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ORIGINAL

Decision No. 89710 DEC 12 1978

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA GAS COMPANY for Authority to Increase Rates Charged by it for Gas Service.

Application No. 57639
(Filed October 28, 1977)

(See Decision No. 89208 for appearances.)

A.57639 dz

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OPINION

Southern California Gas Company (SoCal) seeks authorization to increase its rates approximately $334.0 million (33.5 percent) annually at the estimated test year 1979 level of sales.

After notice, 46 days of hearings were held before Administrative Law Judge N. R. Johnson during the period December 7, 1977 through May 12, 1978, and the matter was submitted subject to receipt of concurrent opening briefs due on or before June 12, 1978 and concurrent closing briefs due on or before June 27, 1978.

Opening and/or reply briefs were received from SoCal, the Commission staff, California Manufacturers Association (CMA), State of California Energy Resources Conservation and Development Commission (ERCDC), General Motors (GM), the cities of Long Beach (LB), Los Angeles (LA), and San Diego (SD), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (Edison), and Tehachapi-Cummings County Water District (Tehachapi).

On November 1, 1978 Valley Nitrogen Producers, Inc., USA Petrodom Corp., and Union Oil of California (Ammonia Manufacturers) petitioned to set aside submission and reopen the hearing for the receipt of additional evidence on the effect of further gas rate increases on petitioners' operations. The petition is denied as unnecessary on the basis set forth in the discussion herein on rate design for Priority 2 consumers.

Public Witness Statements and/or Testimony

Public hearings were held at Los Angeles on December 7, 1977, at Santa Barbara on December 8, 1977, at San Bernardino on December 13, 1977, at Palm Springs on December 14, 1977, and at Santa Ana on December 20, 1977 to provide SoCal's customers with a

convenient opportunity to present statements and/or testimony on the rate increase application. These presentations encompassed a wide variety of subjects including rate design, public ownership of gas facilities, the high level of executive salaries and retirement pay, the effect of rate increases on environment, alternate sources of energy, research, and development projects, the effect of conservation on rates, and SoCal's billing practices. The primary focus of the statements and testimony, however, was the need and justification for the requested rate relief. The arguments advanced in favor of granting the requested rate increase were based on the need of those stockholders who derive a major portion of their retirement income from Pacific Lighting Corporation's (PLC) stock dividends and those nonstockholders who felt that prompt rate relief was necessary in order to maintain a strong and viable utility. Statements in opposition to the increase related to the inability of senior citizens and the handicapped, indigent, and unemployed on low, fixed incomes to pay such increases; the financial hardship such increases would cause small businesses, such as laundromats, where the gas bills represent a major expense item; the relative percentage of the requested increase as compared to the increases in consumers' wages and the rate of inflation; and the reluctance of ratepayers to pay increased rates to compensate SoCal for having a declining gas supply. It is axiomatic that all of the above-listed subject matters are included in our overall considerations of the proper disposition of the instant application.

Transcript Corrections

On the last day of hearing the parties were advised that requests for transcript corrections were to be submitted to all parties by June 1, 1978. Exceptions were to be taken by the due date of the opening briefs, i.e., June 12, 1978, and those requested corrections that were not protested would be placed in

the formal file as approved. Requests for transcript corrections were received from SoCal, the Commission staff, Edison, and ERCDC. As indicated by letter dated June 12, 1978, the Commission staff took exception to six proposed transcript corrections on the basis that they attempt to improve or change testimony which is more accurate as presently transcribed. The requested correction for Volume 10, page 446, line 29 correlates with the balance of the answer to the cross-examination question and will be approved. The other five corrections protested by the staff will not be approved. The balance of SoCal's proposed transcript corrections, together with all the corrections proposed by the staff, Edison, and ERCDC, will be adopted.

I. SOCAL's PRESENT OPERATIONS

SoCal, a wholly owned subsidiary of PLC, is a gas distribution utility engaged in public utility operations in the counties of Los Angeles, Fresno, Imperial, Kern, Kings, Orange, Riverside, San Bernardino, San Luis Obispo, Santa Barbara, Tulare, and Ventura. SoCal also sells gas at wholesale to the Municipal Gas Department of the city of Long Beach and to SDG&E.

SoCal purchases gas from El Paso Natural Gas Company (El Paso) and another subsidiary of PLC, Pacific Lighting Service Company (PLS). PLS owns four natural gas storage reservoirs located at Goleta, Montebello, East Whittier, and Aliso Canyon. These storage fields have a combined working capacity of 97,300,000 Mcf. PLS purchases all its natural gas from Transwestern Pipeline Company (Transwestern) and from California sources and sells it to SoCal on a cost-of-service basis approved by this Commission.

SoCal owns underground storage fields at Playa del Rey with a working capacity of 2,600,000 Mcf and at Honor Rancho with a working capacity of 22,500,000 Mcf. SoCal, under its contract with PLS, operates the above-listed PLS underground storage facilities.

As of March 31, 1977 SoCal owned 2,241 miles of transmission pipeline, including 19 miles jointly owned with PLS, and 31,776 miles of various distribution pipeline. Also as of March 31, 1977 SoCal had 2,790,880 gas services supplying 3,487,302 active meters.

In addition to the Pacific Lighting utilities (PLU), i.e., PLS and SoCal, PLC owns a number of subsidiaries engaged in utility-related enterprises such as the exploration, development, transportation, and sale of natural gas, coal gasification companies, sales assistance, equipment leasing, and petroleum products companies, and such nonutility subsidiary companies as mortgage loan servicing, building construction, real estate development, furniture sales, and agricultural growing, packing, and marketing services.

II. PARTIAL GENERAL RATE INCREASE

On April 28, 1978 SoCal made a motion that this Commission grant a partial general rate increase based on test year 1978 summary of earnings to become effective no later than August 31, 1978. According to SoCal, the magnitude of its revenue deficiency for test year 1978 at the then existing rates necessitated that it be afforded the opportunity to earn additional revenues sufficient to at least partially reduce the erosion of its earnings in 1978.

SoCal alleged that the requested relief would partially and equitably resolve the practical conflict between SoCal's need for timely rate relief and the obvious public necessity for full and complete proceedings prior to a final order to be based on results of operation for test year 1979.

The specific amount of the partial rate increase sought was $118,598,000 on an annualized basis and was based on the additional revenue required to raise SoCal's 1978 annualized rate of return to its last authorized level of 8.8 percent computed on the Commission staff's 1978 test year summary of earings. The staff's estimates were based on assumptions and procedures with which SoCal did not agree, but the urgent need for partial rate relief without needless disputes required, according to SoCal, that it accept the staff recommendations.

The other parties to the proceeding objected to the granting of the partial increase generally on the bases that the Regulatory Lag Plan scheduling was being met, obviating the necessity of such relief, and that any increases granted could prejudice any rate restructuring found necessary as a result of this proceeding or from the action of the California Supreme Court resulting from its review of the July 1977 PGA decision.

In D.89208, dated August 8, 1978, which granted the partial motion we stated that:

> "It is anticipated that the draft of the final decision (based on a 1979 test year) will be forthcoming on the due date of August 9, 1978 within the ten-month period in the above-quoted reference." (Mimeo. page 17.)

* * *

> "It will be noted that we plan to have the final rates for test year 1979 placed into effect by January 1, 1979. This partial increase is being authorized because the record shows that the applicant requires rate relief for 1978, based on the 1978 test year showing, and such relief should not be delayed. If we waited until late 1978 and issued one decision, based on a 1979 test year, the applicant would never realize any of the additional revenues shown to be required during 1978. Granting SoCal interim rate relief in 1978, based on a 1978 test year, provides us time to prepare and issue a final decision (on a 1979 test year) that fully addresses the multitude of complex issues in this proceeding." (Mimeo. page 19.)

III. RATE OF RETURN

General

The United States Supreme Court has broadly defined the revenue requirement of utility companies as being the minimum amount which will enable the company to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed (Federal Power Commission et al. v The Hope Natural Gas Company (1944) 320 US 591, 605; 88 L ed 333, 346), and will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties (Bluefield Waterworks and Improvement Company v West Virginia Public Service Commission (1923) 262 US 679, 692, 693; 67 L ed at 1176). The determination of the sum specific to satisfy those requirements derives from the application of logic and informed judgment to numerous complex and interrelated factors such as the cost of money, capital structure of the utility in question as compared with other similar utilities, interest coverage ratios, return on common equity, price/earnings ratios, and price-book ratios. In California this net revenue requirement is expressed as a percentage return on weighted average depreciated rate base for California jurisdictional operations and is intended to provide sufficient funds to pay interest on the utilities' long-term debt, dividends on its preferred and preference stock, and a predetermined reasonable return on common equity. Complete showings on rate of return were presented by SoCal, the Commission staff, and LA. SoCal and PLS are discussed in portions of this decision as though they were a single entity known as PLU because they essentially operate as a single unit. According to the record the two utilities

would actually merge were it not for PLS debenture bond restrictions. All utility employees work for SoCal. Because of the integrated nature of SoCal and PLS, this Commission has considered their capital structure and financial requirements on a consolidated basis for the purpose of rate of return determination for a number of years.

Position of PLU

An overview of PLU's position relative to the amount of increase required was presented as a policy statement by the chairman of the boards of directors, Harvey A. Proctor. He testified that additional gas supplies adequate for the need of Southern Californians are essential to the economic welfare of the area and that there are no viable alternate sources of energy available. He noted that all prospective new supplies available to southern California, whether from pipeline, conversion of coal to methane, or overseas, as liquefied natural gas (LNG), will require significant capital investments. He stated that at present rates, SoCal's earnings by test year 1979 will be seriously deficient because of increased costs and/or inadequate revenues caused by inflation, decline in gas supply, higher cost of plant additions, increased business risk, inadequate return, and expanded energy conservation and research and development projects.

He outlined in detail the increased costs resulting from the necessity of expanding storage facilities, the amortization of unused distribution facilities and depreciation accruals on transmission lines on a volume basis, the effects of inflation and the ever-growing complexity of extensive and expensive rules and regulations imposed by governmental agencies.

Mr. Proctor further testified that failure to keep the PLU financially healthy will most certainly lead to erosion of both the amount and quality of gas service available to southern Californians which, in turn, will lead to a crippling of our economy or the need to substitute more costly or polluting forms of energy. He stated that the last authorized rate of return of 8.8 percent with a return on equity of 12 percent was obviously inadequate as evidenced by the derating of SoCal's bonds and the sale of PLC stock at a price less than 80 percent of its book value. Furthermore, if PLU is not allowed rates of return at a level that will produce sufficient equity earnings, then capital for new gas supplies cannot be raised on reasonable terms and these projects may not be completed. According to the testimony, Mr. Proctor chose the requested 15 percent return on equity after a number of discussions with PLU executives, and a review and analysis of a variety of statistical and factual information.

Mr. Proctor further testified that this rate increase application is probably the most important single rate case in which he has been involved, not only because of the magnitude of the requested increase, but because, in his opinion, we are at a crossroad in California and up against a go or no-go situation with respect to various gas supply projects.

SoCal's basic presentation on its required revenue increase, expressed as a test year 1979 requested rate of return of 10.20 percent with a 15 percent return on equity to provide a times interest coverage of 2.54 after taxes, was made by John C. Abram, senior vice president and director of SoCal and director of PLS.

Mr. Abram assumed 1979 test year financing of $40 million debt at 9 percent interest, unamortized gains on reacquired debt of $700,000, unamortized investment tax credit (ITC) of $3.6 million, and $25 million equity capital. He developed a capital structure consisting of 46.9 percent long-term debt at a cost of 7.64 percent, 5.6 percent short-term debt with an embedded cost of 7.75 percent, 9.3 percent preferred stock at a cost of 5.47 percent, 0.3 percent unamortized gain on reacquired debt at zero cost, and 1.1 percent unamortized ITC and 36.8 percent common equity at a cost of 15 percent.

The 5.47 percent preferred stock cost represents the embedded cost of $21.5 million of SoCal and $110.1 million of PLC outstanding preferred stock with no new issue of preferred stock included in the estimates for test year 1979.

The net gains from the acquisition of long-term debt purchased to meet sinking fund obligations were treated as interest-free capital as ordered by D.86595 dated November 2, 1976 in SoCal's A.55345 for a general rate increase.

According to the testimony unamortized ITC is being included as a capital item earning at an equity rate upon the advice of SoCal tax experts' analyses of current Internal Revenue Service (IRS) requirements.

Inasmuch as most of the cost of bonds and preferred stock, fixed by the terms of the offering, are already a matter of record, controversy on an appropriate allowable rate of return centers about the appropriate return on common equity that should be permitted.

Mr. Abram testified that in arriving at his recommendation for a 15 percent return on common equity, he looked at economic factors within SoCal's service area, the general economy, the demands for capital as related to total demands as well as the

Pacific Lighting group, the current and historic return expectations of the capital markets, and factors specific to PLU such as gas supply, cost increases, comparative operations, competition, service areas, size, regulatory environment, and quality of service.

The statistical comparisons and data supporting Mr. Abrams' recommendations are set forth in tabulations and charts in Exhibit 12-A for 1978 and Exhibit 12-B for 1979. These tabulations encompass capital structure and cost factors; sources of financing; comparative data for 60 utilities including 15 natural gas distribution utilities, 15 integrated natural gas systems, 15 electric utilities, and 15 western energy utilities; and a risk differential analysis of PLU. We believe the salient points emphasized in the tabulations and charts are as follows:

1. PLS' debentures display a generally strong "A" rating as contrasted to SoCal's bonds, which show a weak "A" rating.

2. Tabulations show that the market price to book value ratios and percent institutional holdings of common stock are less for PLU than other utilities indicating the financial community's evaluation of its greater financial risk is being reflected both in the market price and the actions of the more sophisticated investors.

3. PLU's debt security issues reflect the assignment of high risk as evidenced by such conditions of issue as the relatively short-term maturity of the issue and the relatively greater length of refund protection required.

4. The authorized equity returns for the 60 comparative utilities range from a low of 11.6 percent to a high of 17.2 percent.

5. The median earnings on equity at year-end 1976 experienced by 1,100 of the county's largest companies with whom PLU must compete for the investment dollar were 14.3 percent.

6. A linear regression of 1974-1976 average return on common equity and average market-to-book ratios and a multiple regression of the current year recorded return on equity related to market-to-book ratio with a lagged variable of market to book indicated if PLU earned a 15 percent return on equity over a sustained period of time, its market-to-book ratio would reach 1.1 approximately two years after it began earning the 15 percent return on equity.

7. PLU displays greater financial risk than other natural gas utilities because it is more heavily dependent upon capital from external sources.

Position of Commission Staff

The staff position on the cost of capital and recommended rate of return was presented by Principal Financial Examiner Russell J. Leonard. Mr. Leonard's prepared testimony discussed his accompanying exhibit containing 28 tables pertaining to interest rates, debt costs, earnings, capital structure, financing and other data regarding growth in net plant investment, revenues, expenses, and customers. His recommended rate of return is 9.40 percent which would provide a return on common equity on his assumed capital structure of 12.68 percent and a times interest coverage of 2.45.

He testified that such a times interest coverage should be adequate to maintain SoCal's present "A" rating for bonds, particularly when additional income from other sources is considered. He stated, however, that he did not believe that rate of return should be determined by the interest coverage allegedly required to sustain bond ratings.

Mr. Leonard utilized the averages of ten gas utilities, ten electric utilities, and ten combination gas and electric utilities as a comparison for PLU's times long-term debt interest

earned, average common equity ratios, earnings rate on average common equity, dividend payout ratios, earnings rate on average total capital, average plant investment, operating revenues and expenses, net operating income, operating ratios, operating revenues to average net plant investment ratios, net operating income to average net plant investment ratios, average number of customers, average net plant investment per customer, operating revenues and expenses per customer, and net operating revenues per customer. In addition, he presented tabulations of prime interest and discount rates, trends in interest rates, yields on public utility bonds, PLU's effective dividend rate, common stock book values, dividends and earnings, PLU's financing and capital structure, and recommended rate of return data. These tabulations, according to the record, served as additional guides in determining his judgmental recommendation on the appropriate rate of return.

