

Decision 82 09 105

SEP 22 1982

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of SOUTHERN CALIFORNIA GAS)
COMPANY and PACIFIC LIGHTING GAS)
SUPPLY COMPANY to Increase)
Revenues Under the Consolidated)
Adjustment Mechanism to Offset)
Changed Gas Costs Resulting from)
Increases in the Price of Natural)
Gas Purchased from EL PASO NATURAL)
GAS COMPANY, TRANSWESTERN)
PIPELINE COMPANY, PACIFIC)
INTERSTATE TRANSMISSION COMPANY,)
PACIFIC GAS AND ELECTRIC COMPANY)
and California sources; to Adjust)
Revenues to Recover the)
Undercollection in the CAM)
Balancing Account; to Reflect in)
the CAM Balancing Account Costs)
Related to Franchise Fees and)
Uncollectible Expense and Increased)
Carrying Costs on Natural Gas)
Stored Underground; and to Revise)
Section II of the Preliminary)
Statement of the Tariffs.)

Application 60867
(Filed September 4, 1981;
Petition for Modification
filed July 8, 1982)

In the Matter of the Application)
of SAN DIEGO GAS & ELECTRIC COMPANY)
For Authority to Increase its Gas)
Rates and Charges Pursuant to its)
Proposed Consolidated Adjustment)
Mechanism.)

Application 60901
(Filed September 15, 1981)

In the Matter of the Application)
of SOUTHERN CALIFORNIA GAS COMPANY)
and PACIFIC LIGHTING GAS SUPPLY)
COMPANY to Increase Revenues Under)
the Consolidated Adjustment)
Mechanism to Offset Changed Gas)
Costs Resulting From Increases in)
the Price of Natural Gas Purchased)
from El Paso Natural Gas Company,)
Transwestern Pipeline Company,)
Pacific Interstate Transmission)
Company, Pacific Gas and Electric)
Company and to Recover the)
Undercollection in the CAM)
Balancing Account; to Reflect in)
the CAM Balancing Account Costs)
Related to Franchise Fees and)
Uncollectible Expense and Increased)
Carrying Costs on Natural Gas)
Stored Underground; and to Revise)
Section H of the Preliminary)
Statement of the Tariffs.)

Application 82-03-16
(Filed March 5, 1982)

In the Matter of the Application)
of SAN DIEGO GAS & ELECTRIC COMPANY)
For Authority to Increase its Gas)
Rates and Charges Pursuant to its)
Filed Consolidated Adjustment)
Mechanism.)

Application 82-03-38
(Filed March 9, 1982)

(See Decision 82-04-116 for appearances.)

OPINION ON PETITION FOR MODIFICATION

Introduction

Decision (D.) 82-04-116 issued April 28, 1982 addressed several significant economic issues and, among other things, established policies for Southern California Gas Company (SoCal) in the following areas:

1. The appropriate rate design guidelines for SoCal;
2. The appropriate economic test for new long-term gas supply projects; and
3. The appropriate economic test for short-term discretionary gas purchases.

By petition for modification filed July 8, 1982, SoCal requests the Commission to clarify D.82-04-116 in certain respects to eliminate what SoCal perceives as unfavorable side effects of the decision.

SoCal seeks the following modifications:

1. The discretionary gas purchase test of D.82-04-116, coupled with \$35 million in gas cost disallowances imposed on April 28, 1982, have introduced an enormous element of risk into SoCal's operations. The Commission should lessen that risk and provide some certainty to gas purchase policy by declaring that discretionary gas purchases which meet its new economic test are reasonable per se as long as less expensive gas is not concurrently turned back;
2. If the Commission decides not to do away with the rebuttable presumption of the discretionary gas purchase test, it should clarify the legal function of the presumption to make it conform to the requirements of the Evidence Code, in order to lessen the uncertainty now existing;
3. The definition of "discretionary purchase," and Finding of Fact 31, should be modified

to state precisely when "summer" and "winter" begin; to state that purchases of gas under the Pan Alberta contract in excess of the minimum daily quantities beginning September 1 of each contract year will not be deemed discretionary, as long as El Paso and Transwestern supplies are not concurrently turned back; and to state that Pan Alberta purchases above the minimum daily contract amount during the summer which may be necessary to satisfy the minimum annual contract obligation will not be deemed discretionary;

4. The newly instituted "reasonableness review" of SoCal's purchase, supply, and storage policies should be separate from the semi-annual consolidated adjustment mechanism (CAM) proceedings;
5. The Commission-established marginal rate should be subject to review and possible adjustment in each semiannual CAM proceeding, and Finding of Fact 30 should be modified accordingly; and
6. An ordering paragraph should be added to the decision declaring that the interim rates approved by D.93629 have now become final.

