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Decision S2 12 112 DEC 22 1982

Onfile

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for authority, among other things, to increase its rates and charges for electric and gas service.

Application 60153
(Filed December 23, 1980)

(Electric and Gas)

In the Matter of the Application of PACIFIC GAS AND ELECTRIC COMPANY for authority to increase its electric rates and charges effective August 1, 1981, to establish an annual energy rate and to make certain other rate charges in accordance with the energy cost adjustment clause as modified by Decision No. 92496.

Application 60616
(Filed June 2, 1981)

(Electric)

(See Decision 93887 for appearances.)

Additional Appearance

Michael S. Hindus, Attorney at Law, for
The Pacific Gas and Electric Company,
applicant.

OPINION ON ATTRITION PEASE

Pacific Gas & Electric Company (PG&E) filed for 1983 electric and gas attrition rates under the Attrition Rate Adjustment (ARA) mechanism established by Decision (D.) 93887. The rates established by D.93887 included nonlabor expenses escalated by an assumed inflation factor for 1982. It became obvious that

experienced inflation in 1982 has been less than assumed in our decision. This results in an overstatement of 1982 nonlabor expenses and the consequent overstatement of the nonlabor expenses for 1983 since the attrition adjustment is predicated on such overstated base.

The Commission by D.82-11-041 reopened Application (A.) 60153 et al., for the limited purpose of considering the appropriate level of nonlabor expenses for 1982 to which the ARA mechanism should be applied for 1983 nonlabor expenses. Hearing on this limited reopened proceeding was held on November 18, 1982. PG&E, Toward Utility Rate Normalization (TURN), City and County of San Francisco (City) and the Commission Staff (staff) participated in the reopened proceeding. The matter is now ready for decision.

PG&E's Position

PG&E's Manager of Revenue Requirements, Roy Davis offered testimony on the information required by D.82-11-041. Witness Davis calculated the 1982 nonlabor expense base for indexing to be \$216,523,000 for the Electric Department and \$100,438,000 for the Gas Department by adjusting the 1981 and 1982 nonlabor escalation factors used in D.93887 of 10.01% and 9.15% to the actual or current estimate of 9.56% for 1981 and 2.72% for 1982. He then used the most current (October 1982) Data Resources, Incorporated (DRI) estimates for 1983 in developing the nonlabor escalation rate (Modified PPI) of 4.69% which he applied on the modified nonlabor base of \$216,523,000 for the Electric Department and \$100,438,000 for the Gas Department and arrived at his additional revenue requirement

figures for nonlabor expenses of \$10,235,000 and \$4,747,000 for the Electric and Gas Departments, respectively. Based on the above adjustment for nonlabor expenses PG&E calculates its adjusted revenue requirements for its Electric Department to be \$171,000,000 and for its Gas Department \$52,900,000. These compare to the additional revenues requested under Supplement to Advice Letter 909-E of \$173,805,000 and under Supplement to Advice Letter 1200-G of \$54,201,000 for the Electric and Gas Departments, respectively.

While PG&E has supplied the information required by D.82-11-041, PG&E takes the position that it is improper to correct one segment of the attrition allowance without considering the changes that may have taken place in the various other items. PG&E contends that it has attempted to live with the revenue and expense levels adopted by D.93887 by adopting such expense levels for its 1982 budget. It has cut and trimmed its proposed expenditures for 1982 so that its expenditures in total would equate to the levels authorized by D.93887. If the Commission were to authorize an attrition allowance less than what PG&E has requested in its Supplements to Advice Letters 909-E and 1200-G, PG&E claims that it will have to reduce its expenses for 1983 below the levels for 1982. PG&E does not object to modifying the nonlabor escalation rate to the more current estimate of 4.69% for 1983 compared to the 5.6% nonlabor escalation rate used in the advice letters which were the most recent estimates that were available at the time the advice letters were filed under the filing schedule required by the ARA mechanism.

