from staff and other interested parties. This differs from the treatment accorded Southern California Edison Company in its general rate case decision issued today because only one of Edison's thirty-nine RD&D programs is scheduled to terminate prior to Edison's 1987 attrition year.

Table 9

Administrative and General Expenses
Test Year 1985
(Thousands of Dollars)

Account No.	Item	Authorized
	Operation	
920	Administrative and General Salaries	$ 50,927
921	Office Supplies and Expenses	27,029
923	Outside Services employed	10,811
924	Property Insurance	1,767
925	Injuries and Damages	6,749
926	Employee Pension and Benefits	72,887
927	Franchise Requirements	15,694
928	Regulatory Commiss[illegible]xpenses	350
930	Miscellaneous General Expenses	25,108
931	Rents	4,121
	Total Operating Expenses	$215,443
	Maintenance	
932	General Plant	2,819
	Total Administrative and General Expenses	$218,262

I. Clearing Accounts

Clearing Accounts accumulate costs which provide benefits to various departments; examples of such costs would include automobiles, communication, and storage expenses. These common costs are subsequently cleared, or reallocated, to those departments receiving such benefit, all in conformance with the Uniform System of Accounts. To facilitate the efficient processing of this case, all costs have been shown before such accounting allocations are made, in other words on a direct cost basis. These accounting allocations do not impact the final revenue requirement.

Staff and Applicants differ by $1,843,000 in the adjustment to Clearing Accounts for differences in O&M labor expenses. Company and staff have agreed upon the methodology to calculate this adjustment. Our adopted figure of $58,196,000 flows from the adjustments discussed previously.

J. O&M Summary

The above discussion completes the resolution of all O&M issues. The table below illustrates the results.

Table 10

Southern California Gas Company
Operating and Maintenance Expenses
Test Year 1985
(Thousands of Dollars)

Item	Staff	Company	Authorized
1983 Vacancy Adjustment	$ (630)	$ (630)	$ (630)
PLGS Cost of Service	121,957	129,031	112,898
Storage Expenses	20,742	20,742	20,742
Transmission Expenses	18,621	18,621	18,621
Distribution Expenses	77,022	87,517	82,949
Customer Service Expenses	66,629	68,158	66,704
Customer Accounts Expenses	73,501	77,635	75,788
Market Services Expenses	28,453	29,814	20,175
Administrative and General Expenses	215,748	222,929	219,827
Clearing Accounts	57,671	59,897	58,196
Total Operating and Maintenance Expenses	$679,393	$713,714	$675,270

(Red Figures)

IX. Taxes

With the completion of our discussion and resolution of O&M expenses the next main item to discuss is Taxes.

Although the final comparison exhibit shows a difference between the staff and SoCal of $17,980,000 for this item, there is no difference regarding the proper method of calculating tax expense. The differences result from different assumptions regarding O&M expense levels and long-term debt interest rates. The following table develops adopted tax expense levels.

Table

	SoCal	Authorized
Ad Valorem Tax	$ 14,144	$ 13,998
Payroll Tax	21,705	21,357
Federal Income Tax	126,713	103,439
Calif. Corp. Franchise Tax	27,207	23,739
Total Taxes	$189,769	$162,533

The latest property tax assessment is used to calculate the ad valorem taxes. The payroll tax difference is the result of our resolution of O&M issues discussed earlier. The differences is the Federal Income Tax and California Corp. Tax are due primarily to the tax adjustment for operating interest expenses caused by different long-term debt interest rate assumptions.

X. Depreciation Expense

SoCal and our staff are also in agreement on the depreciation expense level of $101,617,000, which will be adopted. We will also adopt the recommendation of RRD staff that SoCal conduct a study of the mortality curves and average service lives of its gas plant for use in SoCal's next general rate case.

XI. Rate Base

Rate base is comprised of estimated plant, works in progress, gas in storage, materials and supplies, working cash, deferred tax reserve and depreciation reserve. The only contested element of rate base is working cash. In the comparison exhibit, the difference between SoCal and the staff is $34,059,000.

