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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Petition of Kelco Division of Merck & Co., Inc. for Modification of Resolution G-2780.

Application 88-05-039
(Filed May 19, 1988)

OPINION ON PETITION OF THE KELCO DIVISION OF MERCK & CO., INC., FOR MODIFICATION OF RESOLUTION G-2780

I. Introduction

This application arises from a petition by the Kelco Division of Merck & Co., Inc. ("Kelco") to modify Resolution G-2780. That resolution approves certain tariffs filed by San Diego Gas & Electric Company ("SDG&E") to implement our new gas rate structure. (See Decision ("D.") 87-12-039.)

Kelco is a cogenerator that buys gas from SDG&E. Kelco says that its gas rates, under new SDG&E tariffs governing gas sales to cogenerators, have risen much more than anticipated, when compared to the rate increase that was projected for SDG&E's cogeneration customer class as a whole. Kelco asks that we apply a 10% "rate limiter" to the increase experienced by any of SDG&E's cogeneration customers. As an alternative, Kelco asks that SDG&E's rates for cogeneration customers be collected subject to refund pending a hearing on whether the rates approved in Resolution G-2780 would result in revenue exceeding the revenue requirement assigned to SDG&E's cogeneration customer class. SDG&E and the Division of Ratepayer Advocates ("DRA") oppose Kelco's petition.

We find that Kelco has not shown the rate increase it is experiencing to be either anomalous or excessive. We therefore deny the application.

II. Positions of the Parties

A. Kelco

According to Kelco, Resolution G-2780 authorized establishment of default gas rates for SDG&E's cogeneration customers.[1] The resolution responds to Advice Letters (A.L.) 634-G and 634-G-A, filed by SDG&E to comply with D.87-12-039. All of these sources project increased revenues from cogeneration customers resulting from the new rates, but the projections vary. D.87-12-039 (at Appendix A, page 11 of that decision) indicates a 2.1% increase, A.L. 634-G puts the increase at 9.5%, and A.L. 634-G-A (which supersedes A.L. 634-G) projects an 8.9% increase. However, Kelco's calculation of the actual increase that it will incur under the new rates is 18 to 25%.

Kelco protested A.L. 634-G regarding the cogeneration rates. SDG&E responded but only to the extent of clarifying why the percentage increase suggested by the advice letters was several times higher than the original 2.1% increase indicated in D.87-12-039. SDG&E's response did not explain why Kelco would experience a rate increase that was apparently more than double the increase suggested by A.L. 634-G-A.

This unexplained phenomenon creates doubt whether the actual rates to be paid by SDG&E's cogeneration gas customers are consistent with the rate increases intended by the Commission for

1 This sentence and the rest of Section II.A represents Kelco's summary or interpretation of the relevant facts. For convenience, we will not repeat "according to Kelco" with each sentence, but the absence of that qualifier should not be taken as acceptance of Kelco's position. Our summaries of SDG&E's and DRA's positions (Sections II.B and II.C) will also use this shorthand.

such customers. Furthermore, the actual increase that Kelco projects for itself is so extreme as to constitute "rate shock."

The solution is to modify Resolution G-2780 by imposing a 10% "rate limiter" on SDG&E's cogeneration gas rates to prevent significant economic dislocation and to protect against overrecovery of SDG&E's revenue requirement.

The rate limiter could only have a benign effect:

> "If Kelco's assessment with respect to its expected rate increase is incorrect and cogeneration gas rates are indeed increasing by 8.9%, Commission imposition of a 'rate limiter' will be academic in its effect. If in reality, however, actual cogeneration rate increases are far greater than those considered by the Commission, a 'rate limiter' is entirely appropriate. Furthermore, given the existence of the Negotiated Revenue Stability Balancing Account, any revenue shortfall that might be occasioned by Commission imposition of a cogeneration 'rate limiter' could be allocated in SDG&E's annual cost allocation proceeding scheduled for consideration in March, 1989. Consequently, adoption of a 'rate limiter' would ensure compliance with Commission intent while it would avoid irreparably harming the interests of any parties, including SDG&E." (Petition, pp. 10-11.)