PG&E considers the Commission's decision to selectively review a small component of the ARA mechanism is procedurally and substantively wrong and that such action constitutes the most blatant form of one-sided ratemaking. PG&E contends that in any rate case,

some estimated costs turn out to be overstated and some understated and what matters is the overall result. PG&E further argues that had inflation actually exceeded the level estimated in D.93887, it seriously doubts whether the Commission would have reopened D.93887 and revised the nonlabor base upward.

PG&E states that it is committed to living within the rate case adopted revenue levels, and it will continue to do so regardless of what happens in this proceeding. Should the Commission adopt the staff's recommendation, PG&E's management will reluctantly but decisively make the necessary management decisions to reduce expenditures. Those painful decisions will eventually affect the service. PG&E also states that the progress made in the past several years in developing a more favorable regulatory climate will be endangered and ultimately cost the ratepayers an increased cost of capital.

TURN's Position

Mrs. Siegel argued on behalf of TURN that the attrition allowance is inappropriate and that all the issues involved in the attrition mechanism should be the subject matter of this reopened hearing. TURN argues that it would not be satisfied with the \$22 million reduction recommended by the staff.

On October 28, 1982 TURN filed a Petition to Reopen A.60153 and Modify PG&E's Attrition Allowance for 1983 (petition). In its petition TURN alleges that:

1. The attrition allowance is a device to avoid regulation of a utility's operation.
2. California utilities have an advantage over companies under recorded test year regulation.
3. Inflation could drop as low as 2% and the consensus opinion of economists is that inflation for 1983 would be no more than 5%.

4. Inflation rates will remain low because the recession will keep price boosts down.
5. The Consumer Price Index (CPI) shows a continuing decline.
6. PG&E reports that per share earnings for the 12 months ended September 30, 1982 reflected an overall 11-1/2% overall return compared to the 12.2% authorized return.
7. Utility stocks are selling close to book value.
8. Staff used a 10% inflation factor for 1982 and if 1982 inflation bears out the predictions of the forecasters PG&E will not only be making a cool 5% on nonlabor costs for 1982, but this will be compounded into 1983.
9. At a minimum all data must be recomputed based on 1981 base rates.
10. Use of obsolete data for labor expenses will inflate the labor adjustments for 1983.

TURN concludes in its petition that since inflation is down PG&E, like all other corporate enterprises, should be able to absorb a predictable 5% inflation cost by further efficiencies in its operation. TURN requests that the Commission take action to make the ratepayers whole by denying the attrition increase.

City's Position

City takes the position that the limited reopening on the nonlabor base as set forth in D.82-11-041 is inadequate and requests that the Commission stay the ARA mechanism and reopen the entire attrition issue. City argues that the concept of attrition allowances is a virtually new concept. Since the panic of double digit inflation is gone, City reasons that the attrition allowance should also be removed.

In response to TURN's petition of October 28, 1982, City filed a Statement in Support of TURN's Petition (statement). City in its statement requests that A.60153 be reopened to abolish the 1983 attrition allowance for PG&E.

Staff Position

The staff offered Bruce M. DeBerry, project manager in the Revenue Requirements Division, to testify on the subject matter of the reopened hearings ordered by D.82-11-041. The staff computations were identical with those of PG&E except for the correction of the 1983 base rates for the difference between adopted and experienced nonlabor inflation factors used in establishing 1982 test year rates. Table 1 shows the staff's recalculation of the nonlabor expense base for 1982 and the necessary correction to 1983 rates. The table shows reductions in the 1982 nonlabor expense bases for indexing of \$14,498,000 and \$6,726,000 for the Electric and Gas Departments, respectively. Staff witness DeBerry testified that 1983 rates should be corrected by these amounts, otherwise, the overstated nonlabor expenses for 1982 would be continued on into 1983 since the 1982 test year rates are the base for 1983 rates. Witness DeBerry further testified that it would be fair and reasonable to recognize the actual inflation experienced in the test year in calculating attrition year rates regardless of whether such actual inflation represented an increase or decrease from the estimates adopted in the decision.