Mr. Leonard testified that the 30 comparison companies are large regulated public utilities having business and financial risks similar to those of PLU as contrasted to industrial enterprises which generally have greater portions of equity in their capital structure and operate in a world of intense competition with earnings subject to broad fluctuations. He stated under cross-examination that within reasonable ranges utilities subject to similar business risks should have similar returns on equity. The record shows that the range of authorized return on equity for combination gas and electric companies was from 12.75 to 14.1 percent (13.2 percent average), for electric utilities the range was from 12.63 to 14.3 percent (13.6 percent average), and for gas utilities the range was from 12.6 to 14.5 percent (13.4 percent average). For these 30 utilities the average percent common equity as related to the capital structure was 35.31 percent for combination gas and electric utilities, 32.51 percent for electric

utilities, and 39.39 percent for gas utilities as compared to PLU's percent common equity as adopted by Mr. Leonard of 39.60 percent.

Mr. Leonard testified under cross-examination that had he included short-term debt in his times-interest coverage, it would reduce the stated five-year average from 2.57 to 2.4 times. Mr. Leonard excluded the short-term debt from the times-interest coverage computation because on the PLC system interest on advances from associated companies is classified as payables to associated companies rather than debt.

Mr. Leonard further testified that, in general, the higher the percent of equity in the capital structure the lower the allowable return on equity, and that it was to a utility's benefit to firm up its equity position even if it has to sell stock below book value to do so; that a 12.68 percent allowance on equity applied to PLU's adopted capital structure would provide a 9.33 percent rate of return as compared to 9.40 percent on the staff's adopted capital structure; and that unamortized gains in reacquired debt should be included in the calculation of the overall cost of debt.

Position of LA

LA's position on recommended rate of return was presented by Senior Public Utilities Engineer Manuel Kroman. For the test year 1979, he recommends an overall rate of return of 9.40 percent with an allowance of 13.04 percent on common equity and a times interest coverage of 2.33. Mr. Kroman testified that in arriving at his recommended rate of return he considered the relationship of comparative data presented in SoCal's last general rate increase application to similar data presented in this proceeding; the change in outstanding capital stock and debt between 1973 and 1976 for the group of 15 western energy utilities utilized in SoCal's exhibits; Moody's bond ratings and times charges earned after income taxes for "A" and "Aa" rated utility bonds; percentage

income represented by allowance for funds used during construction for 15 straight electric and 15 western energy utilities; recorded return on average common equity for 15 gas distribution companies, 15 straight electric companies, 15 western energy companies, Moody's 24 utilities, Dow Jones 15 utilities, and privately owned Class A and B electric utilities; the recorded return on common equity relative to market-to-book ratios for 83 utilities, ratio of market price to book value for Dow Jones 30 industrials, Moody's 24 utilities, 15 western energy utilities and Dow Jones 15 utilities; and the indicated relationship between return on common equity and ratio of market price to book value.

Mr. Kroman further testified that except for a risk differential analysis, SoCal's evidence on rate of return is largely an updating of the material presented by SoCal's witness Jensen in A.55345 in which SoCal had also requested a 15 percent return on equity. According to the record, the comparative data indicate that interest rates have fallen dramatically, the rate of inflation has moderated significantly, PLU's experienced return on equity has improved, comparative earnings of other utilities have deteriorated, and PLC's market-to-book ratio has improved. Under these circumstances, Mr. Kroman concludes that the updated version of material fails to even a greater extent to justify a 15 percent return on common equity than the 1975 proceeding.

Other factors emphasized by Mr. Kroman's testimony are as follows:

1. For the 15 western energy utilities the average increase in outstanding capital stock between year-end 1973 and year-end 1976 was 50.5 percent as compared to PLU's increase of 29.1 percent.

2. SoCal's times interest coverage of debt compares favorably with the median of 2.56 times for "Aa" utilities and 2.36 times for "A" utilities.

3. Adjusted to a 37.5 percent equity ratio the return on common equity experienced by domestic energy utilities over a representative time period ranged from 11 to 12 percent.

In its brief, LA notes that Finding 11 of D.88835 dated May 16, 1978 in C.10261, our investigation into a natural gas supply adjustment mechanism (SAM), states that the reduction in risk to utility shareholders caused by SAM should be considered by us in setting a rate of return in a rate proceeding. As a result, LA recommends a rate of return of 7.90 percent, a reduction of 1.5 percent from the originally recommended 9.4 percent rate of return, to reflect this decreased risk.

Position of SD

SD presented no direct evidence on recommended rate of return. However, in its brief, SD concludes that SoCal should be granted a rate increase which will enable it to earn a rate of return of something less than 9.40 percent. The "something less", according to SD, should be determined by this Commission's assessment of the reduction of risk caused by the above-cited SAM decision.

Discussion

SoCal's capital structures at the end of the 1979 test year as estimated by SoCal and the Commission staff are as follows:

	Applicant's Estimated Capital December 31, 1979				Staff's Estimated Capital December 31, 1979			
Item	Amount	Ratio	Cost	Weighted	Amount	Ratio	Cost	Weighted
LT Debt	$ 663,800	46.90%	7.64%	3.58%	$ 663,825	50.41%	7.62%	3.84%
ST Debt	80,000	5.60	7.75	.43	-	-	-	-
Pfd Stock	131,600	9.30	5.47	.51	131,600	9.99	5.47	.54
Unam. Gain	4,400	.30	-	-	-	-	-	-
Unam. ITC	15,000	1.10	15.00	.16	-	-	-	-
Com. Equity	521,400	36.80	15.00	5.52	521,400	39.60	12.68	5.02
Total	$1,416,200	100.00%		10.20%	$1,316,825	100.00%		9.40%

It will be noted from the above tabulation that the differences between SoCal's and the staff's capital structure relate to the inclusion in SoCal's estimates of short-term debt, unamortized gain on reacquired debt, and unamortized ITC and a lesser embedded cost of debt used by the staff.

By D.89578 dated October 31, 1978 in Cases Nos. 4230 and 6998, our investigations relating to the adoption of revised uniform systems of account, we concluded that Federal Energy Regulatory Commission (FERC) Orders Nos. 561 and 561A should be adopted. Such rules prescribe a formula for determining the maximum allowance for funds used during construction (AFUDC) rate. The inclusion of short-term debt in determining the allowed rate of return, coupled with the FERC formula for computing AFUDC, would result in a double counting of short-term debt. To avoid such a double counting, we will exclude the short-term debt from the cost of capital computations.

Another factor differentiating the staff-adopted capital structure is the treatment of unamortized gain on reacquired debt. Both LA and PLU include unamortized gain as interest-free capital to be amortized over the remaining life of individual bond issues affected by sinking fund retirements as set forth in D.86595 dated November 2, 1976 on SoCal's A.55345 for a general rate increase. The staff, however, added the unamortized gains of $4.4 million to the net proceeds of outstanding bonds to derive an embedded cost of long-term debt of 7.62 percent.

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In D.86595, relative to the treatment of unamortized gain on reacquired debt, we stated: "...there is no basis for continuing to consider these gains as nonoperating income." (Mimeo. page 95.) It will be noted that the staff's treatment of this item excludes the gains from nonoperating income and thereby complies with the intent, if not the letter, of the decision. Further, the staff's methodology conforms with general instruction 17(B) of the Uniform System of Accounts. Under these circumstances we will adopt the staff's methodology.

Mr. Abram testified that unamortized ITC is included in SoCal's capital structure at the same cost as the return on common equity upon the advice of SoCal's tax experts. Their analyses of current IRS requirements indicated that, in their opinion, if unamortized ITC were not so included in the capital structure, SoCal could lose its eligibility for the additional 6 percent ITC authorized by the Tax Reduction Act of 1975.

We addressed this matter in D.87828 dated September 7, 1977 in Edison's A.54946. Finding 5 in that decision states:

> "5. The inclusion of unamortized ITC as equity capital is required only for regulatory agencies that utilize capital structure in deriving rate base and not for regulatory agencies, such as this Commission, that derive rate base from the weighted average depreciated plant balances." (Mimeo page 18.)

The California Supreme Court denied Edison's Petition for Writ of Review S.F. No. 23723, June 22, 1978. Edison filed an appeal with the United States Supreme Court which was denied December 11, 1978. (Docket No. 78-646.)

We note in passing that the loss of eligibility for the additional 6 percent investment credit is contingent on the utilization of the unamortized ITC to directly or indirectly reduce rate base. In this proceeding SoCal's senior vice president responded to an examination question to the effect that the unamortized ITC was invested in utility plant with a corresponding increase

in rate base. It is axiomatic that if unamortized ITC is utilized to increase rate base, its exclusion from the capital structure cannot be construed as being a rate base reduction. Consequently, the unamortized ITC will be excluded from our adopted capital structure. In determining a reasonable return for SoCal we have considered the risk reduction effect of funds available to SoCal resulting from additional ITC benefits accruing as a result of its election of Option 2 (ratable flow-through for the additional 6 percent).

SoCal is requesting a 15 percent return on equity as contrasted with the recommended return on equity of the Commission staff of 12.68 percent and of LA of 13.04 percent. LA contends that when consideration is given the differences in equity ratios between the staff and LA's capital structure, the recommended return on equity of the staff and SoCal are virtually identical.

SoCal argues that its recommended rate of return on equity of 15 percent is the only one that adequately compensates investors for the financial and operating risks that confront PLU on the following bases:

1. The requested 15 percent return on equity is within the range of returns on equity authorized other comparable public utilities.

2. The results of three independent statistical analyses indicate that were PLU to earn a 15 percent return on equity on a consistent basis, PLC's common stock would be expected to sell at or very slightly above book value approximately two years after such return was being earned.

3. The staff's recommended return on equity (12.68 percent) is wholly inadequate and does not even equal the 13.4 percent average for the ten gas distribution utility group used by the staff for comparison purposes. Such a return on equity recommendation, according to SoCal, contrasts with the staff witness' philosophy that utilities that have substantially similar business and financial risks ought to have similar returns on equity.

4. Although the staff witness agreed that greater risks require higher returns, he failed to give any consideration to gas supply risks or the special problems facing PLU.

5. The effect of the staff witness' recommended rate of return on the price of PLC common stock was not considered.

6. The staff's recommended return on equity is insufficient to attract necessary debt and equity financing on reasonable terms.

7. Although LA recognizes the risks inherent in PLU's operations, LA's witness fails to recommend return on equity sufficient to compensate for such risks.

8. Regression analyses developed in LA's exhibit and testimony, other than the one by SoCal duplicated in that exhibit, are so low in correlation as to be completely unreliable.

9. The recommended 15 percent return on equity provides a balance between the interest of ratepayers and stockholders by neither enriching nor impoverishing either party.

10. The vigor, imagination, and results of SoCal's conservation programs are second to none and deserve favorable consideration in rate of return.

11. This Commission's D.88835 dated May 16, 1978 in C.10261 (SAM) has helped to eliminate the short-term risk of supply forecasting but cannot eradicate the long-term risk of declining supplies.

The Commission staff argues that its recommended 9.40 percent rate of return and 12.68 percent return on common equity for the test year 1979 will be sufficient to allow the company to earn a reasonable return for its investors and insure confidence in its financial soundness while charging its consumers equitable rates on the following bases:

1. SoCal's expressed concern that the past relatively low return on common equity discourages investors and hampers its ability to market its securities or otherwise raise money in

the market place is contradicted by (a) its witness' response to cross-examination indicating that PLU has always been able to sell securities at competitive prices while earning well below the 15 percent level presently requested; and (b) a statement appearing in PLC's 1977 annual report indicating that the year 1977 was a good one because of improved earnings, the greater availability of gas than expected, and some signs of improved regulatory climate in California.

2. SoCal's determination of the necessity of a 15 percent return on equity relied heavily on market price of stock as a major consideration and this has never been generally accepted as a valid indication of a fair return on equity.

3. This Commission's adoption of the Regulatory Lag Plan will lessen SoCal's risk of doing business and improve its status in the financial community.

4. The adoption of SAM will reduce the risk to SoCal's shareholders and should be considered by this Commission in setting a reasonable return on equity in this proceeding.

5. The return on equity for industrial enterprises should not be considered in arriving at a return on equity for a utility company, as was done by SoCal, because it has long been established that industrial companies are in the high risk sector of the economy, whereas utility companies are a less risky investment requiring a lower return on equity.

LA argues that the requested 15 percent return on equity is excessive and that its recommended return on equity of 13.04 percent should be adopted on the following bases:

1. SoCal's rate of return evidence consists largely of an updating of studies presented by SoCal in its last general rate proceeding where a 15 percent return on equity was also requested.

The evidence in that proceeding supported only a 12 percent return on equity and the evidence in this proceeding is even less persuasive because of lower interest rates, the moderation of the rate of inflation, the improvement in the experienced return on equity, the deterioration of the comparative earnings of other utilities, and the improvement in PLC's market-to-book ratio.

2. LA's rate of return evidence clearly shows that a broad spectrum of energy utilities are earning in the 11 to 12 percent range of return on equity after making adjustments to reflect differences in capital structure.

3. SoCal's risk differential analysis which attempts to correlate PLC's market-to-book ratios with differences between PLU's authorized return on equity, less 10-year moving averages of Moody's "Aa" public utility distributed bond yields, is shown to be entirely without merit.

4. The recommended 13.04 percent return on equity provides a generous increase from the 12 percent return on equity authorized in the last general rate proceeding.

5. The after-tax coverage of LA's recommended rate of return equates to 2.33 times for 1975 as compared to "A" rated energy utilities typically covering their interest charges by only 2.18 to 2.36 times after taxes.

6. The adoption of SAM, as this Commission stated, reduces the risk to utility shareholders and should be considered in setting a reasonable rate of return in rate proceedings. LA recommends a reduction in rate of return of 1.5 percent to compensate for this reduction in business risk.

After careful consideration of the evidence of record on rate of return in this proceeding and the arguments advanced by the various parties to the proceeding, we adopt as reasonable a return on equity of 13.49 percent which, applied to our capital

structure and costs, translates to a rate of return of 9.73 percent developed as follows:

Item	Adopted Capital Structure		
	Capital Ratio	Cost Factor	Weighted Costs
Long-Term Debt	50.41%	7.62%	3.84%
Preferred Stock	9.99	5.47	0.55
Common Equity	39.60	13.49	5.34
Total	100.00%	-	9.73%

This return on capital is the minimum needed to attract capital as a reasonable cost and not impair the credit of SoCal. This rate of return will provide an approximate times interest coverage after income taxes of 2.53 times and an interest plus preferred dividend coverage of 2.22 times. Relating this 9.73 percent rate of return to our subsequently discussed adopted summary of earnings of SoCal's operations results in a gross revenue increase requirement of approximately $201,500,000 over rates existing prior to D.89208 (which granted a partial general increase).

The 13.49 percent rate on equity authorized herein is made with recognition that the next test year we will use to set rates for SoCal will be 1981. We realize, from this evidentiary record, that costs will tend to increase generally, as will the utility's embedded cost of debt. If we were to consider a test year earlier than 1981 for SoCal's next general rate proceeding, we would authorize a lower return on equity. Accordingly, we are authorizing the rates herein (through adoption of a results of operation and return on rate base) conditional upon employing 1981 as the next earliest test year for establishing SoCal's base rates (and issuing a rate decision prior to the beginning of such test year).

Our purpose for expressly and conditionally setting SoCal's rates to have a minimum two-year rate life should be obvious. This Commission is not staffed to process rate applications for all the major utilities annually. This was true when the Regulatory Lag Plan was adopted, and the recent hiring freeze and budget reductions have contributed and will further contribute significantly to our staffing problems. In order to process rate increase applications within the time frame of the lag plan, and have new rates in effect at the start of the test year, we simply cannot have every major utility before us annually. It is therefore appropriate and in the public interest (for both ratepayers and utilities) to establish and announce ground rules, and set rates so that major utilities can reasonably go at least two years without general rate relief.