Kelco has responded to the opposition (discussed in Sections II.B and II.C below) filed by SDG&E and DRA to this petition. Kelco criticizes the "fundamental premise" of these filings, namely, "that this Commission could care less about the impacts [of the new rates] upon individual cogeneration customers," and the corollary that "any remedial action might require adjustment to the rates of other customers or customer classes and therefore should be denied." (Response, p. 2.) Kelco cites its own "informal canvassing" of SDG&E cogeneration customers, constituting about half of SDG&E's cogeneration gas throughput, to support the proposition that "the actual rates, when applied to individual cogeneration customers in SDG&E's service territory, may result in collection by SDG&E in excess of the revenue requirement allocated to the entire cogeneration customer class." (Id., pp. 6-7.)

B. SDG&E

SDG&E opposes the petition by pointing out (1) various factors that might cause Kelco to experience a higher rate increase than the cogenerator customer class taken as a whole, and (2) flaws in Kelco's proposed remedy.[2]

Three significant individual factors suggest that Kelco should expect a higher-than-average rate increase. First, Kelco purchases some gas under an "otherwise applicable rate" (i.e., not the power plant-equivalent rate). Kelco formerly qualified for the GN-36 schedule (based on Number 6 fuel oil capability) as its otherwise applicable rate. That schedule was 5¢/therm lower than the GN-3 schedule which applies to most cogenerators. However, the GN-36 schedule is no longer available, so Kelco no longer enjoys that price advantage.

Second, the power plant-equivalent rate sees a percentage increase more than twice as great as the otherwise applicable rate.[3] Therefore, a cogenerator like Kelco, whose gas usage at

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2 SDG&E also says that Kelco should have sought modification of the underlying Commission decision, D.87-12-039, and not the implementing resolution (Resolution G-2780). This is an arguable point, but we will not dispose of the petition on procedural grounds. The substantive dispute and the arguments pro and con are the same regardless of the order to which the petition is nominally directed. The parties already discuss both the resolution and the decision; requiring Kelco to file a new petition would only waste time and paper.

3 The power plant-equivalent rate applies to that amount of a cogenerator's gas consumption that would be required to generate an amount of electricity equivalent to the cogenerator's output. All other gas consumed by the cogenerator is charged at the otherwise applicable rate.

the power plant-equivalent rate is a relatively large part of its total usage (as compared to cogenerators as a group), will see a relatively higher percentage increase in its bill.[4]

Third, the demand ratchet applied to Kelco's operating characteristics causes a greater-than average impact on Kelco's gas costs. The ratchet (incorporated in the noncore default rate) pegs the demand charge in the otherwise applicable rate to "a customer's highest demand in the previous 11 months. The higher the proportion of a cogenerator's consumption that is charged at that rate, in any given month, the greater the effect the ratchet will have on the total bill. Cogeneration customers who experience high gas demand and low net powerhouse output for only a few months of a year will see the largest bill increases. . . . Kelco's usage characteristics contain the factors which will lead to greater bill increases under the new rates relative to other cogenerators. The demand ratchet accordingly tends to increase Kelco's bill more than it increases other cogenerators' bills." (SDG&E Opposition, p. 7.)

Another factor that influences the rate increase actually experienced by Kelco and other cogenerators is that the test period assumptions from which the rates were set (and average increase calculated) do not, and probably cannot ever, perfectly match the actual level of sales and other material variables. For example, the projected cogenerator rate increases in D.86-12-009 and the advice letters all depend on sales forecasts developed in mid to late 1986. However, based on SDG&E's most recent 12 months of recorded data (April 1987 to March 1988), the resulting rate increase for the cogeneration class is 13%.

4 Stated differently, the proportion of Kelco's gas usage billed at the otherwise applicable rate is about 30% smaller than the proportion for the typical cogenerator. Kelco thus would experience a greater increase (compared to the class average) due to its specific usage pattern.