Table 1

RECALCULATION OF NONLABOR EXPENSE
(S000)

Line No.	Items	Escalation Rates	Electric*	Gas
1	1982 Base for Indexing**		\$231,021	\$107,164
	Adopted Escalation Factors			
2	1982	1.0915		
3	1981	1.1001		
4	1982 Base for Indexing in 1980 Dollars***		192,396	89,247
	Current Escalation Factors			
5	1982	1.0272		
6	1981	1.0956		
7	Revised 1982 Base for Indexing****		216,523	100,438
8	Correction to 1983 rates (Line 1 less Line 7)		14,498	6,726

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- * CPUC Jurisdictional
 ** D.93887, Appendix E
 *** Line 4 = Line 1/ (Line 2 x Line 3)
 **** Line 7 = Line 4 x Line 5 x Line 6

Issues

The following issues were raised in this reopened hearing:

1. Is it reasonable to reopen D.93887 to correct one segment of the attrition allowance without considering the changes that may have taken place in various items?
2. Is it reasonable to adjust the 1983 attrition allowances to correct for 1982 nonlabor inflation estimate errors which are built into the 1982 rates?

Discussion

On the one hand, we have PG&E arguing that it is improper to reopen D.93887 to review selectively a small component of the ARA mechanism and that the Commission should reconsider its order and allow the ARA mechanism to operate in the manner it was supposed to operate as set forth in D.93887. On the other hand, we have TURN and City arguing that they agree with PG&E that the Commission should not be reviewing just the nonlabor component, but should be reviewing the entire attrition allowance question to see if any allowance is in fact warranted under current economic conditions.

We disagree with PG&E that the selective reopening is improper. We consider the magnitude of the error in the estimate of the inflation rate used in developing 1982 test year nonlabor expenses large enough to require reopening and reconsideration of the nonlabor expense base we adopted in D.93887 which is to be indexed in determining the attrition allowance for 1983.

We have also carefully reviewed TURN's petition and City's statement. We find nothing in these to cause us to modify D.93887 to abandon the ARA mechanism. We do, however, see the necessity of modifying the ARA in the future to require correction of attrition year rates for any differences between the actual inflation in the test year and the estimates adopted in our decision for the test year. We will require PG&E and the staff to propose appropriate changes in the ARA mechanism in PG&E's 1984 test year general rate case to permit such corrections.

PG&E argues that the staff's recommendation to adjust 1983 attrition allowances to correct 1982 nonlabor inflation estimate errors is wrong, since PG&E has adopted revenues granted in D.93887 in setting its 1982 budget. PG&E argues that to the extent the Commission reduces the 1982 nonlabor base PG&E will have to reduce its expenditures to live within the authorized revenue levels resulting in a reduction in the level of service offered in 1983 over 1982. We are not moved by PG&E's argument and agree with staff that the correction of the 1982 nonlabor base as well as the correction for the 1982 nonlabor inflation rate error is proper. We believe that PG&E's management will make the proper choices to compensate for the reduction in the expected attrition allowances by stressing greater efficiencies.

Table 2 shows the calculation of our adopted 1983 attrition allowance for the Electric Department. Table 3 shows a similar calculation of our adopted 1983 attrition allowance for the Gas Department.

Table 2
 Electric Department
 Calculation of 1983 Attrition Allowance
 (\$000)

		<u>Adopted Revenue Requirement</u>
LABOR		
Base per D.93887	\$416,861	
Escalation Factor	7.3%	
Franchise & Uncollectible Factor	1.00793	
TOTAL		\$30,672
NONLABOR		
Base per D.82-11-041	\$216,523	
Escalation Factor	4.69%	
Franchise & Uncollectible Factor	1.00793	
TOTAL		\$10,235
Correction for 1982 nonlabor inflation*		\$(14,498)
FIXED ATTRITION ITEMS		
Depreciation		\$48,121
Income Tax		(3,234)
Rate Base		57,429
Financial Attrition		<u>20,520</u>
SUBTOTAL		\$149,245
ANNUAL ENERGY RATE		557
(Rate of Return)		
CONSERVATION PROGRAM EXPANSION**		<u>6,700</u>
TOTAL		<u>\$156,502</u>

(Red Figure)

* From Table 1, Exhibit 236.