Issues Presented

1. Whether the Commission should declare that discretionary purchases which meet the economic test are "reasonable per se" as long as less expensive gas is not concurrently turned back.

The Commission's adopted economic test for discretionary purchases of gas is tied to the "marginal rate" which the Commission adopted for rate design purposes. The Commission stated that "[p]urchases of discretionary gas supplies at or below the marginal rate will be presumed reasonable. Purchases of discretionary gas supplies in excess of that rate may be deemed reasonable only upon a strong showing." It is SoCal's contention that the Commission's

newly adopted marginal rate test imposes on SoCal a severe risk of cost disallowances, while seeking to achieve a "clear and useful" guideline for discretionary purchases at a least-cost fuel mix for the region.

In particular, SoCal claims that the Commission's disallowance of nearly \$35 million in gas costs on the same day as the decision in question was issued, coupled with the "rebuttable presumption" of the new marginal rate economic test, have greatly increased the risk to investors of making further discretionary gas purchases. SoCal notes that at the same time there has been no concurrent increase in return on equity to compensate investors for the increased risk, nor has there been any other compensating benefit to SoCal. SoCal maintains that this increased risk applies specifically to discretionary purchases of Transwestern, PG&E, and Mich-Con gas, all of which would initially meet the Commission's newly adopted economic test. SoCal argues that even if it clearly appears at the time of an opportunity to purchase such gas that the purchase would not only pass the economic test, but would contribute to a least-cost fuel mix for the region by displacing higher-cost oil and resulting "in a net economic benefit to the regional economy," the Commission's decisions force SoCal to run an unacceptably high risk that the cost of the purchase may be disallowed because of a later availability of even lower cost supplies.

SoCal contends that it is literally impossible for it to predict either the exact costs to the region of burning gas or oil, or the possibility of any future supply turnback, at the time a discretionary gas purchase decision must be made. SoCal states that it is therefore impossible to know whether a discretionary purchase will be found prudent, even if it satisfies the marginal rate economic test.

To rectify this perceived wrong, SoCal suggests the following modification:

"If the Commission concludes that the significant benefits to SoCal Gas's customers, to the regional economy, to the public health, and to the state as a whole, from further discretionary purchases should be retained, ...the Commission should modify its discretionary gas purchase test to lessen the risk and make it possible for discretionary purchases to continue. This can be done by replacing the 'rebuttable presumption' of prudence with a test that establishes certainty at the time of a discretionary purchase. . . . The Commission can assure that the benefits of discretionary gas are available by doing away with the 'rebuttable presumption' of prudence and declaring that any discretionary purchase of gas which passes the economic test is reasonable per se, as long as there is no concurrent turnback of less expensive supplies."

Our review of SoCal's petition for modification fails to persuade us that discretionary purchases which meet the economic test should be found "reasonable per se" as long as less expensive gas is not concurrently turned back. SoCal's filing misapprehends the nature and purpose of the economic test for determining the prudence of short-term discretionary gas purchases. The test was established to serve as a guide for SoCal in meeting its burden of proving the prudence of a particular discretionary gas purchase. It was not intended to operate, as SoCal would have it modified, as a substitute for SoCal's burden of proof.

Our current procedures contemplate an annual review of the prudence and reasonableness of SoCal's gas purchases. During such review, the prudence of SoCal's discretionary gas purchase decisions are judged according to information available at the time of the purchase decision. SoCal's petition raises the false specter that the economic test established in D.82-04-116 subjects SoCal to the

untenable possibility that its actions will be judged unreasonable in light of information that was not available at the time the purchase decision was made. There is no basis for SoCal's interpretation. Furthermore, the economic test proposed by SoCal is so facile and superficial that its adoption would essentially remove any element of risk for SoCal in reaching its discretionary gas purchase decisions.