A. Working Cash

SoCal originally estimated its working cash allowance to be $17,700,000 but later reduced this to $8,100,000 because it conformed its methodology to the method we adopted for PG&E and SDG&E which was decided after submission of this application. Further, in its opening brief, SoCal accepted certain staff adjustments and reduced its request to $2,940,000. The staff estimate of working cash is a negative $18,659,000 for a difference of $21,599,000. The discussion below will include items of major difference between the company and the staff. Table 11 which follows will show the adopted amounts for all working cash major accounts and develop the total working cash requirement of $2,562,000.

Several of the issues relating to working cash were considered and resolved in our discussion of working cash for PLGS. These issues are principally Gas Purchase Lag and Federal Income Tax Lag.

1. Deposit Float

Deposit float can take the form of either an adjustment to the lead-lag days or as an operational cash requirement. The staff has made this adjustment in the lead-lag days. In our prior SDG&E case, we preferred that this adjustment be made as an operational cash requirement. We will continue this practice for SoCal and add the $13,000,000 float to SoCal's estimated minimum cash balance of $7,100,000 to produce a minimum operational cash balance of $20,100,000.

2. Prepayments Account 165

SoCal shows an estimated cash requirement of $1,525,000 for unaccrued balance of prepayments. This item can also be considered as either a cash requirement or included in the lead-lag study although our adopted working cash rules (SP-U-16) indicates that it should be in working cash. The staff recommended no dollars for prepayments in the cash requirements but could not show that these items were included in its lead-lag study. The SoCal estimate is adopted.

3. Miscellaneous Work Orders in Progress (Account 184)

SoCal requests $1,423,000 as a cash requirement, whereas the staff recommends no dollars. The staff testified that amounts are cleared from this account to expenses or to CWIP. Estimates included in rates to cover expenses and plant additions fully compensate SoCal. To earn a rate of return on Account 186.10 would be to compensate it once in plant additions or expenses and again in the operational cash requirement. We will adopt the staff adjustment.

4. Miscellaneous Deferred Debits (Account 186)

The staff's estimate is $293,000 versus SoCal's $797,000. The staff testimony applicable to the above Account 184 is also applicable here. The staff adjustment is adopted.

5. Accounts Payable (Account 232)

Differing methodologies account for the large difference between the company and the staff. The company used as a cash flow method whereas the staff used 13-month averages. Although we find the 13-month average acceptable, we will utilize the company's method for this case because it apparently gives a more accurate recognition to the average time interval during which the company has use of interest free funds. The following staff sub-account adjustments will be rejected -- Accounts Nos. 232.01, 232.02, 232.07, 232.70, and 232.71. The remaining staff adjustments will be adopted and produce a total accounts payable of a negative $6,047,000.

6. Lead-Lag Study

The lead-lag study differences result from different positions taken on many issues resolved in the above discussion of various accounts - namely Deposit Float, Income Tax Lag, and Gas Purchase Lag. The recalculation of the lead-lag study recognizing these effects produces a lead-lag adjustment of a negative $18,439,000.

Table 11

Determination of Working Cash Capital
(Thousands of Dollars)

LN No.	Acct. No.	Item	Authorized
1		Operational Cash Req. Deposit Float	$13,000
2		Min. Cash Balances	7,400
3	134.20	Special Deposits	8
4	135.00	Working Funds	152
5	142.00	Cust. Ac. Rec. Over/ Short	0
6	143.00	Other Ac. Receivable	5,569
7	146.00	Ac. Rec. Assoc. Co.	(13)
8	155.01	Energy Conserv.-Mdse.	576
9	165.00	Prepayments	1,525
10	172.00	Rents Receivable	14
11	174.00	Misc. Curr. & Acc. Assets	1,924
12	184.02	Misc. Wk. Orders in Prog.	0
13	186.00	Misc. Deferred Debits	293
14		Total Op. Cash Req.	30,148
15	232.00	Accounts Payable	(6,047)
16	234.00	Ac. Pay.-Assoc. Co.	(11)
17	241.00	Tax Collections Payable	(2,379)
18	253.00	Misc. Def. Credits	(2,925)
19	263.20	Pensions & Benefits Reserv.	0
20		Rounding	0
21		Lead-Lag Study, Table 16-H	(16,224)
22		Total Working Cash Allow.	$2,562