Employing 1981 as the next earliest test year for establishing SoCal's rates will not be a hardship on the utility. Gas expense, which is potentially the most volatile expense item, is covered under the PGA procedure (guaranteeing recovery of reasonable incurred gas expense). The Commission's Regulatory Lag Plan established July 6, 1977 by Resolution No. A-4693 has reduced delay when applications are processed, enabling new rates to go into effect at the start of the test year. We have adopted an SAM to insure that swings in sales volume between general rate decisions do not cause an erosion in earnings. Although SAM does not guarantee a gas utility will realize its authorized rate of return, it minimizes the impact of the most volatile contingencies facing a gas utility, gas supply available for sale, and less use per customer due to conservation efforts.

The factors that may operate between general rate proceedings in such a manner as to preclude SoCal's realizing its authorized return on equity are expenditures subject to its management's review and discretion. The innovative ratemaking procedures we have adopted, and continue to explore, have clearly paved the way to going a minimum of two years between general rate increases.

We note that the financial community has for some time either not recommended the purchase of California utility stocks, such as PLC's, or has been relatively apathetic toward such stocks, alleging that California has an unfavorable regulatory climate. It is said that the reputed unfavorable regulatory climate causes California utility stocks to sell below book value. This decision authorizes rates that provide SoCal the opportunity to realize high quality earnings and increases the return on equity by 1.49 points. We will follow with interest the reaction of the financial community and the price of SoCal's common stock.

IV. CONSOLIDATED TAX RETURN ISSUE

Background

Internal Revenue Code Sections 1501 et seq. permit an affiliated group of corporations, consisting of a parent corporation and its 80 percent or more owned domestic subsidiaries, to file a consolidated federal income tax return. According to the record, PLC first elected to file a consolidated return in 1954 when the affiliated groups consisted of PLC, PLS, Southern Counties Gas Company of California, and SoCal. The requirements for inclusion in the California-combined report are somewhat different; however, they do follow the concept of the corporation being a member of unitary business.

It is clear from the record that the nonutility-related affiliates were formed and/or acquired during the period when PLC's expansion and growth were at a very modest level with the hopes of improving its financial strength and earnings by having such affiliates' subsidiary companies operate profitably and ultimately provide approximately 25 percent of PLC's net income. Such operations did not materialize as planned due to adverse economic conditions created in a large part by the sharp and extensive rise in the world price of oil. Furthermore, according to the record, this objective was abandoned because of the magnitude of the gas supply financing problem. As a result, additional nonutility affiliates of the PLC family were created and/or acquired solely to assure adequate supplies of gas for utility affiliates to continue future operations.

The present PLC corporate family includes such nonutility subsidiaries as Pacific Indonesia LNG Company, Pacific Alaska LNG Company, Pacific Interstate Transmission Company, Pacific Coal Gasification Company, Western Terminal LNG Company, California LNG Company, and Pacific Lighting Marine Company that are currently involved in proceedings before federal regulatory authorities, primarily the Department of Energy. Also included are such diverse nonutility-related subsidiaries as computer systems, agricultural companies, apartment management, real estate developers, motels, and industrial parks.

One of the Commission staff financial examiners, Mr. L. M. Humphrey, recommended that for ratemaking purposes the income tax allowance be based on effective federal and state income taxes that it is estimated will actually be paid by the consolidated group, i.e., 32.64 percent for federal income taxes and 6 percent for state franchise tax. Rebuttal testimony and exhibits in opposition to this proposal were presented by PLC's controller, Mr. Lloyd A. Levitin, and by Mr. Proctor.

On September 6, 1978 we issued OII 24 instituting an investigation into the method to be used by this Commission to establish the proper level of income tax expense for ratemaking purposes. One of the issues to be considered in this investigation was whether, for purposes of computing estimated test year income tax expense, the impact of nonutility and affiliated entities operations as reflected in consolidated income tax returns should be considered. Consequently, in this proceeding we will compute the income tax for ratemaking purposes as though SoCal were filing a separate return, as we have in past proceedings.

OII 24 is the best forum to fully explore the feasibility and ramifications of changing our ratemaking treatment of federal income tax expense. We are confident, as a review of OII 24 will show, that a more fully developed evidentiary record will result in that proceeding, and we can more thoroughly discharge our obligation to review the ratemaking treatment of income tax expense.

V. CONSERVATION

A. GENERAL

In D.84902 dated September 16, 1975 in Pacific Gas and Electric Company's (PG&E) A.54279, A.54280, and A.54281 for general rate increases we identified conservation as the most important task facing the utilities today and stated our intention to make the vigor, imagination, and effectiveness of a utility's conservation efforts a key question in future rate proceedings and decisions on supply authorizations. One year later, in D.86595 we placed SoCal on notice that we expected a continued expansion of efforts in conservation and stated that in subsequent proceedings a more detailed analysis will be undertaken and SoCal's rate of return will be adjusted upward or downward as the evidence indicates. Expenditures in the amount of $7,244,000 for conservation programs were approved for SoCal in D.86595. Out of this amount $2,500,000 was allowed for conservation advertising. In this proceeding SoCal presented testimony indicating that it required $24,632,210 for its voluntary load reduction program (VLRP) for the test year 1979. As $7,163,000 has previously been authorized by D.86595, the SoCal witness testified that an additional $17,469,210 is necessary for it to implement its 1979 test year conservation programs.

B. POSITIONS OF PARTIES

Position of SoCal

Testimony was presented on behalf of SoCal by its vice president of consumer services, Patrick R. Shea. He testified that SoCal's continuing objective is to significantly reduce the consumption of natural gas through a sensible cost-effective and achievable VLRP. He stated that SoCal's past conservation efforts have been successful as indicated by (a) surpassing its 1976 conservation goal of a 3.5 percent reduction in natural gas consumption with an annual savings of 3.8 percent or 165,994 M-therms; (b) being an industry leader in developing viable and effective conservation programs (SoCal conducted its first energy conservation seminar in 1972); (c) the introduction in 1973 of its CONCERN (Conserve Our Nations Crucial Energy Resource Now) program, which continues today as a valuable aid in promoting conservation in residential, commercial, industrial, and mobile home markets; (d) its program for marketing insulation in 1974; and (e) the implementation in 1975 of its VLRP. According to the testimony, additional conservation activities initiated over the past several years include the direct sale of water flow-reducing devices, water heater insulation blankets, night setback thermostats, weather stripping, solar pool covers, and several special pilotless gas range, furnace, and dryer programs. He stated that to date these conservation efforts have earned SoCal several conservation awards and commendations from such groups as the Federal Energy Administration, the Los Angeles County Board of Supervisors, the Community Redevelopment Agency of Los Angeles, and the Southern California Sales and Marketing Council.

According to this witness' testimony, the increased amount of $17,469,210 for test year 1979 over previously Commission-approved amounts is primarily made up of expenses for

incentive programs which are more costly than the voluntary programs presently being conducted by SoCal. The most significant increase is for existing residential retrofit insulation programs where the goal for the test year 1979 is 150,000 insulated residential attics.

SoCal argues that it made this filing for a rate increase application with full knowledge and belief of tremendous strides in the area of conservation and fully expected rewards in the form of increased rate of return allowances. SoCal notes that its 1976 goal was 16,000 M^2cf of gas to be saved and for that year the actual saving was 16,599 M^2cf. Similarly, for the year 1977 the goal was 19,700 M^2cf and the actual saving was 23,000 M^2cf. The goal for test year 1979 is 35,263 M^2cf, equal to a saving of approximately 7.2 percent.

SoCal notes that the Commission staff is in general agreement with SoCal's proposed conservation programs for test years 1978 and 1979, except in the area of SoCal's proposed conservation advertising budget and proposed expenditures to encourage purchase of pilotless and more efficient appliances.

SoCal argues that the requested $5 million for test year 1979 conservation advertising expense is absolutely necessary if it is to adequately inform people of the various methods, ideas, products, and programs which will assist in accomplishing conservation and thereby achieve its expanded conservation goals. In view of SoCal's proposed increase in its VLRP, which staff witnesses recommend be further expanded, SoCal cannot understand the staff recommendation that $2,123,000 in the proposed conservation advertising budget for the test year 1979 be eliminated. According to the record the staff's witness recommended that this amount be eliminated because the incentives themselves should serve the purpose of inducing additional sales of retrofit insulation and the expansion of advertising efforts is, therefore, not prudent.

SoCal argues that the general advertising in question is not advertising directly in support of the incentive programs, but is basic advertising that provides support for all programs. According to SoCal, the amount eliminated was allocated to incentive programs solely for inclusion in the cost-effectiveness report required to be furnished to the staff and does not reflect amounts to be spent on advertising for specific programs.

The proposed disallowance by the staff witness of pilotless and more efficient appliances because of the July 8, 1978 state law prohibiting the sale of new pilot-burning equipment is, according to SoCal, shortsighted because there is a definite need to convince its customers through advertising to replace their old equipment with new pilotless and energy-efficient gas appliances prior to the time they might normally make such replacements.

SoCal argues that the unparalleled success of its conservation programs warrants an upward adjustment to its rate of return and that, if granted, such an adjustment would demonstrate that this Commission honors its commitments. According to SoCal, such an upward adjustment to its rate of return would encourage all California utilities to aggressively pursue conservation with the same vigor demonstrated by SoCal. SoCal takes issue with staff witness Lucchi's position that he would not make a recommendation for an increased rate of return based on the success of previous conservation programs because he does not believe SoCal's efforts are going to achieve the goals that he envisions should be achieved in the next five years. SoCal notes that the same witness implied that even if SoCal achieved residential customer saturation of 90 percent for insulation, a 100 percent for pilot turnoffs, 80 percent for pilotless ranges, and 83 percent for solar water heating, it might not be enough to warrant an increase in rate of return. SoCal further notes that staff witness Lucchi wants it

to develop "yes" answers for the energy conservation program check list where SoCal had previously marked "no" even though he does not know whether or not the items marked "no" were cost-effective. SoCal further takes issue with the staff's inability to define "vigor and imagination" when these Commission-imposed words could hold the key to an upward or downward adjustment in SoCal's rate of return.

Position of Commission Staff

Testimony and exhibits on conservation were presented on behalf of the Commission staff by one of its supervising utilities engineers, Sesto F. Lucchi, by one of its senior utilities engineers, Iraj R. Farzaneh, by one of its economic research analysts, Marshall B. Enderby, and by Russell Leonard.

The salient recommendations presented by these Commission staff witnesses are as follows:

1. SoCal should be directed to either (a) analyze and describe the impacts of price on gas consumption; (b) evaluate key conservation programs in terms of probability levels using the GUESS simulation model with the Monte Carlo simulation technique;[1] (c) display a sensitivity analysis of the key variables affecting the conservation programs; (d) improve the 10-year cumulative conservation estimates by adding data about the actual effectiveness of SoCal's programs such as commercial and industrial energy audits; or (e) consider using a multiple regression approach to determine the overall impact of conservation programs.

2. SoCal should be required to submit a listing, description, and detailed summary of all its surveys used to help measure the impact of conservation efforts for its next general rate proceeding.

1/ "Monte Carlo" simulation is a method of estimating a parameter by simulation (e.g., estimating the probability that a specific coin will come up heads or tails based on 10,000 flips).

3. SoCal staff should meet with the staffs of other utilities for the purpose of exchanging ideas and information about the measurement efforts of conservation programs including econometric consumer surveys, and other methods.

4. The optimum level of expenditures for conservation programs for test year 1978 is $18,341,100 and for test year 1979 is $21,586,000. The staff's downward adjustment to SoCal's proposed expenditures of $2,538,900 for the test year consists of $223,000 to reflect less activity in improved efficiency appliance promotion where efficient appliances are required by law, a reduction of $339,400 in general advertising for the residential sector, a disallowance of $1,422,000 of general advertising expenses for major incentive programs, a disallowance of $554,500 in the rental major incentive program so as to disallow all but the value of the incentives on this program.

5. Expenses related to the cash incentives and administration of insulation incentive program ($8,972,000 for the test year 1978 and $11,592,700 for test year 1979) be reallocated to insulation programs which comply with D.88551[2/] or any related decisions.

6. SoCal's energy savings goals, efforts, and accomplishments are presently inadequate. The staff recommends that SoCal expand its programs to attain a minimum conservation effect of 30 percent based on year 1978 gas sales in five years with the exception of solar water heating which should reach its potential within 10 years.

7. The staff-prepared check list should be reviewed for additional ideas and programs that would effectively result in increased gas conservation.

2/ D.88551 dated March 21, 1978 on C.10032 our investigation into the implementation of home insulation programs.

8. No positive or negative adjustment to SoCal's rate of return is appropriate at this time. However, if SoCal fails to expand its conservation goals and achievements in the near future, a reduction in rate of return would be recommended by the staff in the next general rate proceeding. Staff witness Leonard recommended that any future rate of return adjustment for conservation be confined within a range of one-half of one percent.

9. SoCal should coordinate planning of its solar information program and activities with the staff of ERCDC.

10. SoCal's reports on its measurement efforts and its efforts to develop measurement techniques are inadequate.

11. Variables utilized by SoCal in multiple regression analysis to forecast firm gas requirements fail to fall within the limits of statistical significance.

12. SoCal should revise its billing format to provide its customers with the opportunity to measure the effectiveness of their conservation efforts. The staff provided SoCal with a sample of its proposed bill and a list of items to be included in the billing format.

Position of ERCDC

Testimony and exhibits were presented on behalf of ERCDC by one of its energy analysts, John P. Keane. Mr. Keane testified that it is the policy of ERCDC that utility companies should undertake all conservation efforts that are at least as cost-effective as supplying energy from new sources and that such companies should promote energy conservation measures with at least as much vigor as they have in the past promoted energy sales growth. This witness further testified that ERCDC recommends that this Commission direct SoCal to institute appropriate monitoring and evaluation mechanisms in all of its programs if they do not already exist and to carefully assess the operating expense levels for proposed programs that lack sufficient information from which to make an informed subjective evaluation as to their potential cost-effectiveness.

ERCDC supports the CPUC staff's recommended budget adjustment to eliminate advertising support for conservation programs required by law, but encourages SoCal to pursue programs which attempt to influence its customers to sell, purchase, or install gas appliances and devices whose efficiency is above that of the statutory mandate. According to the record ERCDC recognizes the need for a coordinated consumer information program on the availability of solar energy alternatives to avoid potential duplication of effort and wasteful expenditures of public and ratepayer funds. ERCDC maintains that a certain amount of advertising is required to inform the public of specific energy conservation options. Such advertising can be in the form of radio and television spots, billboards and road signs, advertisements in newspapers and magazines, and bill inserts with positive action response envelopes. According to ERCDC the proper mix of the various advertising options available to produce a desired level of awareness and motivation of the targeted audience must be arrived at through careful employment of numerous marketing research techniques that currently exist. ERCDC recommends that SoCal be required to measure the effectiveness of its advertising programs and its experimental techniques and clearly and completely document these effectiveness measures in its annual conservation program reports due March 31 of each year. In its briefs ERCDC states that the record indicates the need for definition of a standard of vigor, imagination, and effectiveness of a utility's conservation efforts so that SoCal will clearly understand this Commission's expectations and so that all concerned can measure SoCal's response to these expectations. ERCDC notes that throughout this proceeding SoCal has professed an uncertainty as to the Commission's expectations. ERCDC submits that the proper foundational standard is the goal of effecting as much cost-effective conservation as is

feasible. It advocates that SoCal bear the specific burden of proving in all future rate application proceedings that each of its nonexperimental programs is capturing all cost-effective savings feasible.

ERCDC notes that this Commission's definition of worthwhile conservation programs relate to the comparison of its costs to the alternative costs of new supplies, but that the specific cost of such alternative supplies is conspicuously absent from the evidence presented by SoCal and the Commission staff.