As we stated in D.82-04-116, "the test...is not intended to serve as a formulaic device by which SoCal, the Commission, or any interested party can unequivocally determine on any given day whether specific discretionary purchases are prudent or not." If SoCal's requested modification were adopted, the mere meeting of the economic test would fulfill SoCal's burden of proof. SoCal would have no obligation to provide further evidence at hearing in support of its purchase decision under any circumstances. The issue of prudence would be foreclosed. This was not our intention.

The hearing process remains our prime vehicle for determining the prudence of utility actions. Under the current economic test, a rebuttable presumption of reasonableness is created if SoCal establishes that its discretionary purchases met the economic test. As we will clarify in a subsequent portion of this decision, this rebuttable presumption can be challenged through an evidentiary showing by parties to the application, such as staff or intervenors. However, the overall burden of proof remains with SoCal. In response to the intervenor/staff showing, SoCal, at its option, may present further evidence indicating that its discretionary gas purchases were reasonable in light of the circumstances existing at the time of the act. SoCal is not subjected to judgment by hindsight. It has merely been told that the "economic test" is an element of its burden of proof. It still has the ultimate responsibility for informing and convincing the Commission that its actions were prudent. This process is fair and

equitably balances the interests of the ratepayer, SoCal, and its shareholders. We will not modify the decision as SoCal requests.

2. Whether the Commission should clarify the legal function of the rebuttable presumption created when discretionary purchases meet the economic test.

SoCal asserts that D.82-04-116 failed to make clear that once SoCal has established the rebuttable presumption of prudence by showing that its discretionary purchases meet the economic test, the burden of producing further evidence shifts. We will clarify the legal effect of the economic test and its rebuttable presumption in the context of the hearing room.

In any review of the reasonableness of SoCal's gas purchase policies, the fundamental burden of proving the reasonableness of its actions remains on SoCal throughout the proceedings. However, once SoCal creates the rebuttable presumption of prudence by showing that its discretionary purchases meet the economic test, the burden of producing further evidence does indeed shift from SoCal. If no other party produces evidence asserting that purchases which meet the test were nevertheless imprudent, SoCal would not be obligated to present additional evidence to establish the prudence of discretionary purchases which meet the economic test. Parties who would contend that such discretionary purchases were nevertheless imprudent must then submit or adduce evidence to support their assertion and rebut the presumption of reasonableness.

3. Whether the Commission should remove the unnecessary constraints and uncertainties created by its definition of "discretionary purchase."

D.82-04-116 found it necessary to define what constitutes a "discretionary purchase" in order to determine which purchased gas volumes would be subject to application of the economic test.

The Commission's definition of "discretionary purchase" states as follows:

"For SoCal, only the required daily take would be considered the minimum contractual obligation in September, with amounts above that treated as discretionary and subject to the economic test. Summer minimum takes would reflect minimum daily requirements, with winter purchases increased to meet the annual obligation (absent capacity constraints). Amounts in excess of these targets would be considered discretionary, regardless of the month involved."

SoCal's Pan Alberta contractual obligations, as modified by FERC, include minimum daily and minimum annual volumes. The daily minimum requires SoCal to purchase approximately 40% of the contract volumes, while the minimum annual amount is approximately 70% of the contract volumes. SoCal contends that our definition of discretionary purchases is ambiguous as between its 40 and 70% obligations, and urges the Commission to consider no purchase discretionary until that point in the contract year is reached when minimum daily purchases for the balance of the year, combined with earlier takes, will be sufficient to meet the annual minimum requirement. We rejected this approach in D.82-04-116 because we are concerned that purchases of expensive Pan Alberta supply be minimized.

To clarify our definition of discretionary purchases with respect to the Pan Alberta contract, we hold that purchases above the daily minimum volumes will be subject to the economic test for discretionary supply. In meeting its burden of proof for discretionary purchases, however, SoCal may show that the volumes of discretionary gas were bought to meet the minimum annual required takes. But it shall remain SoCal's burden to demonstrate that the timing of such purchases was appropriate, and that less expensive supply was not refused in order to make such purchases. Were we to adopt any other standard, SoCal could purchase full contract volumes of Pan Alberta supply, on a daily basis, and not be concerned about the loss of cheaper supply until after the annual contract obligation had been satisfied.

4. Whether the annual reasonableness review should be held separately from the semiannual CAM proceeding.

SoCal fears that conducting the annual reasonableness review as part of a semiannual CAM proceeding, as ordered in D.82-04-116, could result in a substantial delay in issuing the final CAM decision, with all the extra costs for the ratepayers and short-term debt problems

for SoCal which flow from delay in issuing CAM decisions. SoCal recommends that the reasonableness review be conducted in a separate proceeding to be held in June of each year to avoid unnecessary delay.