(Red Figures)

Table 12

Rate Base in 000's

Gas Plant in Service	$2,527,837
Work in Progress (non interest bearing)	28,655
Material and Supplies	14,917
Gas Stored Underground	83,168
Working Cash	2,562
Total	$2,657,139
Less Adjustments:	
Customers' Advances for Construction	29,718
Depreciation Reserves	932,630
Gain on sale of El Monte and Pasadena facilities	620
Accum. Defer. Fed. Inc. Taxes	36,393
Total	$ 999,361
Weighted Average Rate Base	$1,657,778

The Table above develops our final adopted rate base estimates.

XII. Miscellaneous Adjustments

A. Female and Minority Business Enterprises

SoCal sets forth its program on its Female and Minority Business Enterprise (F/MBE) in its report in this proceeding. SoCal's affirmative action procurement program has goals of providing maximum opportunities for F/MBEs to participate in its purchasing and contracting activities on a competitive basis and increase female and minority business enterprise participation in the supply of goods and services to the company. This program consists of four distinct activities designed to achieve these goals including buyer awareness outreach activities, administrative assistance and technical assistance. SoCal witness Warren Mitchell testified very enthusiastically about SoCal's F/MBE program, stating that SoCal is generally pleased with the results it has achieved and with the progress it is making with this program. Mitchell testified that the key element of SoCal's program is its outreach efforts which allow SoCal to bring new female and minority suppliers into the organization for consideration as suppliers and to get them into SoCal's data base so that SoCal can call on them for bids for goods and services. This outreach is then backed up with administrative assistance, which includes marketing training, training on how to fill out bid forms, a breakdown of procurement process within the company, etc. Furthermore, technical assistance is provided to assure that F/MBE's understand SoCal's specification. This technical assistance includes plant visits and include SoCal assisting F/MBE with recommendations for equipment that will enable them to meet SoCal's requirements.

Staff witness Martin Lyons reviewed and evaluated SoCal's compliance our prior orders on this subject and concludes that SoCal is in compliance. However, in the staff brief, the staff takes the position that the program outlined in our recent Pac Bell decision (D.84-06-111) should be fairly uniform throughout the state for all utilities. Staff therefore recommends that SoCal should be required to enhance its goal setting and recordkeeping to have a program similar to one provided in Pac Bell. Public Advocates, Inc. takes a similar though not identical position.

SoCal argues that imposition of a set of detailed, complicated goals will increase program costs and could be counter-productive to increasing F/MBE participation in company operations. SoCal also argues that if it is ordered to set goals then more data is required as follows:

> "For goals to be successful, they must be based on reliable data so that those who implement the program can agree that the goals are realistic (Tr.28/2823). To develop detailed goals for numerous minority classifications requires information on the capacity of both majority and majority vendors and the ability of F/MBE's to meet the Company's demands. The Company does

not currently possess this information. Mr. Mitchell testified that the start-up costs to produce the data base would be $300,000 and that the annual updating cost would exceed $80,000 per year (Tr. 28/2811-813). To the extent that utilities have common vendors in their data bases, some potential sharing of costs may exist (TR. 28/2851). If it is required to establish detailed goals SoCalGas should be granted adequate revenue to develop an expanded data base."