EECDC notes that a rehearing has been granted on a portion of D.88551 and expresses concern that expenses required by D.88551 will divert funds from SoCal's other conservation programs. Consequently, ERCDC recommends that SoCal's insulation programs (except for reallocation of rental market insulation program funds) be funded as proposed to insure the operation of an insulation program while simultaneously providing funds should D.88551 be reaffirmed.

ERCDC concurs with the Commission staff that SoCal's advertising program should not be greatly expanded until the measurement evaluation techniques are substantially improved and reliable information on such programs is available and indicates its belief that the $1,422,000 which the Commission staff recommends be cut from the general advertising of major incentive programs be applied instead to expansion of existing programs or for the development of new cost-effective programs.

Position of SD

In its brief SD states that it is not difficult to understand why SoCal wants to spend huge sums of money on conservation programs because they can recover these expenses from the ratepayers and if some of these programs prove to be effective, they may be able to get an increased rate of return. SD suggests that under these circumstances the ratepayer is required to pay for all these

conservation programs and if a program has some success, in addition to paying for the conservation programs, he will be asked to pay higher rates in the form of an increased rate of return to the utility. SD notes that so-called "conservation" of natural gas is not conservation in a normal sense but simply a reallocation of gas from one customer to another.

Position of LA

LA asserts that the costs associated with implementing the conservation programs must be cost-justified and should not impose an unnecessary financial burden on the ratepayer. LA alleges that absent adequate financial justification and a reasonable vehicle for evaluating the successes of the VLRP, money will be squandered.

LA argues that a fatal defect of the VLRP is the absence of adequate information to justify the expense to the ratepayer and cites several examples contained in the record wherein precise annual estimated expenditures are set forth to justify estimated savings that cannot precisely be measured by SoCal and are described as "general contribution to savings". LA notes that SoCal and its stockholders additionally benefit from the VLRP because the corporate image of SoCal is greatly enhanced by the conservation advertising and all of the public contacts associated with the VLRP. LA argues that the Commission has historically disallowed expenses geared toward enhancing the corporate image of utilities and feels that the fact that the expenses are now clothed in the hallowed aura of conservation does not mean they should be condoned.

Position of LB

Included in the testimony of LB's witness Cullum was a detailed outline of conservation programs LB has filed in concert with SoCal and SDG&E in recent years. He noted that these programs include informational mailing, school educational programs, and community information seminars with special instructional programs

for senior citizens and other low income groups on utility conservation. He further testified that LB, recognizing the need for the conservation of a dwindling natural resource, revised its rate schedules to eliminate declining rate blocks thereby encouraging conservation by all customers. LB takes issue with staff witness Lucchi's proposal that wholesale customers of SoCal be required to implement a program necessary to conserve an equal percentage of natural gas with that of SoCal. LB contends that should the Commission adopt Mr. Lucchi's proposal it will result in a substantial increase in conservation expenses by wholesale customers, including Long Beach. LB further alleges that spreading of SoCal's conservation costs to wholesale customers would be tantamount to requiring the customers of LB and SDG&E to, in effect, pay for its conservation efforts.

Position of Edison

In its brief, Edison urges that allocated costs of service should serve as a starting point for the establishment of rates for all customer classes. According to Edison, to do otherwise would permit certain of these classes to continue to be lulled into inaction by their ability to purchase natural gas at unrealistically low prices which would, according to Edison, clearly be at odds with the conservation objectives urged by this Commission.

C. DISCUSSION

The component parts of the conservation issue that surfaced during the proceedings were:

1. What is conservation?
2. What constitutes vigor and imagination?
3. The appropriate level of funding SoCal's conservation efforts.
4. SoCal's conservation goals.

5. Measurement of cost-effectiveness.
6. Report card billing.
7. Effect of conservation activity on authorizing a reasonable rate of return.

Conservation Defined

Mr. Enderby of the Commission staff defines conservation as "the reduction in wasteful natural gas usage" or "the reduction in overall natural gas usage". In general, these definitions are acceptable to most parties in this proceeding. However, several parties note that the gas not consumed by the high priority users through the conservation efforts is actually burned by low priority users and, therefore, in their opinion is not conservation but rather a transfer of natural gas from one priority customer class to another priority customer class. It should be noted, however, that the gas burned by the low priority user as a result of savings of the high priority user generally displaces alternate forms of fossil fuels with a resulting overall savings in the burning of fossil fuels. Therefore, the reduction in natural gas consumption by the high priority consumer accomplished through the conservation efforts is true conservation in spite of the fact that the gas saved could be utilized by low priority customers.

Vigor and Imagination

The "vigor, imagination, and effectiveness of a utility's conservation efforts" is the yardstick we have indicated which should be used to determine a utility's commitment to conservation. From the record it is quite clear that SoCal, the Commission staff, and other parties to the proceeding have widely varying opinions as to what constitutes "vigor, imagination, and effectiveness". SoCal is convinced that it has adequately met these standards in its conservation activities, and is therefore entitled to an upward adjustment in its rate of return. The Commission staff maintains that SoCal's proposed programs are not adequate to achieve the goals the staff believes

should be met and therefore falls short of the yardstick of performance quoted above. The Energy Commission maintains that the degree of "vigor, imagination, and effectiveness" is measured by the degree of implementation of all cost-effective conservation programs.

All three positions have some merit. The establishment of finite parameters delineating precisely our yardstick of utility performance in the conservation field is difficult, if not impossible. Consequently, the utility's conservation efforts must be evaluated on an individual basis. In evaluating the utility's individual efforts, primary consideration will be given to the total amount of cost-effective conservation programs available to the utility and the percentage reduction in sales that will be achieved by the implementation of such conservation programs.

Level of Funding

For the test year 1979 SoCal requests $24,632,210 to implement its conservation program to achieve a reduction of 35,263 M^2cf of gas, a reduction of 7.2 percent.

From the record it is apparent that SoCal and the Commission staff are in agreement as to the proper amount of funding for conservation expense with respect to residential consumer information and commercial and industrial programs and such major incentive programs as residential furnace derating and commercial and industrial incentive programs. Of the $2,538,900 downward adjustment made in SoCal's conservation

programs by the Commission staff, $1,761,400 is related to the proposed conservation advertising budget and $1,422,000 of this latter amount is related to advertising of major incentive programs. The staff witness Farzaneh testified that the incentives themselves should serve as a powerful tool for inducing additional sales of insulation retrofit and, therefore, expansion of advertising efforts and accompanying expenditures is not prudent. This staff witness also made an additional adjustment of 10¢ per residential customer to reflect less advertising activities in the appliance conservation programs and general advertising activities. SoCal argues that with its proposed increase in its VLRP, coupled with the staff's recommendations that the program be expanded even more, it is inconceivable that the staff could recommend a reduction of $1,761,400 for the test year 1978 and $2,123,000 for the test year 1979. SoCal states that the full proposed expenses are absolutely necessary if it is to achieve its expanded conservation goals and inform the people of the various methods, ideas, products, and programs which will assist in accomplishing conservation. SoCal further argues that the general advertising deleted by the staff is not advertising directly in support of programs but is basic advertising that reminds people of the conservation action they can take. According to SoCal such informational advertising is essential to motivate customers to conserve energy by informing them of the reality of potential severity of energy shortages. The insulation incentive program contemplated by SoCal in the record of this proceeding is substantially different from that established by D.88551 in C.10032. D.88925 dated May 31, 1978 granted a limited rehearing for the purpose of receiving evidence and argument on the issue of the reasonableness of this incentive program delineated in Ordering Paragraph 3 of D.88551. Rehearing of D.88551, including the reasonableness of the cash incentives as proposed by SoCal for 1979, was held on October 30 and November 9, 13, and 14, 1978. We have not yet

issued our decision on rehearing granted by D.88928. We will adopt the staff's recommendation for disallowance of the rental major incentive program proposed by SoCal because it was not proven cost-effective, and we will also adopt staff's general advertising adjustment which we will discuss further. We will include $11,592,700 for equivalent incentive programs for the test year 1979.

The staff adjustment of $223,000 in the residential sector to reflect less activity in the area of new, improved efficiency appliance promotion where the improvement is mandated by law and the related reduction for residential advertising of $339,400 appears reasonable and will be adopted.

We have reduced SoCal's proposed $5,046,000 conservation advertising expense level by $2,123,000 and adopted a conservation advertising expense level of $2,923,000 for test year 1979 which we believe is a reasonable level. SoCal should reallocate this advertising to provide maximum support to all conservation programs and should concentrate its efforts toward more direct individual customer contact. SoCal should resort to newspaper, billboard, and media coverage only in instances where prompt action and mass appeals are necessary for proper program implementation. SoCal should avoid using conservation advertising for enhancing its corporate image as pointed out by LA.

The balance of SoCal's conservation expense of $21,777,910 will be included in our adopted summary of earnings with the following precautions to be observed by SoCal.

The adopted conservation expense amount of $21,777,910 includes $11,592,700 for test year 1979 insulation incentive programs. SoCal should apply these funds to implement the insulation incentives program resulting from the rehearings of D.88551 in Case No. 10032. In the event that the planned programs are denied by any determination in Case No. 10032, the $11,592,700 should be applied to other conservation activities with emphasis directed to the installation of hardware devices primarily for residential gas customers. These alternative conservation programs should be developed in cooperation

with the staff of the Energy Conservation Branch and should meet the following criteria:

1. Funds shall only be used on cost-effective programs.
2. The programs should emphasize more direct communication with customers and less media advertising.
3. Program emphasis should be directed to the high priority residential and small commercial gas customers.
4. The programs should emphasize the installation of proven conservation hardware (such as water heater insulation and furnace filter replacement).
5. Expanded residential energy audits activities as defined in the National Energy Act may also be an appropriate candidate program element. If acceptable alternative programs are not developed, that portion of the $11,592,700 that SoCal proposed to apply to such programs should be refunded.

SoCal's Conservation Goals

The Commission staff takes the position that SoCal's conservation objective of a reduction of 35,263 M^2cf, or 7.2 percent, for test year 1979 is inadequate and recommends conservation of 135,107 M^2cf within a five-year period and an additional 43,981 M^2cf solar savings to be achieved within a ten-year period. The residential conservation portion of the staff recommendation to be achieved, totaling 71,044 M^2cf, consists of 32,400 M^2cf for ceiling and wall insulation, 13,150 M^2cf for summer turnoff of furnace pilot lights, 2,765 M^2cf for hot water heater blankets, 3,885 M^2cf for water flow devices, 3,439 M^2cf for cooking, and unspecified savings estimated by SoCal to be 15,405 M^2cf.

The total conservation savings goal recommended by the Commission staff is 30 percent overall based on the year 1978 sales. Such overall savings reflect 38 percent savings in residential sales, 20 percent savings each in commercial and industrial sales, 8 percent in gas engine sales, 20 percent each in large

commercial, industrial, and utility electric sales savings, and 33 percent savings for wholesale sales. According to the record, to achieve the 38 percent residential sales reduction described above, it will be necessary for SoCal to achieve residential customer saturations of 90 percent for ceiling insulation, 100 percent for pilot turnoffs, 80 percent for pilotless ranges within a five-year period, and 83 percent customer saturation for solar water heating within a ten-year period.

ERCDC agrees with the Commission staff that the conservation programs proposed by SoCal are inadequate. It is ERCDC's recommendation that SoCal implement all cost-effective programs but ERCDC does not recommend any specific amount of savings as a total or as a percentage to be achieved by SoCal before an upward adjustment be made to its rate of return.

It is obvious from the record that SoCal has an opportunity to expand its cost-effective conservation programs well beyond what is presently under consideration during this proceeding. The Commission staff's goal of 30 percent savings over a ten-year period can be construed as a very commendable goal. While emphasizing and implementing all cost-effective programs could conceivably result in SoCal approaching a 30 percent overall savings in a five-year or ten-year period, it would appear to be extremely difficult, if not impossible, to achieve the specific customer saturations espoused by the Commission staff. However, the seriousness of the near future gas supply shortage problem as pointed out in the staff's Exhibit No. 76, showing an average annual decline of 6.1 percent, further reinforces the need for conservation goals. Therefore, while we will accept SoCal's 1979 goal of 7.2 percent, we will require SoCal to continue to expand its conservation activities to move toward a level commensurate with the staff goals. We will also require SoCal to institute adequate evaluation programs so that we can adequately monitor the effectiveness of SoCal's efforts to achieve further conservation.

We will use this data to measure SoCal's conservation program progress against staff's revised goals for subsequent years in the utility's next general rate proceeding.

Cost-effectiveness Measurement

SoCal's measurement and evaluation techniques were subject to criticism on the record by ERCDC's witness Keane who testified that SoCal's showing failed to include sufficient information to adequately evaluate its programs, by staff witness Lucchi who testified that the staff believes more progress is needed in this area of program measurement, by staff witness Farzaneh who testified that SoCal's residential consumer information programs needed evaluation to assure that expenditures for each program benefit the ratepayer, and by staff witness Enderby who testified that he was not completely satisfied with the accuracy of the existing estimates set forth by SoCal.

In its brief ERCDC recommended two proposed ordering paragraphs that provide:

"1. In all future rate applications SoCal shall identify the cost of gas saved by its conservation programs.

"2. SoCal shall improve its measurement and evaluation of conservation program savings and shall present more complete and creditable evidence of program impacts in all future conservation reports to this Commission and in all future rate applications."

Similarly, in Appendix A attached to the staff's brief the staff set forth quantitative measurement recommendations which were extracted from the "Report on the Quantitative Measurement of Southern California Gas Company's Conservation Programs Test Years 1978 and 1979", presented into evidence by staff witness Enderby.

We are persuaded that SoCal's present methodology and programs for evaluating the effectiveness of its conservation programs are inadequate and the ordering paragraphs herein will detail specific measures for quantitative measurement of SoCal's conservation programs.

Report Card Billing

We concur with the recommendation of the staff that SoCal's billing format should be revised to inform the public of the need for individual energy conservation effort. The existing format of the bills is inadequate to the extent that it does not explain rate design innovations that are adopted by the Commission to encourage conservation. The bill format should be revised to give more information to the public in order that customers may react to inverted type rate designs as well as monitor their individual conservation activities.

Rate of Return Adjustment

SoCal argues that because of the unparalleled success of its conservation programs an upward adjustment to its rate of return would demonstrate that this Commission honors its commitments and further that such adjustment would give encouragement to all California utilities to aggressively pursue conservation with the same vigor demonstrated by SoCal.

The staff argues that SoCal's energy savings goals and accomplishments are presently inadequate as measured against programs designed to attain a minimum conservation effect of 30 percent based on the 1978 gas sales as recommended by the staff. In response to SoCal counsel's allegations that the staff has not developed standards by which SoCal can have its rate of return adjusted upward due to its conservation programs, the staff argues it is the utility's responsibility to determine through its own studies and review processes and discussions with the Energy Conservation Team the effectiveness and adequacy of its conservation goals.

ERCDC argues that SoCal's proof of full implementation of all cost-effective conservation programs should be a measure determinant in whether or not a rate of return adjustment is warranted.

The yardstick for the measurement of whether or not a rate of return adjustment is warranted is the "vigor, imagination, and effectiveness" of the utility's conservation efforts.[3/] Because of the present lack of the means to accurately evaluate the effectiveness of SoCal's conservation efforts, we are not in a position at this time to adjust its rate of return either upward or downward to reflect its conservation efforts. The data to be obtained as a result of this decision will hopefully enable us to make such an adjustment, if warranted, in the next general rate case.

3/ The National Energy Conservation Policy Act (Act) calls for each regulated utility to develop a conservation program in compliance with a state plan (to be prepared within guidelines developed by The Department of Energy (DOE)). The Act instructs DOE to allow ongoing conservation programs to continue. It will be necessary, however, for those programs to later comply with the procedures introduced through the state plan, and (where supplying, installation, or financing of conservation measures is involved) avoid unfair marketing practices, and anticompetitive activities.