Test period rate-setting cannot provide a guarantee of the absolute level of the bills charged to any class, let alone to an individual customer. In particular, the Commission's primary concern in D.87-12-039 was not with raising (or lowering) cogenerators' gas rates but rather with maintaining the parity relationship of those rates and the price of gas consumed in utility electric generation.[5] Kelco makes no claim that SDG&E's cogeneration rates violate the parity principle.

C. <u>DRA</u>

DRA says that Kelco's petition "rests upon both a misunderstanding of the Commission's intent and a misleading analysis of the impact of the resolution on Kelco. Furthermore, adoption of the proposal is likely to result in an unwarranted shift of cost responsibility from cogenerators to other customer classes." (DRA Opposition, p. 2)

Resolution G-2780 authorizes an 8.9% increase in gas rates for SDG&E's cogeneration customers. However the 8.9% increase is based on class-allocated revenue and therefore refers to class average rates. Within the class, one customer may experience a rate increase above or below the class average, depending on the customer's individual usage pattern. The resolution does not say or imply that each customer's rate increase will equal the class average.

No valid conclusions can be drawn from Kelco's bill impact analysis. That analysis doesn't illustrate a problem in the cogeneration rate (a single schedule) since it addresses service under two different schedules.

Adoption of Kelco's recommended rate limiter might cause undercollection of noncore revenues. Someone would have to absorb

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5 Public Utilities Code Section 454.4 requires this parity relationship.

this undercollection (shareholders, customer classes other than cogenerators, or a combination of both). The Kelco proposal that a revenue shortfall due to the rate limiter be assigned to the Negotiated Revenue Stability Account is a misuse of that account, which serves only to track and limit the impact of sales variations on earnings. The proposal would redistribute the potential shortfall but only by burdening other customers with the cogenerators' avoided revenue responsibility.

III. Discussion

Kelco apparently is experiencing a gas rate increase higher than it expected and higher than the projected average increase for the relevant (cogeneration) customer class. However, we agree with SDG&E and DRA that individual customers may sometimes experience rate impacts that differ widely from the customer class average. This is a common phenomenon where we are implementing major and complex rate design changes. The new gas rates are the product of such changes.

SDG&E has identified various factors in the new rates and Kelco's circumstances that explain why Kelco would experience a higher-than-average increase under both of the revised rate schedules under which its gas consumption is billed. Kelco has virtually no rebuttal, and offers instead an "informal canvassing" of other SDG&E cogeneration gas customers. Besides being merely anecdotal, this "informal canvassing" does not necessarily support Kelco's position. This is because the other cogeneration customers' expectations were probably based on SDG&E's test period sales projections, which do not match with the rate increases that result from recorded usage.

We are concerned with "rate shock," but we find that Kelco's showing does not establish the necessity for a rate limiter in this case. First, the rate limiter itself presents fairness problems that DRA and SDG&E have noted. Second, the magnitude of Kelco's alleged increase, while significant, is not so great as to justify the extraordinary remedies that Kelco requests. We have resorted to such remedies in the past, but chiefly where all of a small utility's ratepayers would otherwise experience a rate increase over 50%. (Generally, this occurs with the smaller water and telephone companies. See, e.g., D.82-03-023; D.82-04-009; D.82-12-045.)

We will deny Kelco's application.

Findings of Fact

1. Kelco is experiencing a gas rate increase higher than it expected and higher than the projected average increase for the relevant (cogeneration) customer class.

2. Kelco has not shown the rate increase it is experiencing to be either anomalous or excessive.

Conclusions of Law

1. Kelco's proposed "rate limiter" should be resorted to only in rare instances where "rate shock" is compellingly demonstrated.

2. SDG&E should not be required to collect its rates for cogeneration customers subject to refund.

3. This decision should be given immediate effect.

ORDER

IT IS ORDERED that the application of the Kelco Division of Merck & Co., Inc., to modify Resolution G-2780 is denied.

This order is effective today.

Dated SEP 14 1988, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

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

Victor Weisser

Victor Weisser, Executive Director