We find that no additional reporting specificity is required at this time. The Federal reporting category scheme in use currently is sufficiently detailed to provide data to assess progress in this area. We believe that goals based on adequate data is desirable. The record in this proceeding indicates that there is substantial overlap in the groups of vendors supplying goods and services to both SoCal and Southern California Edison. In this proceeding, SoCal indicated an approximate cost of $300,000 to establish and maintain an adequate data base required in any goal setting process. We will therefore authorize SoCal to work with Southern California Edison and our staff to develop a data base of vendors common to those two Southern California utilities. Other utilities should be invited to join in this effort so that it can be as cost-efficient as possible. A dollar authorization in 1985 dollars of $150,000 for 1985 and $40,000 per year therefore is reasonable. With this monetary authorization, SoCal is directed to institute the following reporting program:

Purchase Categories	Ethnic Categories
Commodities	Federal standards as are currently used
Services	
Construction	

There shall be no minimum purchase category. All purchases shall be classified into the three purchase categories and reported in terms of the appropriate ethnic categories.

SoCal shall engage in the same type of goal setting process as we provided in the Pac Bell decision. SoCal shall meet and negotiate with representative minority groups in its service territory to draft and submit in its next general rate case filing a report covering F/MBE activity for the previous two years.

B. Safety

Staff has submitted an exhibit, which was not entered into evidence in this proceeding, recommending that SoCal be penalized with a net reduction in earnings because of substantial noncompliance with General Order (GO) 112-D during the period 1980 to 1983. The staff position is that it seeks compliance with the general order rather than just a punitive fine. Over several months, SoCal and the staff have attempted to settle this dispute. The negotiations have resulted in a "stipulation and agreement" which was submitted and received as an exhibit on October 1, 1984.

The essence of the agreement is that SoCal will initiate a detailed ten point safety program that will bring SoCal into compliance with GO 112-D in exchange for the staff (1) not recommending the penalty and (2) recommending the recovery of expenses for the program. The agreed upon expense of this program is $417,000 in 1985 dollars.

Discussion

We will adopt the stipulation in principle, however, the stipulation does not include any showing that the $417,000 in expenses associated with the expected results of the program have not already been included or should have been included in SoCal's other expense estimates. We will look to SoCal's showing for guidance.

In its brief at page 67, SoCal argues for its estimates of Distribution expenses in Accounts 887 and 892 as follows:

> "To summarize, Staff formed its relatively lower estimates based on its four-year average methodology (Tr. 8/1749, 1752). SoCalGas witness O'Rourke, on the other hand, testified that the difference between SoCalGas and Staff is due to the cathodic safety protection maintenance program, the cost of complying with the April 1, 1983 federal damage regulation and the 8.58 percent increase in leak survey footage and the increased leak repairs caused by the 1-2-4 Leak Survey Program (Exh. 80, p. 8)."

We also note our disposition of this issue was as follows:

> "<u>Accounts 887 (Mains) and 892 (Services)</u>
> These accounts are the primary accounts that house the mandated new safety related activities. The staff failed to fully consider these programs separately. SoCal made a convincing showing of its expanded safety program and the Company's estimate will be adopted ($14,224,000 and $16,997,000)."

We, therefore, believe that the company will be fully compensated for the agreed upon program without any additional expenses above our already authorized Distribution and related expenses. We fully expect SoCal to implement the agreed upon improved safety program and to achieve acceptable compliance with GO 112-D, and will require reports of progress in such program.

C. <u>LNG Implementation</u>

In D.84-09-089 dated September 6, 1984 in A.82-12-02 we provided two options to PLGS/SoCal on ratemaking treatment for the LNG facility which is no longer needed. In that decision, we also provided that recovery of the authorized LNG expenses would be implemented in this general rate case. At the time of the "update" hearings in this matter, SoCal had not elected either option. However, at the update hearings both SoCal and the staff agreed on a minimum level of first year expenses that would be authorized under either option.

Subsequently, SoCal has chosen the option to begin recovery of non-site related expenses now and retain the site as plant-held-for-future use. The staff and SoCal agreed that SoCal should be allowed to recover these expenses and that any differences between the minimum level and final authorized level could be made up in the three remaining years. The result is that SoCal will have increased expenses from PLGS of $17,479,000 less $8,947,000 in taxes. This adjustment will be made to that Preliminary Summary of Earnings and shown on the Final Summary of Earnings.