It may be a year or more before utility conservation programs in compliance with the Act are submitted. In the interim period the need to move forward with vigorous conservation activities remains. SoCal should therefore continue to develop its programs, assuming that the ongoing conservation programs will be allowed to continue, being aware of the possible limitations and additional mandate activities implicit in the Act. The Commission staff should be consulted to assist SoCal in determining reasonable interim steps to be taken in anticipation of DOE's possible interpretation of any vague portions of the Act.

VI. RESULTS OF OPERATION

General

Comprehensive results of operation data were presented into evidence in this proceeding by SoCal and the Commission staff. Exhibit 96, presented by SoCal's witness R. N. McClure, provides a comparison of SoCal's and the Commission staff's results of operation summaries for the test year 1979 for SoCal and PLS.

The staff's total revenue estimate of operating revenues for PLS exceeds SoCal's estimate by $1,522,000 and is included in SoCal's and the staff's estimates of SoCal's production expenses.

The significant differences between SoCal's and the Commission staff's estimates for SoCal's 1979 test year operations are as follows:

1. Revenues - The staff's revenue estimate is $147,252,000 higher than SoCal's with $139,408,000 of the difference relating to higher gas supplies stipulated to by SoCal and the availability of later data to the staff. Of the remaining difference of $7,844,000, $2,210,000 relates to the staff use of a higher heating value for gas sold than SoCal and $4,984,000 relates to the estimated oil revenues from the Honor Rancho field.

2. Expenses - The expense estimate differentials are summarized as follows:

   a. Production - The staff's estimate of production expense is $73,235,000 higher than SoCal's, of which $71,949,000 is due to greater supplies stipulated to by SoCal, $1,522,000 relates to higher charges by PLS on the cost of service tariff, and $236,000 relates to higher gas requirements estimated by SoCal.

   b. Storage, Transmission, and Distribution - The staff's estimates for these expenses total $6,541,000 less than SoCal's with the differences consisting of $381,000 wage adjustment, $2,352,000 from differences in the basic estimates, $730,000 in supervision and engineering, and $3,078,000 in customer installations.

   c. Customers' Accounts - SoCal's estimate exceeds the staff's by $792,000 with the staff's estimate of expense related to gas requirements exceeding SoCal's by $246,000 and SoCal's exceeding the staff's by $131,000 for the wage adjustment and $907,000 for postage expense.

   d. Market Services - SoCal's estimate exceeds the staff's by $3,074,000 consisting of $28,000 wage adjustment, $923,000 for Account 912, Demonstration and Selling, and $2,123,000 for Account 913, Advertising Expense.

   e. Administrative and General Expenses - SoCal's estimate exceeds the staff's by $5,389,000 and consists of the staff's estimate exceeding SoCal's by $1,776,000 relating to gas requirements, gas supply, and heating value, and SoCal's estimate exceeding the staff's by $142,000 wage adjustment, $5,343,000 pensions and benefits, $59,000 basic estimates, $1,039,000 dues and donations, and $582,000 for outside services.

f. Taxes - The staff estimate of payroll taxes exceeds SoCal's by $664,000 and SoCal's estimate of ad valorem taxes exceeds the staff's by $1,620,000. There are also differences in the income tax computations reflecting the differences in revenues and expenses listed above, differences in interest costs previously discussed, differences in depreciation expense subsequently discussed, and allowances for income taxes on contributions in aid of construction.

g. Depreciation Expense - SoCal's estimate of depreciation expense is $13,319,000 higher than the staff's and reflects unit of production (UOP) depreciation, five-year amortization of facilities to serve Priority 4 and 5 customers, shorter lives for distribution services, and lower plant balances based on later data.

3. Rate Base - The staff's estimated rate base is $3,560,000 greater than SoCal's, reflecting $2,568,000 less gas plant in service, $23,482,000 more gas stored underground, $24,253,000 less working cash, and $6,967,000 less depreciation reserve.

Revenues

As noted above, $2,210,000 of the difference in the revenue estimates of SoCal and the staff relates to the heating value of the gas to be sold. According to the testimony of one of SoCal's vice presidents, W. C. Cole, the heating value for test year 1979 will vary between 1,042 and 1,060 Btu's per cubic foot with the computed weighted average being 1,052. According to the testimony of one of the staff's senior utilities engineers, Joseph L. Fowler, the weighted average heating value for test year 1979 should be 1,054 Btu's per cubic foot. According to the record, the system weighted average heating value in Btu's per cubic foot was 1,060 for 1971, 1,058 for 1972, 1,055 for 1973, 1,058 for 1974, 1,054 for 1975, 1,054 for 1976, and

based on 10 months recorded for 1977 the estimated heating value for 1977 is 1,054 Btu's per cubic foot. It would appear that the downward trend in heating value has leveled off for the last three years indicating the number of wells and the basic mix of dry gas and oil gas has more or less stabilized. We will therefore adopt the staff estimate of heat content for test year 1979 of 1,054 Btu's per cubic foot.

SoCal initially forecast its revenues for the sale of oil at Honor Rancho at $1.6 million for test year 1978 and test year 1979. Based on an engineering study dated March 7, 1978, supplied to the staff on March 8, 1978, SoCal revised its estimates to $2.5 million for test year 1978 and $1 million for test year 1979.

The staff's estimates, presented by research analyst Ida Goalwin, were $6,600,000 for the test years 1978 and 1979 and were based on 1977 recorded revenues.

SoCal argues that the initial years' operations of a storage field cannot be used as a basis for estimating test years 1978 and 1979 oil revenues because the initial recovery of oil per Mcf of gas withdrawn resulting from repressuring the field and the associated cleanup operation will decrease sharply after the initial year.

In support of her position, witness Goalwin testified that a representative of the California Division of Oil and Gas (DOG) informed her that other similar fields showed a decrease of 5 to 10 percent on a yearly basis as contrasted to the 49 percent decrease indicated by SoCal's most recent study, and that the recorded data for January and February indicated Honor Rancho generated just under $1 million in revenue in those two months. SoCal argues that if the staff were to review the March and April 1978 production data filed with DOG, they would find

the production of oil during March and April was only one-third of the production during January and February 1978 and that this Commission should therefore adopt SoCal's oil revenue estimates of $2.5 million for 1978 and $1 million for 1979.

It is obvious from the record that the oil production from Honor Rancho decreased sharply from the maximum in November 1977 of slightly in excess of 156,000 barrels to 52,736 barrels in January 1978, but that the drop-off in production is somewhat less than anticipated by SoCal. We will, therefore, adopt as reasonable for this proceeding oil production revenues from Honor Rancho equal to the average of SoCal's 1978 and 1979 estimates, or $1,750,000.

Wage Adjustment

The staff's estimates included an adjustment for a wage increase of 7-1/4 percent which, at the time of preparation of the staff's report, had not been approved. A wage agreement granting a 7 percent increase was subsequently negotiated and the adopted results of operation figures reflect the effect of this increase.

Production Expense

The difference in production expense estimates between SoCal and the Commission staff totals $73,235,000 and consists of $236,000 relating to the staff's lower estimate for gas requirements, $71,949 relating to the staff's higher estimate of gas supply expense, and $1,522,000 relating to the staff's higher estimate of PLS service tariff charges.

The gas requirement estimate difference reflects later data being available to the staff and, therefore, the staff estimate is more reliable and will be adopted.

The staff's higher estimate of gas supply expense reflects the greater gas supply availability stipulated to by SoCal and it will be adopted.

The difference of $1,522,000, due to higher PLS charges flowed through to SoCal via PLS's service tariff, reflects primarily additional supplies stipulated to by SoCal, higher ad valorem taxes paid by PLS, higher depreciation expenses reflecting UOP for transmission facilities, five-year amortization of Priority 4 and 5 facilities, and lower plant balances. The staff's estimates will be adopted in accordance with our discussion of the resolution of similar differences in estimates relating to SoCal's operations.

Storage, Transmission, and Distribution Expense

The staff's estimates are lower than SoCal's by $265,000 for storage expense, $740,000 for transmission expense, and $5,536,000 for distribution expense, for a total of $6,541,000. Of this, $381,000 relates to the wage adjustment previously discussed, $2,352,000 relates to the differences in the basic estimates, $730,000 relates to supervision and engineering, and the remaining $3,078,000 relates to differences in customer installation expenses.

The differences in SoCal's and the staff's estimates for storage, transmission, and distribution supervision and engineering (excluding customer services expense) expenses totaling $730,000 are due to the staff's utilities engineer, Gary Loo, normalizing the amount of such expense capitalized. According to the record, Mr. Loo noted that SoCal's percentage of direct charges capitalized for test years 1978 and 1979 represented less than one-half the rate used by SoCal for the years 1974 through 1976. Mr. Loo utilized a 35 percent capitalization ratio which was nearly equivalent to the utility's 1976 recorded figure. SoCal argues that such normalization is inappropriate because in 1975 it instituted its capital limitation program whereby for the next five years capital construction would be deferred whenever possible. Such a deferral of capital construction results in less supervision expense being reassigned to plant and relatively more being charged the expense accounts. This explanation appears reasonable and we will adopt SoCal's estimates for these supervision and engineering accounts.

The $2,352,000 basic estimate differential consists of $31,000 in storage expense, $244,000 in transmission expense, and $2,077,000 in distribution expenses, with $1,617,000 of the latter relating to operation and maintenance of meters and house regulator estimates. The meter and house regulator operating expense estimate was prepared by the staff using historical trending methods modified by engineering judgment as contrasted to SoCal's use of its normal forecasting methods which, according to SoCal, are highly accurate. We will adopt the staff's estimate of $17,129,000 for Account 878, Meter and House Regulator Operating Expense. According to the record, the staff's estimate of Account 893, Meter and House Regulator Maintenance Expense, was prepared using historical trends modified by engineering judgment and SoCal's estimate was prepared using a meter performance program and related statistical sampling techniques. We will adopt SoCal's estimate of $6,232,000 for this account. The balance of the distribution expense differential of $460,000 consists of $253,000 in supervision and engineering previously discussed and $207,000 in Account 880, Other Expenses. We will adopt the staff's estimate for this account of $9,813,000.

The $3,078,000 differential in customer installations is accounted for in Account 879, Customers Installation Expense. According to the record, the staff witness annualized 10 months' recorded 1977 data in averaging four years' recorded expense. This average was increased 8 percent for growth in 1978 and an additional 7.5 percent for growth in 1979.

According to the testimony of SoCal's vice president of consumer affairs, Patrick R. Shea, increased expenses are projected for Accounts 878 and 879 to meet a number of policy changes made to improve service and carry out SoCal's responsibilities

in the VLRP. In response to cross-examination questions, Mr. Shea testified that starting late in 1977 its customer service people are to perform an internal inspection of older in-service regulators to provide for increased customers' safety, SoCal's leak investigation procedures were improved to reduce response time, and further improvements are being implemented in leak investigation procedures to expand the use of leak detector devices. The increase in 1979 test year customer service activity required to carry out the increased customer service responsibilities in the VLRP is estimated by Mr. Shea to be $1,366,000. The staff argues that the adopted test year figures in the last general rate increase matter were substantially above the actual recorded figures and that SoCal has a long history of overestimating future expenses. We will adopt the staff's estimate of Account 879, Customer Installations Expense, plus SoCal's estimate of $1,366,000 for increased customer responsibilities in the VLRP, or a total of $16,092,000.

Customers' Accounts Expense

The primary difference between SoCal's and the Commission staff's estimate for this category is in Account 903, Customer Records and Collections, and represents the cost of postage. The staff estimate was lower than SoCal's by $907,000 representing a deletion of SoCal's estimate of a postage rate increase from 12¢ to 14¢ for bulk mailings. On May 29, 1978 the new postage rate increasing bulk mailings from 12¢ to 13¢ went into effect. The increase in this account for this postage increase is approximately $470,000 which we will add to the staff's estimate for this item.

Market Services

As discussed in Section V, Conservation, we reduced SoCal's estimate of advertising expense for conservation, Account No. 913, by $2,123,000, and adjusted its estimate of demonstration and selling expense downward $778,000, to eliminate expense for promoting improved efficiency appliances mandated by law and the rental major incentive program excluding the value of the incentives.

Administrative and General Expense

The staff estimates of the Administrative and General Expenses related to gas requirements, gas supply, and heating value will be adopted cognizant with our adoption of the staff's estimates of the previously discussed revenue and production expense estimates.

SoCal's estimate of pensions and benefits expenses for test year 1979 exceeds staff's by $5,343,000 and consists of $3,240,000 pension plan expense, $1,524,000 medical plan expense, $468,000 savings plan expense, and $111,000 difference in reflecting the effect of wage increase on benefits.

The recorded 1977 pension plan expense was $16,890,000. SoCal retains the services of an enrolled actuary to determine annually SoCal's pension plan expense. According to his computations, a wage increase of 7.25 percent in 1977 would result in an increased pension expense of 9.44 percent for that year. It is SoCal's position that the costs of a pension plan are determined by reference to the amount of unfunded liability in the plan resulting in a roll-up effect on pension plan costs of a greater percent than the percent wage increase. In response to cross-examination questions, staff witness Goalwin testified that the roll-up effect of pension plan costs resulting from a percentage wage increase could be greater or less than the percentage wage increase depending on what the plan earned in the prior year and noted that because 1976 was a good year, the payments made in 1977 were actually lower than payments made in 1976 in spite of a wage increase. Under these circumstances, witness Goalwin testified it was logical to use the percentage wage increase in determining the percentage pension plan cost increase.

SoCal applies its derived 9.44 percent factor to 1977 recorded data on a compound basis to derive its 1979 estimated expense of $22,178,000. To this figure SoCal added $1,900,000 for pension plan improvements to be negotiated with the unions in 1979 on the basis that, historically, SoCal has granted plan improvements each time the plan was subject to negotiation. The staff applied an estimated 7.25 percent wage increase factor to the recorded 1977 pension plan costs to derive the 1979 test year estimate as $19,428,000. No allowance was made for pension plan improvements consistent with past Commission policy to exclude such allowances before they are actually negotiated. We will adopt the staff's estimate adjusted to reflect the 7 percent wage increase, or $19,337,000.

The difference in the staff's and SoCal's estimates of medical plan expense of $1,525,000 consists, in part, of a $337,000 disallowance by the staff for improvements in the medical plan which had not at that time been negotiated and, in part, from the staff's assuming a 15 percent annual increase in premium costs as contrasted to SoCal's assumption of a 20 percent annual increase in premium costs. According to the record, the actual negotiated improved medical plan costs amount to $261,000 for the test year 1978, which, increased by 15 percent, would approximate $300,000 for the test year 1979. We will add this $300,000 to the staff's estimated test year in 1979 medical plan costs of $9,458,000 and adopt the resulting sum of $9,758,000 as reasonable for medical plan costs for test year 1979.

The difference of $468,000 between SoCal's and the staff's estimates for savings plan costs consisted of a disallowance of retirement savings plan improvements to be negotiated with the unions in 1979 amounting to $348,000 and the use of different estimating techniques, including those relating to forfeitures. It is SoCal's position that the staff's methodology reflects an accumulation of forfeitures from year to year and results in an understatement of an expense of $94,000. A review of the record indicates that the staff properly deducted each year's forfeitures only in the year which they occurred. We will adopt the staff's estimate adjusted to reflect the 7 percent wage increase previously discussed.

Testimony and exhibits on dues and donations were presented on behalf of SoCal by its manager of public affairs planning, Eugene L. O'Rourke, and on behalf of the Commission staff by a utilities engineer, James R. Barrett.

Mr. O'Rourke testified that SoCal contributes a little more than $800,000 annually to various health and welfare, civic, cultural, and educational organizations. These contributions are accounted for in Account 426.1 which is a balance sheet income deduction item and not treated as an expense in the ratemaking process. However, for purposes of this proceeding, the $836,000 contribution item has been included in administrative and general expenses in Account 930 for test year 1979. SoCal justified this action on the basis that it cannot be insensitive to the needs of the community it serves nor can it remain aloof from the environment of its service area. Mr. O'Rourke further testified that it is SoCal's conviction that it has a definite obligation to contribute to community organizations and, therefore, such contributions are an essential cost of doing business. He notes that the regulatory commissions across the nation are increasingly recognizing the validity of these expenses and are allowing charitable contributions for ratemaking purposes. He states that the criteria applied by these commissions in allowing such expenses are that the contributions be reasonable, impartial, and of general benefit to the community and stated that it is his belief that SoCal's contributions meet this criteria.