We will reject SoCal's proposal for an annual reasonableness review separate from the CAM proceeding. We think it important to hold the reasonableness reviews in conjunction with SoCal's requests for CAM rate relief. Their relationship provides a strong inducement to SoCal, staff, and interested parties to be prompt and forthright in their exchange of information and analyses regarding SoCal's gas purchase policies. There is nothing inherent in the process which precludes a prompt, simultaneous resolution of CAM rate requests and annual reasonableness reviews. Furthermore, we do not favor unnecessary proliferation of proceedings and hearings. We see no need to further tax the limited resources of the Commission by creating another proceeding for SoCal in June of each year.

However, we agree that timing difficulties are present in a review period ending August 31 of each year, as established in D.82-04-116. Since SoCal must file its CAM in early September, records necessary to enable a concurrent reasonableness/CAM review are not likely to be available. We therefore establish the annual reasonableness review period as the 12-month period ending June 30 of each year, except for the initial review period to be considered in the October 1982 CAM proceeding, which shall be the 9-month period ending June 30, 1982, because three months in 1981 have been left over from our last review.

We further agree with SoCal that the Commission determination of the marginal rate should be subject to review and possible adjustment in each semiannual CAM proceeding rather than on an annual basis. It is true that all the factors which are relevant to determining the marginal rate--the "measures of a reasonable price for discretionary purchases," the "variable

cost of the most expensive gas supply," and the price of various grades of fuel and distillate oil--are subject to substantial change over any six-month period. It is important to maintain an updated marginal rate which reflects the realities of the world in which SoCal is operating. Since the factors which determine the marginal rate are so subject to change, it makes more sense to consider the marginal rate twice annually than to consider it only once. Therefore, we will review and possibly adjust the marginal rate in every CAM proceeding.

Finally, we will correct an oversight in D.82-04-116. The decision failed to declare the interim rates established by D.93629 to be final. We will add an ordering paragraph declaring the authorized rates in D.93629 to be final.

To the extent that relief requested by SoCal in its petition for modification is not granted by this decision, the petition is denied.

Conclusions of Law

1. SoCal's petition for modification should be granted in part and denied in part.
2. The Commission should clarify the legal effect of the economic test and its rebuttable presumption.
3. The Commission should clarify and modify its definition of "discretionary purchases."
4. The Commission-established marginal rate should be subject to review and possible adjustment in each semiannual CAM proceeding.
5. The interim rates authorized By D.93629 should be declared final.
6. The annual reasonableness review period for SoCal's CAM should cover the 12-month period ending June 30 of each year.
7. The following order should be effective today since it clarifies D.82-04-116 and SoCal is now preparing for its next CAM filing.

O R D E R

IT IS ORDERED that:

1. Consistent with this decision, the petition for modification of D.82-04-116 filed by the Southern California Gas Company is granted in part and denied in part.
2. Consistent with this decision, the legal effect of the economic test and its rebuttable presumption is adopted.
3. Consistent with this decision, a modified definition of "discretionary purchases" is adopted.
4. The Commission-established marginal rate will be reviewed in each semiannual CAM proceeding.
5. The interim rates authorized by D.93629 are final.
6. The annual reasonableness review period for the Southern California Gas Company's consolidated adjustment mechanism shall cover the 12-month period ending June 30 of each year, except for the initial review period which shall cover the 9-month period ending June 30, 1982.
7. To the extent D.82-04-116 conflicts with this decision, D.82-04-116 is modified.

This order is effective today.

Dated SEP 22 1982, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. CRAVELLE
LEONARD M. CRIMES, JR.
VICTOR CALVO
PRISCILLA C. CREW
Commissioners

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


Joseph E. Bodovitz, Executive Director

to state precisely when "summer" and "winter" begin; to state that purchases of gas under the Pan Alberta contract in excess of the minimum daily quantities beginning September 1 of each contract year will not be deemed discretionary, as long as El Paso and Transwestern supplies are not concurrently turned back; and to state that Pan Alberta purchases above the minimum daily contract amount during the summer which may be necessary to satisfy the minimum annual contract obligation will not be deemed discretionary;

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