D. Joint Meter Reading

In D.84-12-068 (mimeo p. 93) also issued today, we authorized the establishment of a pilot joint meter reading program between SoCal and Edison. To implement that program we will allow SoCal to accrue expenses of up to $500,000 over three years in an interest bearing memorandum account. This pilot program will conclude at year end 1987. We expect SoCal and Edison to work together and keep staff informed. The utilities will submit a joint progress report annually and the first report will be due on July 1, 1986. SoCal may seek to recover all reasonably incurred costs for this program in its next general rate case.

XIII. Final Summary of Earnings

The following table shows the total revenue requirement increase ($96,395,000) resulting from our Summary of Earnings plus Miscellaneous Adjustments and compares estimates of present rates with authorized results. This new margin requirement will be carried over to our decision issued today in A.84-09-022, SoCal's fall CAM. The entire new revenue requirement (general rate case plus CAM) will be recovered in rates established in the CAM proceeding.

TABLE 13

SOUTHERN CALIFORNIA GAS COMPANY

RESULTS OF OPERATIONS - TEST YEAR 1985

(000)

Line No.	Item	Adopted Estimates of Present Rates	Authorized
1	OPERATING REVENUES		
2	Operating Revenues	$1,048,702	$1,152,747
3	OPERATING EXPENSES		
4	1983 Voc. Adjustments	(630)	(630)
5	Reassignments	(45,804)	(45,804)
6	PLGS Cost of Service	112,213	112,898
7	Clearing Accounts	58,196	58,196
8	Storage	20,742	20,742
9	Transmission	18,621	18,621
10	Distribution	82,949	82,949
11	Customer Services	66,704	66,704
12	Customer Accounts	75,112	75,788
13	Market Services	20,175	20,175
14	Administrative & General	218,261	219,827
15	Subtotal	$ 626,539	$ 629,466
16	Inflation - Labor	$ 26,581	$ 26,581
17	Non-Labor	16,163	16,163
18	Subtotal	$ 42,744	$ 42,744
19	Depreciation	101,617	101,617
20	Taxes Other Than Income	35,355	35,355
21	CCFT	14,032	23,739
22	FIT	61,390	103,439
23	Subtotal	$ 110,777	$ 162,533
24	Total Operating Expenses (lines 15,18,19,23)	881,677	936,360
25	Net Operating Income (line 2 less 24)	$ 167,025	$ 216,387
26	Rate Base		$1,659,408
27	Rate of Return		13.04%
28	Amortization of overcollection in		
29	PCB and conservation balancing		
30	Account - 1985 Adjustment		(7,650)
31	Adjusted 1985 Net Operating Income (less 25, less 30)		$ 208,737
32	Adjusted 1985 Rate of Return		12.58%

XIV. Findings and Conclusions

Findings of Fact

1. SoCal's net operating revenue at present rates is $1,048,708,000.

2. Labor escalation factors of 4.125% for 1984 and 9.456% for 1985 is reasonable.

3. Non-Labor escalation rates of 3.71% and 8.049% for 1984 and 1985 are reasonable.

4. Ten Section was not sufficiently useful to be afforded rate base treatment for the period January 1, 1983 to January 1, 1985.

5. It is reasonable to afford Ten Section abandoned plant in service treatment for those costs and improvements in rate base as of January 1, 1983.

6. Rocky Mountain has been abandoned for ratemaking purposes; ANGTS has not been abandoned for ratemaking purposes.

7. Rocky Mountain, ITA, and ITA(A) projects all fall within our exception to the used and useful rule.

8. Recovery of direct costs without AFUDC over a four period without a return is reasonable for Rocky Mountain, ITA, and ITA(A) projects.

9. PLGS cost of service for 1985 is $112,898,000.

10. A long-term rate for new debt issuances in 1985 of 13% is reasonable.

11. SoCal's average embedded cost of debt and preferred stock for 1985 is as follows:

Long-term Debt	11.85%
Commercial Bank Loan	12.14%
Preferred	6.91%

12. A return on common equity of 15.75% will enable SoCal to attract capital and provide reasonable service to its customers.