Mr. Barrett testified that he had deleted those contributions as an allowable expense for ratemaking purposes on the basis that this Commission has consistently disallowed such expenditures for rate fixing purposes as constituting involuntary contributions by the ratepayer and noted that such disallowances have been upheld by the California Supreme Court.

We are not persuaded that the actions of other regulatory commissions present sufficient reason for us to reverse our previous position on this matter and will, therefore, adopt the staff's recommendation and disallow the $836,000 charitable contributions proposed by SoCal. Furthermore, we remain bound by California Supreme Court decisions, absent material changes in surrounding circumstances, to disallow these expenses for ratemaking purposes.

With respect to the allowable ratemaking expense for dues, Mr. Barrett testified that the source of disallowed items used as a basis for his recommended disallowance included listings of such items as Admirals Club, Alaska State Chamber of Commerce, and similar activities totaling $223,552, but did not include, to his knowledge, company memberships in business-related organizations. According to the record, however, the adoption of the staff's recommended disallowances would eliminate a portion of American Gas Association expenses and all company memberships in other business-related organizations. Consequently, for the purposes of this proceeding, we will adopt roughly one-half of the staff's disallowance for dues in Account 930, or $92,000.

The staff recommends an adjustment of $582,000 for test year 1979 in Account 923, Outside Services Employed, for the costs for legal service rendered SoCal by PLC. According to the testimony of one of the Commission's financial examiners, Fred K. Hendricks, an examination of the transactions between PLC and SoCal disclosed that during the year 1976 PLC rendered legal services to SoCal pertaining to pension plan and life insurance payments, financial planning, preparation of income tax returns, gas supply financing, and legal services. The staff takes exception to $303,988 charged to SoCal as a legal expense on the basis that it more probably should have been either capitalized or deferred by SoCal for future accounting periods. The composition of the $303,988 exception, based upon results of the staff's four-month review, is as follows:

Classified Items	Amount of Adjustment
New Sources of Gas Supply	$186,649
GEDA	27,359
Additional Storage Facilities	20,671
Long-term Equipment Leasing	21,887
Issuance of Series "K" Bonds	33,135
Solar Energy Product	14,287
Total	$303,988

The $303,988 represents 27.1 percent of the total legal expense charged to SoCal by PLC during 1976. Mr. Barrett translated this 27.1 percent ratio to the test year 1979 estimated legal expenses of $2,149,000 to derive the proposed $582,000 staff adjustment to Account 582. According to the record, the legal expenses relating to procuring new sources of gas supply were not deferrable because they involved either a preliminary good faith investigation of the viability of a potential project or a project that eventually failed; the expenses relating to GEDA projects were spent in connection with Commission investigations; the long-term equipment leasing inquiries were abandoned when difficulties were encountered with the Securities and Exchange Commission; the in-house legal expenses associated with the issuance of Series "K" bonds have never been charged to a securities issue and it would not be proper to do so at this time; and the legal expenses associated with the solar energy project relate to the "Sunflower" project which was denied by this Commission in D.88224 dated December 13, 1977. Under these circumstances, it would appear that the staff's recommended disallowance of $582,000 for Account 582 expense is unreasonable and will not be adopted.

Taxes

Subsequent to the preparation of SoCal's exhibit, the Congress raised both the Federal Insurance Contribution Act (FICA) tax rate and the taxable wage base effective January 1, 1979. Staff estimates of payroll tax were based on the revised figures and will be adopted for this proceeding.

Both the Commission and SoCal used the assessed value of plant determined by the State Board of Equalization (Board) as of March 1, 1977 of $253,399,000 for SoCal and $63,455,000 for PLS as a starting point for the determination of the assessed value for ad valorem tax purposes. SoCal raised these figures 10 percent to obtain 1978 test year assessed valuation and another

10 percent to obtain the 1979 estimated assessed value. The staff obtained the 1978 test year assessed value estimates by adding 25 percent of recorded 1977 plant additions to the March 1, 1977 figures, and the 1979 test year figure by adding 25 percent of plant additions of $82,409,000 for SoCal and $20,712,000 for PLS to the 1978 test year totals.

SoCal's secretary and treasurer, Harold E. Goodenow, testified that prior to 1976 there was reasonable correlation between the increased investment in properties owned by California energy utilities and the increase in the Board's valuation of such properties, but that in 1976 and 1977 the assessed values as determined by the Board were much greater than was warranted by the increased investment in properties. He stated that for the year ended December 31, 1975 SoCal's net utility plant increased by about 3 percent while the Board increased SoCal's 1976 assessment by more than 9 percent. Similarly, in 1976 the net utility plant increased about 9 percent and the assessment was increased by 32 percent. He further testified that he considered the projected 10 percent increase in assessed value for test year 1979 to be most conservative.

In its brief the staff argues that the 10 percent increase utilized by SoCal is inappropriate because on May 24, 1978 the Board announced it increased the market value of the State's 14 largest utilities and railroads an average 7.2 percent and the market value increase for PLU was reported to be approximately 2 percent.

The staff also noted for the test year 1979 SoCal utilized the tax rate of $12.09 for SoCal and $11.31 for PLS as contrasted to the staff's utilization of a tax rate of $11.60 for SoCal and $10.81 for PLS.

The record in this proceeding was not developed on the issue of Article XIII-A of the California Constitution as it relates to ad valorem taxes. Our Decision No. 89208 did, however, provide for a reduction of $19,957,000 for Article XIII-A encompassing the 16-month period, September 1, 1978 through December 31, 1979. Present rates, therefore, currently reflect the reduced ad valorem taxes. Decision No. 89208 also establishes a Tax Initiative Account to track the actual savings associated with Article XIII-A.

In order to reflect Article XIII-A in the rates to be established herein, we will take official notice of SoCal's filing in OII 19, which shows that for the fiscal year 1978-79 the assessed valuation after Article XIII-A relating to operating expenses will be $316,097,000 and for the fiscal year 1979-80, $360,053,000. Using the assumed tax rate contained in SoCal's OII 19 filing of 1¼ percent of market value (or 5 percent of assessed value), we developed ad valorem taxes for the two fiscal years of $15,805,000 and $18,003,000, respectively. For the purpose of this proceeding, we will adopt the sum of $16,904,000 as being representative of post Article XIII-A ad valorem taxes for the test year 1979. Should the taxes when they become known vary from this amount the Tax Initiative Balancing Account will correct any discrepancy, thus protecting both utility and public.

SoCal argues that because of IRS Revenue Ruling 75-557, which shows the contributions for connection fees paid to water and sewer companies for connecting their service to a dwelling as taxable income for the water and sewer utilities, it is reasonable to believe that IRS will also consider contributions in aid of construction to be taxable income.

HR 13511, the recently enacted Revenue Act of 1978, clarifies this problem by conforming the treatment of contributions of electric, gas, and steam utilities to that accorded water and sewer utilities. Such a procedure would treat contributions in aid of construction for distribution facilities as contributions to capital not subject to income tax. Consequently, no provisions for income tax on such contributions need be made in this proceeding.

The Revenue Act of 1978 reduced the corporate tax rate from 48 to 46 percent. The 1979 test year income tax computations reflect this reduction in federal income taxes, as does the net to gross multiplier.

Depreciation Expense

The staff's estimate of depreciation expense is $13,319,000 less than SoCal's estimated depreciation expense. The difference consists of $4,428,000 related to SoCal's utilization of the modified UOP on transmission facility, $870,000 for a five-year amortization of net investment in facilities serving Priority 4 and 5 customers, $6,921,000 reflecting an average service life for plant in Account 380, Distribution Services, of 28 years as proposed by SoCal and 33 years as proposed by the Commission staff, and $1,100,000 difference due to the staff's lower estimate of plant balances based on later data.

In D.88835 dated May 16, 1978 in C.10261, our investigation into an SAM, we noted "SCG proposes to revise its current method of depreciation to apply a UOP method to its transmission facilities and to apply a five-year life for that portion of distribution plant that may be directly assignable to large customers." (Mimeo. page 12.) And further, "should natural gas utilities be allowed to change their method of book depreciation and periodically increase the revenue requirement and rates to consumers outside of a general rate proceeding--all because of a change in a long-term forecast of present connected supplies? The UOP depreciation method has not been shown to be reasonable and will not be adopted. The current Commission prescribed SLRL rates are based upon a theoretically and procedurally sound basis. These estimates consider all depreciation elements, including exhaustion of natural resources. The SLRL depreciation method is reasonable and will continue to be the requirement." (Mimeo. page 13.) Consistent with this decision, we will disallow SoCal's proposed depreciation expense increase of $4,428,000 for UOP on transmission facilities and $870,000 on five-year amortization on Priority 4 and 5 facilities.

SoCal proposes to reduce the average service life of Account 380, Services, from the current life of 30 years (S 3 curve) to 28 years (S 5 curve). SoCal's manager of accounting, Roy F. Brunken, testified that this change in service life was based on a simulated plant balance study by Stone & Webster Management Consultants and reflected physical plant experience going back to 1913. One of the staff's associate utilities engineers, Sung B. Han, testified that he had reviewed these simulated plant balance studies for band lengths of 5, 10, 15, and 20 years. He stated that to come up with a reliable forecast, you need roughly about half of the average service life years of band length, which for Account 380, Services, would be 15 to 20 years. On this basis, he chose the 20-year band length study as providing the most reliable result and adopted a 33-year service life based on the R 2.5 curve. In response to cross-examination questions, Mr. Han admitted that he was the witness on depreciation expense in SoCal's last general rate case and that based on his recommendation, the Commission reduced the average service life for this account from 33 to 30 years. He further testified that because of the proposed change to accruing removal costs in the depreciation reserve rather than expensing these costs, the Commission should be more conservative in estimating service life. From the record it would appear that SoCal's position is reasonable and we will adopt a 28-year average service life for Account 380, Services. We will also adopt the staff's basic depreciation expense estimate ($1,100,000 less than SoCal's estimate) because it is based on updated plant and depreciation reserves that reflect recorded balances.

Weighted Average Rate Base

The staff-sponsored alternate exhibit dated May 10, 1978 shows a 1979 test year weighted average rate base of $296,049,000 as estimated by the staff and $313,020,000 as estimated by SoCal for PLS, and for SoCal, $1,077,938,000, as estimated by the staff, and $1,074,378,000 as estimated by SoCal. The staff estimates of gas plant in service are based on later data, namely, beginning of year 1978 recorded plant in service and August 31, 1977 construction budget estimates, and will be adopted for purposes of this proceeding. The staff's working cash computations used an 8.8 percent rate of return authorized in SoCal's last rate case in accordance with normal practice and will be adopted. The staff's computed depreciation reserve reflects a 33-year life for Account 380, Services. We will change this amount from $569,705,000 to $573,166,000 to reflect our adoption of the previously discussed 28-year service life for Account 380, Services.

The following tabulation summarizes the previously discussed adopted results of operation for the test year 1979 for SoCal and PLS:

SUMMARY OF EARNINGS

Year 1979 at Present Rates[1/]

Item	PLS	SoCal
	(Dollars in Thousands)	
Operating Revenues[1/]		
Gas Sales	$	$1,138,351
Other		2,840
Total Operating Revenues	271,337	1,141,191
Operating Expenses		
Production	225,680	815,756
Storage	-	15,748
Transmission	-	14,312
Distribution	-	83,236
Customers Account	-	54,016
Market Services	-	21,778
Administrative and General	196	102,902
Subtotal	225,876	1,107,748
Depreciation	8,138	60,302
Taxes Other Than Income	2,901	23,192
State Corp. Franchise Tax	1,725	(9,706)
Federal Income Tax	6,645	(46,364)
Total Operating Expenses	245,285	1,135,172
Net Operating Revenues	26,052	6,019
Rate Base	296,049	1,079,620
Rate of Return	8.80%	0.56%

(Red Figure)

1/ Rates placed into effect in July 1977, excluding GEDA adjustments and the partial general increase authorized by D.89208 dated August 8, 1978.

VII. RATE DESIGN

General

Testimony and exhibits on rate design were presented on behalf of SoCal by its rate design manager, John H. Belson, on behalf of the Commission staff by one of its supervising utilities engineers, Robert C. Durkin; on behalf of Edison by its manager of regulatory costs, E. R. Sample, and a consulting engineer, R. P. O'Brien; on behalf of Tehachapi by a consulting engineer, Donald R. Howard, and by its general manager, Robert J. Jasper; on behalf of SDG&E by its gas regulatory supervisor, Henry P. Morse, Jr.; on behalf of LB by its superintendent of gas procurement and regulatory affairs, Vernon E. Cullum, and a consulting engineer, Robert T. Kyle; and on behalf of CMA by its director of energy and environmental quality, Robert E. Burt. In addition, at the request of CMA, SoCal presented five exhibits setting forth the results of cost allocation studies by various methods for test years 1978 and 1979 at SoCal's estimated gas supply conditions, and one exhibit for test year 1979 setting forth the results of cost allocation studies based on the staff's supply estimate stipulated to by SoCal. These exhibits were proffered by M. J. Douglas who was provided by SoCal to verify the accuracy of the figures and computations set forth in the study and to answer clarification questions.

As might be deduced from the number of witnesses appearing to testify on rate design, the apportionment of any authorized increase to the various customer groups and an appropriate design for the various rates within the respective customer groups were among the most controversial issues raised in this proceeding.

Position of SoCal

SoCal's proposed rates reflect restructuring to coincide with end-use priorities established by D.85189 dated December 2, 1975 and D.86357 dated September 1, 1976 in C.9581, C.9642, and C.9884, our investigation into the supply requirements of electric utilities, into natural gas supply and requirements, and into the establishment of priorities among the types of categories of customers, and were designed to provide additional revenues of approximately $259,513,000 for test year 1978, and $334,117,000 for test year 1979. Under SoCal's proposal those customers who presently receive service on a multiple of priorities will have the option of repiping their facilities or entering into contracts providing for the allocation of gas consumption to priorities based on their connected load and curtailment experience during the billing period.

According to the record, the point of departure in the design of the proposed rates was application of a system average increase to all classes of service. Consideration was given to certain constraints resulting from the lifeline bill, the value of service for Priority 2 customers as established by the cost of No. 2 fuel oil, the absolute necessity of increasing lifeline rates, the similarity of usage characteristics of the small Priority 1 customers and the residential customers, and the necessity of maintaining the low priority customers on the system if SoCal is to be successful in its supply acquisition projects.

The proposed customer charge for the residential customers was set at $4 per month for 1978 and $4.50 per month for 1979 to more nearly approximate the $5 per month customer cost indicated by SoCal's studies at the time of the filing of the application. It was noted that more recent studies indicate that such costs are now in excess of $7 per month per customer.

The Priority 2 customers to receive service under proposed Schedule GN-2 are large, high priority, nonresidential customers having no reasonable alternative fuel capability. According to SoCal the only viable alternative energy source for such customers would be relatively more expensive electric service. Consequently, the commodity rate for this group of customers was set at the same level as the high cost tail block for residential customers.

The cost of No. 2 fuel oil which, according to the record, is in the neighborhood of $2.41 per million Btu's for the very large customers and $2.74 per million Btu's for the large customers was considered as the upper limit for Priority 3 and 4 customers resulting in an average proposed increase of 52.1 percent in 1979 for Priority 3 customers and since there are no anticipated Priority 4 sales for test year 1979, the average increase for Priority 4 customers could not be computed.

Steam electric generating plant commodity rates, i.e., Priority 5 customer, were established at the same level as the Priority 3 and 4 rates although it is anticipated the only deliveries to these steam electric generating plants will be gas for flame stabilization and igniter fuel, a Priority 2 use.