** Electric portion of the \$10,000,000 separate adjustment allowed in Finding of Fact 42, page 218, D.93887.

Table 3
Gas Department
Calculation of 1983 Attrition Allowance
(\$000)

	<u>Adopted Revenue Requirement</u>
LABOR	
Base per D.93887	\$211,539
Escalation Factor	7.3%
Franchise & Uncollectible Factor	1.00782
TOTAL	\$15,563
NONLABOR	
Base per D. 82-11-041	\$100,438
Escalation Factor	4.69%
Franchise & Uncollectible Factor	1.00782
TOTAL	\$ 4,747
Correction for 1982 nonlabor inflation*	\$(6,726)
FIXED ATTRITION ITEMS	
Depreciation	\$13,401
Income Tax	(1,228)
Rate Base	10,428
Financial Attrition	<u>6,689</u>
SUBTOTAL	\$42,874
CONSERVATION PROGRAM EXPANSION**	<u>3,300</u>
TOTAL	<u>\$46,174</u>

(Red Figure)

* From Table 1, Exhibit 236.

** Gas portion of the \$10,000,000 separate adjustment allowed in Finding of Fact 42, page 218, D.93887.

Findings of Fact

1. D.82-11-041 reopened D.93887 for the limited purpose of considering the appropriate level of nonlabor expenses for 1982 to which the ARA mechanism should be applied for 1983 nonlabor expenses.

2. It is reasonable to reopen D.93887 to correct one segment of the attrition allowance because of the magnitude of the error in the nonlabor inflation rate for 1982 adopted in D.93887.

3. D.93887 adopted nonlabor escalation factors of 10.01% for 1981 and 9.15% for 1982 in developing nonlabor expenses for test year 1982. Actual experience shows an escalation factor of 9.56% for 1981 and an estimated 2.72% for 1982.

4. It is reasonable to adjust the 1983 attrition allowances to correct for 1982 nonlabor inflation estimate errors which are already built into the 1982 test year rates.

5. TURN's petition and City's statement contain no convincing reasons for abandoning the ARA mechanism.

Conclusions of Law

1. An attrition allowance for 1983 of \$156,502,000 for the Electric Department and \$46,174,000 for the Gas Department effective January 1, 1983 are reasonable and should be granted.

2. TURN's petition and City's statement should be denied.

3. PG&E and the staff should recommend appropriate changes to the ARA mechanism to encompass the changes adopted in this decision to correct inflation factor errors.

4. The effective date of this order should be the date on which it is signed in order to enable PG&E to file rates which can become effective on January 1, 1983.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is authorized to file with this Commission revised tariff schedules for electric rates in accordance with the decision issued today in the rate design phase of A.60153 on or after their effective date of this order. The revised tariff schedule shall become effective not earlier than January 1, 1983, and shall comply with General Order 96-A. The revised schedules shall apply only to service rendered on or after their effective date.

2. PG&E is authorized to file with this Commission revised tariff schedules for gas rates in accordance with the decision issued today in A.82-08-051 on or after the effective date of this order. The revised tariff schedules shall become effective not earlier than January 1, 1983, and shall comply with General Order 96-A. The revised schedules shall apply only to service rendered on or after their effective date.

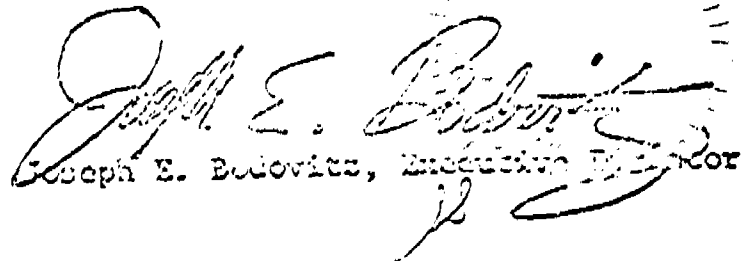
A.60153, A.60616 ALJ/rr

3. The petition of Toward Utility Rate Normalization, supported by the statement of the City of San Francisco, is denied. This order is effective today.

Dated DEC 22 1982, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

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


Joseph E. Bobovics, Executive Director