13. A 15.75% return on equity results in an average return on rate base for SoCal of 13.04%.

14. To earn the 13.04% rate of return on rate base at the level of expenses adopted requires an addition revenue requirement of $96.395 million over revenues at present rates.

15. A trending mechanism for distribution expense accounts not related to newly authorized or mandated activities is reasonable.

16. The PCB balancing account should be continued with the overcollection of $2.1 million being used to reduce the revenue requirement for 1985.

17. An uncollectible rate for residential and commercial customers of .65% is reasonable.

18. SoCal should be authorized to institute the following new conservation programs 1) Home Energy Audits, 2) CACS Audits, and 3) Committed Energy Needs.

19. A stay-the-course policy for Conservation and Research, Design and Development is reasonable.

20. AGA dues not devoted to lobbying is a reasonable expense.

21. It is SoCal's responsibility to design an overall RD&D program acceptable to the Commission under previously established guidelines.

22a. It is reasonable to deny authorization of those ten RD&D projects considered duplicative by staff, but allow SoCal to file an advice letter to implement such projects if the duplication problem can be resolved with staff.

22b. It is reasonable to require SoCal to file an advice letter for approval of their attrition year(s) RD&D programs and budget.

23. SoCal will be in compliance with GO 112-D and the ten-point program of Ex.88, or face a penalty in the attrition phase of this proceeding.

24. SoCal will recover authorized LNG expenses in this proceeding.

25. A revenue requirement increase of $96,395,000 over revenues at present rates is reasonable.

26. The capital structure proposed by SoCal is found to be reasonable and is as follows:

Long-Term Debt	45.00%
Commercial Bank Loan	3.40%
Preferred Stock	9.40%
Common Equity	42.20%

27. It is reasonable for SoCal to take one year to develop the data base necessary to set goals for its F/MBE program.

28. SoCal should work with representative F/MBE development organizations active in SoCal's service territory in setting goals for its F/MBE program.

29. SoCal should submit a report on development of its F/MBE program goals as part of the filing for its 1988 test year general rate case. Also, SoCal will demonstrate the progress it has made in awarding F/MBE contracts in terms of number of contracts and dollar amounts.

30. The one half expense of SoCal estimates will be incurred to develop and administer the proposed expanded F/MBE program is reasonable.

Conclusions of Law

1. SoCal/PLGS should be allowed to file gas rates to recover the additional revenue requirement found reasonable herein.

2. The recovery of the new revenue requirement should be implemented in SoCal/PLGS's CAM decision issued today in A.84-09-022.

INTERIM ORDER

IT IS ORDERED that:

1. By January 31, 1986, SoCal shall, after meeting with authorized representatives of recognized minority groups, draft and submit to the Commission for its approval, a tracking procedure that comprises:

Stated calendar year 1986 F/MBE contract goals for the following ethnic classifications:

Black
Asian
American Indian
Hispanic

Data for each of the above ethnic classifications is to be further categorized as either "male" or "female". Until such time as SoCal's next general rate case proceeding, these contract goals are to be developed and applied in a manner which is consistent with SoCal's current procurement practices.

b. On March 1, 1985 SoCal shall submit to the Commission a report detailing its 1984 F/MBE activities. Since SoCal's data base will not be ready in time for this report, there will be no prescribed format.

c. On October 1, 1985, SoCal shall submit to the Commission a report describing the Company's F/MBE activities in the general categories of Commodities, Construction, and Services and Other, for the period January 1, 1985 through June 30, 1985. The data contained in the above general categories shall be further detailed in corresponding sub-categories for purchase of, or contracts for, similar goods or services.

d. SoCal shall submit an annual F/MBE activity report to the Commission on March 1 of each year, beginning on March 1, 1986. The annual report shall describe the Company's F/MBE activities for the prior calendar year in the detail set forth in sub-paragraph c, and shall set forth the Company's F/MBE contract goals by the general categories of Commodities, Construction, and Services and Other, for the current calendar year.