SoCal proposes that the wholesale gas rates be increased by the system average increase in conformance with past Commission practice.

SoCal's proposed residential rate consists of three tiers as contrasted to the presently effective five-tier rate. Under cross-examination Mr. Belson testified that he could see no justification for the relatively more costly five-tier rate; that most customers are not knowledgeable with respect to rate structure and, therefore, base their decisions on whether to conserve gas on the amount of the total bill rather than the

rate structure; and that the proposed high blocks for heavy usage would tend to discourage excessive use. In the design of its proposed rates, SoCal gave consideration to the establishment of solar rate incentives and time-of-day pricing. The former was rejected because of SoCal's position that solar heating devices should be promoted but not through a discriminatory subsidy brought about by special reduced rates; the latter on the basis that time-of-day rates have no practical application for a natural gas utility service since it is not feasible to reduce gas pressure, and fluctuations in demand are compensated for by curtailment and use of underground storage reservoirs.

Position of the Commission Staff

The staff based its rate design on SoCal's estimated revenue increase of $259.5 million for test year 1978 with the understanding that the rates could be proportionately adjusted upward or downward from that figure in accordance with the authorized revenue increase.

The staff proposed a 12.9 percent increase to the residential rates, a 43.0 percent increase to total nonresidential rates (commercial and industrial), and a 14.6 percent increase to wholesale rates.

With respect to the residential rates the staff proposes a continuation of the presently structured five-tier rate design which was established by D.87587 dated July 12, 1977 on SoCal's A.57196 for a purchased gas adjustment increase. Essentially, the proposed rates provide a decrease in the service charge for residential service from $3.10 a month to $1.20 a month to parallel similar rates for Pacific Gas & Electric Company (PG&E), a 29.2 percent increase in the lifeline commodity rates, and an overall increase in the commodity rate for residential service of 34.3 percent. It was anticipated that the proposed fifth-tier

(over 300 therms) rate of 26 cents per therm would discourage wasteful usage and, therefore, encourage conservation. However, during the hearing it was ascertained that only 1.19 percent of SoCal's customers use in excess of 300 therms and it would, therefore, appear that this would be an ineffective design from a conservation viewpoint. In spite of this result, however, the staff recommends the retention of the five-tier rate.

For nonresidential rates, the staff proposes a commodity rate of 25 cents per therm for Priority 1 customers, 26 cents per therm for Priority 2 customers, and 27 cents per therm for Priority 3, 4, and 5 customers.

According to the staff testimony, the additional costs associated with the storage, transfer, and pretreating of the alternate fuel, together with the related additional labor costs, should be added to the cost of alternate fuels in order to make a valid comparison with the cost of natural gas. According to the staff's interpretation of the results of questionnaires sent to 1,004 SoCal and SDG&E customers, the cost of alternate fuels thus computed could range from 30.9 cents per therm for the large volume, high sulfur fuel oil consumer to 37 cents per therm for the small volume, distillate fuel user fully justifying the level of the staff's proposed rates.

The presently effective wholesale rate tariffs for LB and SDG&E contain both demand and commodity charges. According to the staff testimony, the demand charge served a purpose when gas was plentiful and the supplier was obligated to serve all that was demanded, a situation which no longer exists. The staff, therefore, proposes that two commodity charges be established for SoCal's wholesale customers, one for lifeline volumes and one for nonlifeline volumes. According to the record, the lifeline volumes for SDG&E represent approximately 44.22 percent of SDG&E's sales and the lifeline sales to LB represent approximately one-third of the sales.

In addition to the above-discussed proposed rates, the staff witness presented an array of rate designs based on various assumptions for the consideration of the Commission. The assumptions used for residential rates vary from a zero customer charge up to a customer cost-based amount of $7 a month and a change in the blocking of the schedules to multiples of lifeline blocking as presently exists in the PG&E residential rates. Some variations to the proposed wholesale rates were also set forth in the staff's exhibit.

Position of Edison

Mr. Sample presented the results of recent and past cost allocation studies prepared by SoCal for the consideration of this Commission to demonstrate the effect on Priority 5 gas deliveries to the GN-5 customers and to emphasize the problem which would result if almost all the GN-5 customers' allocated costs were to be collected through the commodity portion of the rate.

According to Edison, SoCal's proposed GN-5 rate schedule for steam electric generating plants is analogous to charging "what the traffic will bear" and if authorized, will permit the subsidizing of other customer classes by the steam electric generating plant customers and will not serve to achieve the conservation of gas as contemplated in D.87587 as justification for the establishment of the GN-5 rate. Edison notes that the smallest cost differential between the residential customer class and the steam electric generating plants is 76.6 cents per Mcf for the test year 1979 and, therefore, there is no cost allocation basis for proposing rates to firm customers below the rates to the GN-5 customers.

Mr. O'Brien presented testimony to show how the fluctuating nature of SoCal's gas supplies, caused by climatic variations and uncertainties in its own source of gas supply, creates serious

operational problems for the gas users with significant economic consequences which, according to his testimony, should be taken into consideration in selecting an appropriate rate design. He noted that the equivalent of 7.9 million barrels of fuel oil in 1976 and 11.4 million barrels of fuel oil in 1977 were unexpectedly delivered to Edison necessitating the deferral and storage of unused oil previously committed for with the attendant cost burdens. According to this witness' testimony, it is inappropriate or inequitable that cost burdens arising from the undesirable volatility of its gas supplies should be shifted to steam electric generating plant agencies and their electric customers and thereby allow the high priority gas customers to receive the incurred benefits therefrom. In Mr. O'Brien's opinion, such a result appears to be the objective of the rate schedules proposed by SoCal. Mr. O'Brien further testified that high prices for steam electric generating plant gas could discourage burning the surplus gas and instead encourage burning fuel oil thus bringing conservation objectives into direct conflict with air pollution control objectives.

To mitigate these difficulties Mr. O'Brien suggested three alternatives: (1) if unexpected supplies become available in 1979, SoCal and Edison negotiate a special contract; (2) a filed tariff be devised that provides for sharing the estimated savings between the parties in proportion to each party's contribution; or (3) a filed tariff for dump gas at a commodity rate not to exceed 125 cents per million Btu's.

Position of Tehachapi

Testimony and exhibits were presented on behalf of Tehachapi by a consulting engineer, D. R. Howard, and by its general manager, Robert J. Jasper.

Mr. Howard noted that water purveyors' maximum demands occur at a time when the gas company is experiencing relatively low gas demand requirements and that they are conserving gas to the maximum extent possible. Furthermore, according to his testimony, the service they perform is absolutely necessary for the existence and well-being of all their consumers and the local economy. Under these circumstances, this witness believes that the first block of SoCal's proposed GN-1 schedule would be appropriate for water purveyors if SoCal's proposed rates are adopted or, alternatively, the middle tier of the domestic rates, should the staff's proposal be adopted.

Mr. Jasper presented testimony indicating that the natural gas cost per acre-foot of water has increased from $33.52 on January 1, 1974 to $101.96 on July 17, 1977. He further testified that if water purveyors continue to receive disproportionate increases, the agricultural economy within the district will be destroyed with the attendant effect on open space caused by subdivisions replacing farms and the adverse effect on the total economy of the area.

Tehachapi filed an amicus curiae brief in California Manufacturers Assn. et al. v Commission, S.F. 23720, where it is alleged that D.87587 restructured rates without due process or advance notice and without required compliance with CEQA. On March 30, 1978 the Court granted the petition for a writ of review and the matter was argued on December 6, 1978. Tehachapi also argues that water purveyors, both public and private like Tehachapi (using large quantities of gas), should be granted a lower rate than other large commercial and industrial users.

Position of SDG&E

SDG&E's gas regulatory supervisor, H. P. Morse, Jr., presented testimony indicating the existence of a substantial rate differential between the rates of SDG&E's and SoCal's retail customers and proposing a simplified cost allocation method which, if used, will help reduce this differential to a more equitable level.

Mr. Morse testified that the presently existing disparity between SDG&E's and SoCal's retail rates was created by the application of the system average increase, including the cost of gas, to the wholesale rate and cited a hypothetical example showing how such a procedure allocated a far greater percentage increase to the wholesale rate non-gas cost than to the retail rate non-gas cost. He presented for the consideration of the Commission a simplified cost allocation method wherein individual expense items were allocated between wholesale and retail customers on the basis of their relative use on average-year temperature conditions. SDG&E also indicated its desire to have all costs, other than production and franchise, combined and billed as the capacity cost of the rate, and the production costs billed as the commodity cost of the rate.

Position of LB

LB's gas procurement and regulatory affairs superintendent, Vernon E. Cullum, presented testimony indicating LB's gas department has lifeline rate schedules paralleling those of regulated utilities, Climate Zone 1 lifeline rates, as well as senior citizens' discounts and, therefore, LB's position relative to lifeline allowances in the wholesale rate was the same as SDG&E's. He noted that cost allocation studies indicate that LB is presently providing an 18 percent rate of return on the facilities installed for its use and that this situation will be greatly aggravated if SoCal's proposed rates are adopted.

Consultant Robert T. Kyle testified that he reviewed SDG&E's proposed methodology for the development of rates to wholesale customers and concludes that it is an excellent basis for determining appropriate rate levels for LB.

He further testified that in his opinion a single rate should be developed for both SDG&E and LB based on the results of a study using the rate methodology proposed by SDG&E.

He stated that SoCal buys natural gas from PLS on a cost-of-service rate schedule approved and regulated by this Commission; that PG&E purchases natural gas from Pacific Gas Transmission Company on a similar type arrangement; and that SoCal and Pacific purchase natural gas from El Paso Natural Gas Company (El Paso) on a cost-of-service rate schedule. Under these circumstances, he believes it is only logical that the wholesale customers of SoCal be provided service on a cost-of-service rate and that the methodology espoused by SDG&E would be an appropriate basis for the design of such rates.

Position of CMA

CMA's director of energy and environmental quality, Robert E. Burt, presented testimony and exhibits regarding the appropriate method of spreading SoCal's natural gas revenue requirement to its various customer classes.

He testified that SoCal's system average rate has increased roughly 53 percent since January 1, 1976 as compared to the increase of approximately 127 percent for large industrial use. He stated that the charts contained in his exhibit depicting the relationship of industrial and commercial rates to residential rates for 19 neighboring, sunbelt, and industrial states shows that only in California are the commercial and industrial rates higher than the average rate for a typical residential customer.

Mr. Burt sponsored several principles of rate design as follows:

(a) Gas rates and resulting class revenues should reflect the costs incurred by the utility to provide this service.

(b) The discrimination between customers requires some objective standard for its measurement.

(c) Rate structures and rates should be stable and predictable.

(d) Artificial gas pricing should not be used as a means of allocating gas supplies.

Cost-of-service data, which, according to Mr. Burt, is essential to both revenue level and rate spread determinations, was submitted at CMA's request by SoCal using three methods, i.e., the base supply and load equation; the coincident extreme peak-day; and the annual average-day methods. The difference in the methods relates to the allocation of the demand-related costs (less than 25 percent of the total costs) to the various customer groups and reflects the weight given to the relative difference in the demand rights of the firm and interruptible customers. According to the testimony, Mr. Burt used the annual average-day cost allocation method in order not to obscure the importance of recognizing costs as a basic element in rate design. This method allocates a greater portion of the costs to the interruptible customer class and a lesser portion of the costs to the residential class than either of the other two methods. According to the testimony even this method shows that at SoCal's proposed rates, the residential customer would receive gas at a rate of more than 43.5 cents per Mcf below the full cost to serve him. This under-collection would be compensated for by the collection of 52.5 cents per Mcf above fully allocated costs by the GN-1 through GN-4 customers and substantial contributions above fully allocated costs by the GN-5 and wholesale customers. Mr. Burt notes that according to this study an increase of $292 million (51.2 percent) would be required to raise the residential group's rate of return to the 10.2 percent requested in SoCal's application.

CMA argues that this Commission exists to insure that consumers are not injured by a monopoly market power which efficiency dictates should be given to certain utilities and that for the Commission to provide protection to some customer groups while neglecting others violates this mandate. According to CMA, for this Commission to fulfill its obligations, it must develop and utilize objective standards by which various rates can be measured to determine whether or not they are just and reasonable. CMA argues that this Commission has traditionally used cost-based regulations as a basis for such evaluation and that it cannot design just, reasonable, and nondiscriminatory rates without such cost-of-service information. CMA further argues that under any cost allocation method the present rates are unlawfully discriminatory. According to CMA, to eliminate this discrimination it is necessary for this Commission to establish lifeline rates that will provide at least a zero rate of return level.

Also, according to this witness' testimony, the present rates are not conservation-oriented because: (1) the artificially low residential rates do not provide the proper conservation signals; (2) the high priority nonresidential rates are priced above the punitive blocks of the residential rates irrespective of whether or not the gas is efficiently utilized; (3) the proposed Priority 3 and 4 rates are priced above the cost of alternate fuels and thereby encourage the transfer of these customers from gas to other types of fuel; and (4) the transfer of these customers to alternate fuels will make gas available to steam electric generating plant customers who, because of the high price or long-term fuel contract commitments, might not accept the gas and this further increases SoCal's revenue instability.

Mr. Burt recommended specific rates for the various customer groups as transitional rates from the presently existing rates to fully compensatory rates at some future time. According to his testimony, such transitional rates are being proposed because of the extremely large increases required to transfer to fully compensatory rates at this time.

For residential service, Mr. Burt proposes a $4 a month customer charge; a lifeline commodity charge of 18.411 cents per therm; a commodity charge of 22.023 cents per therm for nonlifeline uses of 0-300 therms a month (present tiers 2-4); and a commodity charge of 30 cents per therm for uses over 300 therms a month. For proposed Schedules GN-1 through GN-4, Mr. Burt proposes a customer charge of $7.36 a month and a commodity charge of 19.246 cents per therm; for GN-5 he proposes a monthly customer charge of $21,861 and a commodity charge of 16.743 cents per therm; for LB a commodity charge of 14.677 cents per therm; and for SDG&E a commodity charge of 14.83 cents per therm. It is estimated that these rates would provide a net for return and income taxes of 11.2 percent for the residential class, 30.3 percent for GN-1 through GN-4 customer class, 26.7 percent for GN-5 customer class, 16.5 percent for LB, 16.3 percent for SDG&E, and 16.9 percent for the overall system. Such rates would increase the rates for the residential class 41.4 percent, for Schedules GN-1 through GN-4, 8.4 percent, for Schedule GN-5, 14.1 percent, for LB, 0 percent, for SDG&E, 6.8 percent, and for the overall system, 25.1 percent.

Mr. Burt further recommends that if the Commission authorizes substantially less of an increase than requested by SoCal, such an increase be applied exclusively to the residential class of service.

CMA further argues that the Commission staff misused the results of survey data undertaken for use in C.10342 relating to the Priority 2A, 3, and 4 customers' ability to use alternate fuels. According to CMA, the customers who would have to install additional equipment to burn an alternate fuel exclusively are likely to be among smaller customers in the group and that the large customers already have the necessary storage, etc., for such operations. Under these circumstances, according to CMA the assignment of additional costs to these large customers to derive a cost of alternate fuel of 30.9 cents per therm for a large-volume customer who can use 1 percent sulfur fuel and as much as 37 cents per therm for the small-volume customer using distillate fuel is erroneous.

Position of GM

GM states that the bulk of its natural gas requirements from SoCal consists of Priority 2 process gas and that as an interested party it has limited its participation in this proceeding essentially to the issue of rate design.

GM notes that this Commission has expressed its growing concern about the effects of its current rate design philosophy as indicated by D.88664 dated April 4, 1978 in C.9581, et al, wherein we stated: "When there is sufficient gas to serve low priority users without jeopardizing higher priorities, it is not necessarily in the best interests of all customers to have a low priority rate higher than that of the alternate fuels causing those customers who have the capability to convert to do so." (Mimeo. page 2.) In D.88835 dated May 16, 1978 in C.10261, our investigation into SAM, we stated: "We recently recognized that our abandonment of the traditional declining block structure could, in combination with unusual market conditions for alternate fuels, impair utility revenues to such a degree that some form of increase to noninterruptible customers would be required." (Mimeo. page 5.)