2. Southern California Gas Company, Inc./Pacific Lighting Gas Supply Company, Inc. (SoCal/PLGS) is authorized and directed to file with this Commission on or after the effective date of this decision, revised tariff schedules for gas rates as set forth in the concurrent decision on SoCal/PLGS's A.84-09-022 consolidated adjustment mechanism (CAM) proceeding which includes the additional margin authorized in this proceeding.

3. Southern California Gas Company, Inc. shall implement the system safety improvement steps and timing outlined in Exhibit No. 88 in this proceeding and submit a report describing such improvements to the Commission's Service and Safety Branch, by not later than July 31, 1985.

4. In its attrition year filing SoCal shall include its requested level of RD&D expenses and programs for Commission consideration.

This order is effective today.

Dated December 28, 1984, at San Francisco, California.

DONALD VIAL
President
VICTOR CALVO
PRISCILLA C. GREW
WILLIAM T. BAGLEY
FREDERICK R. DUDA
Commissioners

We will file a written dissent in part.

/s/ VICTOR CALVO
Commissioner

/s/ PRISCILLA C. GREW
Commissioner

I will file a concurring opinion.

/s/ WILLIAM T. BAGLEY
Commissioner

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Joseph E. Bodovitz

Joseph E. Bodovitz, Executive Director

APPENDIX A
Page 1

List Of Appearances

Applicant: David B. Follett, Peter N. Osborn, Frederick E. John, Robert B. Keller, and Jeffrey E. Jackson, Attorneys at Law, for Southern California Gas Company and Pacific Lighting Gas Supply Company.

Interested Parties: William L. Knecht, Attorney at Law by Phil Presber, Attorney at Law, for California Association of Utility Shareholders; Brobeck, Phleger & Harrison, by Gordon E. Davis and Richard Harper, Attorneys at Law, for California Manufacturers Association; Robert L. Pettinato, for Los Angeles Dept. of Water & Power; Thomas George Wagner and Earle H. Mowrey, for Transwestern Pipeline Company; Richard K. Durant and H. Robert Barnes, Attorneys at Law, for Southern California Edison Company; E. D. Yates, for California League of Food Processors; Gerald J. La Fave, Attorney at Law, for California Farm Bureau Federation; William L. Reed, Wayne P. Sakarias, and Jeffrey Lee Guttero, Attorneys at Law, for San Diego Gas & Electric Company; John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for City of San Diego; Ira Reiner, City Attorney, by Ed Perez, Deputy City Attorney, for City of Los Angeles; Chadbourne, Parke, Whiteside, and Wolff, by Jerry R. Bloom, for Kimberly-Clark Corporation; Richard L. Hamilton, Attorney at Law, for Western Mobilehome Association; Robert W. Parkin, City Attorney, by Richard A. Allesso, Deputy City Attorney, for City of Long Beach; Robert O. Randall, for Suburban Water Systems; Wayne L. Meek, for Simpson Water Company; Harry K. Winters, for University of California; Downey, Brand, Seymour & Rohwer, by Philip A. Stohr, Attorney at Law, for General Motors Corporation; Sutherland, Ashbill & Brannen, by Edward J. Greiner, Jr. and Earl H. O'Donnell, Attorneys at Law, for Federal Paper Board Company, Inc.; Raymond E. Heytens, for San Gabriel Valley Water Company; Sylvia M. Siegel, Michel Peter Florio, and Jon P. Elliott, for Toward Utility Rate Normalization; Kuhs & Parker, by William C. Kuhs, Attorney at Law, for Tehachapi-Cummings County Water District; Henry Lippitt, 2nd, Attorney at Law,

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Page 2

for California Gas Producers Association; Virginia Jarrow, for Consumers Coalition of California; Herman Mulman, for Seniors for Political Action and Edward Duncan, for himself.

Commission Staff: Arocoles Aguilar and James Rood, Attorneys at Law, Raymond A. Charvez, and Geoffrey W. Meloche.

(END OF APPENDIX A)

A.84-02-25
D.84-12-069

VICTOR CALVO and PRISCILLA GREW, Commissioners, dissenting in part.

We dissent from the majority's conclusions as to the rate of return on equity which should be authorized in this proceeding.

Rate of return is in its essence a matter of judgment. We do not dissent on the ground that we believe our judgment to be any more blessed by insight than that of our fellow commissioners. However, in reviewing the recommendation of the administrative law judge assigned to this case and the arguments of the parties, we concluded that the economic climate which we presently confront is vastly different from the environment which spawned the high rate of return previously awarded to this utility. Interest rates have fallen substantially and stabilized; utilities in need of capital do not face the imminent prospect of long-term or short-term borrowings at the volatile, high rates experienced in the recent past. More importantly, inflation has been significantly arrested, customer demand patterns are more predictable and energy supplies are in abundance in relation to demand. Taken together, these factors lead us to the firm belief that this utility's rate of return on equity should be reduced by this Commission.

The majority ignores the economic factors noted above and abandons risk analysis to keep this utility's rate of return at its last authorized level. The approach taken by the majority to reach this result is particularly appalling to us. The majority takes the administrative law judge's sum total revenue requirement and reduces it to eliminate expenses which it finds, with our support, unnecessary or otherwise not reasonably related to the provision of safe, reliable utility service. Rather than leaving it at that, though, the majority seems to believe that the incremental "margin" it has created between our administrative law judge's recommendation and our own conclusions leaves "room" to raise the utility's rate of return on equity. This is not an analytic or informed approach; it is simple bootstrapping.

CORRECTION

CORRECTION

THIS DOCUMENT

HAS BEEN REPHOTOGRAPHED

TO ASSURE LEGIBILITY

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A.84-02-25
D. 84-12-069

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A test year revenue requirement is the sum total of many discrete parts. Many are discussed in the decision we sign today. But, and we cannot emphasize this enough, those parts are largely distinct and separate. Reducing one expense does not justify increasing another. Such an approach pays respect and homage to the administrative law judge's "bottom line" when it deserves neither. The administrative law judge did not adopt a sum total revenue requirement; the administrative law judge only made recommendations which happened to combine to produce a final number. To treat that number as sacrosanct is to misunderstand and misapply ratemaking principles.

The majority's approach is a clear departure from any economic rigor or analysis and we cannot join in it. Therefore, we must respectfully dissent on this issue.

Victor Calvo

VICTOR CALVO
Commissioner

Priscilla C. Grew

PRISCILLA C. GREW
Commissioner

December 28, 1984
San Francisco, California

A.84-02-25
D.84-12-069

WILLIAM T. BAGLEY, Commissioner, concurring:

I have read the dissent of Commissioners Grew and Calvo re the rate of return on equity set in this matter. Though I am not appalled, I am impelled to respond by this means.

What in fact occurred is as follows:

1. The majority did not raise the authorized rate of return but instead maintained it at 15.75%;
2. The majority did not simply cut expenses (decrease revenue requirements) to "make room" for the authorized rate of return. What we did do is to decrease projected expenses by approximately $20 million.

The majority then "used" approximately $4 million of this $20 million amount to reduce lifeline rates, wholesale capacity charges and GN-34 (II and III) and G-COG rates. Another $12 million will offset a reduction in projected GN-5 rates, mainly for gas sold to Southern California Edison. Finally, the remaining $4 million equates with the earnings differential of 25 basis points, the difference between a 15.50% and the 15.75% rate authorized by this decision. The majority made this judgment to apply 1/5th of these reductions ($4 million out of $20 million) for rate of return purposes in a most deliberative manner and in keeping with the majority's view that such a rate of return on equity was and is justified in today's market place. Considering the new volatility of gas supply prices, realizing that longer term money rates have not decreased, and further being mindful of investment community reactions, the majority's judgment is fair and equitable and is fully supported by the record before us.

/s/ WILLIAM T. BAGLEY, Commissioner

December 28, 1984
San Francisco, California