GM argues that these recent decisions indicate our concern that current utility rate design is counterproductive to our attempts to (1) induce conservation; (2) stabilize utility revenues; and (3) match rate design with end-use priority. GM submits that these problems can be traced to an apparent abandonment of cost-of-service considerations in allocating gas rate burdens among customer classes. GM argues that the application of a value of service standard to different customer classes inequitably results in increasing Priority 2 rates faster than Priority 1 rates even though under the end-use system Priority 1 customers are accorded a higher degree of protection from curtailment and from the burden of converting to costly alternate fuels.

GM notes SoCal's witness' testimony to the effect that it is unwise to set rates for the proposed Schedules GN-3 through GN-5 at high levels in order that the large customers who receive service under these schedules will not leave the system because such customers are essential to both southern California's economy and the success of SoCal's supply acquisition program. GM argues that the value of service criteria apparently utilized by SoCal in the design of its proposed rates becomes a rather transparent excuse to arbitrarily set GN-2 rates at the highest level of any of the rates.

GM also argues that the staff's proposed rate design is totally objectionable in that it not only fails to tend to correct the imbalance between residential and nonresidential rates, but actually aggravates such an imbalance by, for example, reducing the residential customer charge from $3.10 to $1.20 a month. GM supports CMA's rate proposal as a reasonable first step in dealing with the deficiencies of the present rates to maximize residential conservation, to stabilize utility revenue, and to fashion a gas rate design compatible with the end-use priority system. GM urges

the Commission to take advantage of this opportunity to move in the direction of bringing residential rates into balance with nonresidential rates by once again giving cost-of-service its due as an essential ratemaking tool.

Discussion

The issues to be resolved in this proceeding relating to rate design and the allocation of any authorized rate increase to the various customer classes are as follows:

1. Residential rates.
   (a) Amount of increase to lifeline rates.
   (b) Amount of increase to the residential class.
   (c) Blocking of authorized rates.
2. Priority 1 and 2 rates.
   (a) Form of rate.
   (b) Relative level of rate and the justifiable increases.
   (c) Requirement for rates for special customers within group.
3. Priority 3 and 4 rates.
   (a) Relative level of rates and increase justified.
   (b) Cost of alternative fuel.
   (c) Effect of loss of customer on utility's operations.
4. Priority 5 rates.
   (a) Relative level and percent increase justified.
   (b) Form of rates.
   (c) Requirements and supply.
5. Wholesale rates.
   (a) Relative level and increase warranted.
   (b) Lifeline allowances.
   (c) Proposed simplified cost allocation procedure.

Residential Rates

Section 739 of the Public Utilities Code provides as follows: "(b). . . The lifeline rate shall be not greater than the rates in effect on January 1, 1976. The commission shall authorize no increase in the lifeline rate until the average system rate in cents per kilowatt-hour or cents per therm increased 25% or more over the January 1, 1976, level." To effect this Code provision it has been our policy to maintain the lifeline rates at the January 1, 1976 level. In addition, D.87587 dated July 12, 1977 in SoCal's offset A.57196 restructured nonresidential rates to place into effect conservation-oriented rates.

As indicated by the record, the average system increase in cents per therm since January 1, 1976 has been 53 percent. As we stated in D.88651 dated April 4, 1978 in C.9988, our investigation into the determination of lifeline volume of gas:

> "It is time for us to decide and indicate publicly our interpretation of Section 739(b) as it relates to the 25 percent differential. This section prohibits increases above the January 1, 1976 level until the average system rate is 25 percent 'or more' over that level. The phrase 'or more' is indicative of a legislative intent to provide the Commission with some discretion, after the 25 percent differential has been reached, to do what the Commission deems appropriate for ratemaking purposes. Thus, the Commission might continue the level of lifeline rates after the average rate has increased by 25 percent as we have done, or it might raise the whole lifeline level together with the nonlifeline rates.

> We believe the specification of the percentage level with the inclusion of the specific ability to proceed beyond that level is a clear indication of the legislative intent to allow the Commission complete discretion beyond that point. We believe that it is appropriate to establish nonlifeline rates at a level above lifeline rates to encourage conservation. Relative rate levels will be examined and modified as appropriate in all rate proceedings." (Mimeo. page 20a.)

In D.88697 dated April 11, 1978 on SDG&E's A.55627, A.55628, and A.55629 for a general rate increase, we increased lifeline quantities, the system average percentage increase, and the nonlifeline residential quantities a uniform cents per therm.

Failure to increase lifeline rates at this time would unduly aggravate the burden of the nonresidential customer. Consequently, we will raise rates on the lifeline quantities, exclusive of the customer charge which we will maintain at its present level, approximately one-half the average system percentage increase which occurred since January 1, 1976. Such an increase is reasonable when consideration is given to the fact that the lifeline customers have only received a very minor increase (due to GEDA) since lifeline rates became effective almost three years ago.

The residential rates for quantities in excess of lifeline will be increased to a relatively greater extent and in such a manner as to promote conservation. In order to focus the economic effect of our rate changes on large usage residential customers, we will replace the existing five-tier structure with a three-tier structure as follows for Schedules GR and GS:

A.57639 fc

Revised Residential Tiers (Billing Code 3)

Current Tier	Summer[1]	Blocking (Therms) Winter Zone 1	Zone 2	Zone 3
I	26	81	106	141
II	54	-	-	-
III	50	49	24	-
IV	170	170	170	159
V	+300	+300	+300	+300
Revised				
I	26	81	106	141
II	100	100	100	100
III	+126	+181	+206	+241

1/ Summer blocking applies all year to Billing Code 2.

Revised Residential Tiers (Billing Code 1)

Current Tier	Summer	Blocking (Therms) Winter Zone 1	Zone 2	Zone 3
I	0	55	80	115
II	80	25	-	-
III	50	50	50	15
IV	170	170	170	170
V	+300	+300	+300	+300
Revised				
I	0	55	80	115
II	126	100	100	100
III	+126	+155	+180	+215

Tiers I, II, and III for Schedule GM shall be revised, as above, to reflect lifeline quantities for this schedule.

This simplified rate schedule, with rates rounded to no more than 1/10 of a cent, should assist residential customers in understanding how their bills are computed.

AB 2273, signed by the Governor on September 18, 1978, requires lifeline allowances for air conditioning and is effective on June 1, 1979. There are in excess of 17,000 residential gas air conditioners in SoCal's service area. SoCal is directed to prepare an air conditioning lifeline proposal for submission in its next PGA filing, which can then be considered for implementation for the next summer season.

Priority 1 Customers (Nonresidential)

The Priority 1 nonresidential customers are those firm use customers with peak-day demands of less than 100 Mcf per day. According to the record, 75 percent of these customers consume less than 100 therms of gas a month and have usage characteristics similar to the residential customers. On this basis SoCal proposed the same commodity charge for the first 100 therms as for the 0-300 therm block for the proposed nonlifeline residential rate, or 20.149 cents per therm. SoCal and the staff both proposed a monthly customer charge of $5 and CMA proposed a monthly customer charge of $7.36, the indicated cost of service. The staff proposed a commodity charge of 25 cents per therm equal to the fourth tier of its proposed residential rate and CMA proposes a commodity charge of 19.246 cents per therm.

The record clearly supports the similarity of operations of the small GN-1 customer and the small residential customer. However, the adopted residential rate structure does not lend itself to the rate design of the rate schedule for the Priority 1, nonresidential customer class. We will, therefore, adopt a commodity rate between the second and third residential rate blocks and the $5 a month customer charge proposed by both SoCal and the Commission staff.

Priority 2 Customers

This category includes customers where the primary use of natural gas is for feedstock, firm nonresidential use customers with peak-day demands in excess of 99 Mcf, steam electric generating plant start-up igniter and flame stabilization fuel.

SoCal proposes a monthly customer charge of $10 and a commodity charge of 24.970 cents per therm (equal to the highest block of nonlifeline residential rate); the Commission staff proposes a monthly customer charge of $10 and a commodity charge

of 26.000 cents per therm (equal to the highest block of nonlifeline residential rate); CMA proposes a monthly customer charge of $7.36 and a commodity charge of 19.246 cents per therm; and Tehachapi proposes a commodity rate equal to the middle tier of the residential rate if the Commission adopts the staff's rates, and the first block of the GN-1 rate if the Commission adopts SoCal's proposed rates.

SoCal categorizes Priority 2 customers as large, high priority customers having no reasonable alternative fuel capability and established the commodity rate on the value of service concept at the highest nonlifeline rate derived from the approximate cost of No. 2 fuel oil.

Tehachapi notes that its maximum demand occurs when the overall gas company system demand is low and, therefore, its operations do not burden SoCal's production or distribution facilities. Such usage patterns, according to Tehachapi, should be reflected in lower rates. However, these benefits to SoCal might not be as great as envisioned by Tehachapi when consideration is given to the fact that it is during the period of Tehachapi's maximum demand that SoCal's storage injection operations are at their peak. As previously stated Ammonia Manufacturers petitioned to reopen the hearings to receive additional evidence of the effect of additional gas increases on their operations. The specific relief requested was that any increase in the price of natural gas used as raw material feedstock or for process use in ammonia manufacturing plants be deferred. The current rate for such Priority 2 customers is at a level in excess of 7 percent higher than the rate in effect prior to the granting of the partial general increase, and should not be increased further at this time. We will, however, adopt the monthly customer charge of $10 proposed by both the Commission staff and SoCal.

The Ammonia Manufacturers and other Priority 2 customers should participate in future rate proceedings on a timely basis. Priority 2 customers, as well as all customer classes, should prepare for future significant increases in gas costs.

Priority 3 and 4 Customers

For Priority 3 and 4 customers, SoCal proposes a $15 monthly customer charge and a commodity charge of 24.200 cents per therm; the Commission staff proposes a monthly customer charge of $15 and a commodity charge of 27.00 cents per therm; and CMA proposes a monthly customer charge of $7.36 and a commodity charge of 19.246 cents per therm.

According to the record, in the design of Priority 3 and 4 rates SoCal considered the cost of alternate fuel as being the upper limit for service under these schedules and believes it would be unwise to set rates at a level higher than proposed because the customers who received service under these schedules are essential to both the southern California economy and the success of SoCal's supply acquisition program.

The staff's proposed commodity charge of 27 cents per therm reflects the maintenance of the one cent per therm differential between the highest block of the residential rates and the GN-3, GN-4, and GN-5 rate schedules that is contained in the presently effective rates.

CMA notes that SoCal has roughly 1,000 Priority 2A, 3, and 4 customers which, although they differ in their abilities to use alternate fuels and incur different costs associated with such alternate fuels, were at that time all served at a uniform rate of 19.844 cents per therm. CMA argues that if those rates were raised significantly in this proceeding, the result is likely to be a massive voluntary reduction in gas consumption by Priority 3 and 4 customers switching to alternate fuels. CMA argues that high Priority 3 and 4 rates on PG&E's system have caused large scale fuel switching with the result that PG&E has excess gas and depressed earnings. CMA notes that PG&E filed A.57978 proposing a reduction in Priority 3 and 4 rates to stem

the loss of sales. D.89316 dated September 6, 1978 on PG&E's A.57284 and A.57285 for general electric and gas rate increases provided that those customers whose alternate fuel is exclusively oil with a viscosity higher than 150 Saybolt Seconds Universal (SSU) at 100° F. (commonly referred to as Grades Nos. 5 and 6 fuel oil) would receive no additional increase as contrasted to the balance of PG&E's Priority 3 and 4 customers who received a 10 percent increase. It should be noted, however, that according to A.57978 the sales to those customers who would be eligible for the rate reduction represented less than 18 percent of PG&E's Priority 3 and 4 sales. For the remaining 82 plus percent of these categories of customers, D.89316 authorized a 10 percent increase in rates from 22.90 to 25.20 cents per therm.

With respect to lost load, Mr. Burt testified that the cement industry, without exception, either has converted to coal or heavy oil, other coal equivalents like refining coke, or is in the process of converting and will not again receive gas service from SoCal, having made long-term contracts for coal at cost in the general neighborhood of $1 per million Btu's. It is axiomatic that SoCal cannot provide gas service at a cost competitive to $1 per million Btu's.

Mr. Burt further testified that customers capable of using heavy oil are finding such fuel presently available at a cost of $1.80 per million Btu's or lower. Such prices would appear to reflect the temporary surplus of oil rather than prices that will be in effect for a prolonged period of time and, therefore, should not be used as the basis for setting rates in this proceeding.

For the Priority 3 and 4 customers, we will adopt a monthly customer charge of $15 as proposed by SoCal and the Commission staff and retain the current effective commodity charge of 21.226 cents per therm as being sufficiently high to give these customer groups' a proportionate share of the authorized increase and sufficiently low so as to reasonably maintain SoCal's market.

Priority 5 Customers

Priority 5 customers consist of utility steam electric generating plants and utility gas turbines. SoCal proposes to serve these customers under Schedule GN-5 with a monthly customer charge of $100 and a commodity charge of $2.42 per million Btu's. The staff proposes a monthly customer charge of $100 and a commodity charge of $2.70 per million Btu's. CMA originally proposed no customer charge and a commodity charge of $2.146 per million Btu's. However, according to the record, when witness Burt learned of the possibility that the Air Resources Board (ARB) might possibly require the burning of substantial amounts of gas by steam electric generating plants, CMA changed its proposed GN-5 rate to a monthly service charge of $21,861 and a commodity charge of $1.6734 per million Btu's. The proposed monthly customer charges are equal to the full cost of service for this group of customers and the commodity charge was equal to the full cost-of-service charge plus an incremental cost to cover full cost deficiency of the residential class under CMA's proposed rates.

Edison takes issue with SoCal's proposed Schedule GN-5 wherein the $100 per month customer charge will collect less than 1 percent of the fixed cost of the facilities necessary to serve Edison with the result that the inclusion of the fixed costs in the variable component can result in substantial overcollections when GN-5 deliveries dramatically exceed the estimated deliveries. Edison notes that SoCal's proposed rate design is premised on the

assumption that there will be no Priority 5 gas available during test year 1979, and that under these conditions, the imposition of a monthly demand charge (when no gas deliveries are expected) is not justifiable. It should be noted that any overcollections resulting from the proposed rate design, and a greater than anticipated gas supply will be given consideration and weight in the semiannual SAM rate adjustments.

We will adopt the $100 monthly service charge proposed by SoCal and the Commission staff and retain the current effective commodity charge of $2.1226 per million Btu's, the equivalent of the rate established for the GN-3 and GN-4 tariff schedules.

Multiple Priority Customers

SoCal proposes to offer those customers having multiple priorities of service the option of repiping their plants or entering into contracts providing for the allocation of gas consumption to end-use priorities based on their connected load and curtailment experience during the billing period. This proposal is reasonable and will be authorized.

Wholesale Customers

SoCal sells gas for resale to LB under Schedule G-60 and to SDG&E under Schedule G-61. The wholesale rates recommended by SoCal, the Commission staff, and CMA are tabulated below:

Schedule G-60
(Long Beach Gas Department)

	SoCal	Staff	CMA
Monthly demand charge, per Mcf daily contract demand	$ 3.717		
Commodity charge, per therm	17.018¢	17.00¢ 1/	14.677¢
Minimum annual charge for additional peak demand	$283.000		

Schedule G-61
(San Diego Gas & Electric)

	SoCal	Staff	CMA
Monthly demand charge, per Mcf daily contract demand	$ 2.8403		
Commodity charge, per million Btu	170.68¢	160.00¢ 1/	148.30¢
Additional peaking demand gas annual charge peaking	$523,000		
Commodity charge, per million Btu	197.40¢		

1/ Composite average of lifeline and nonlifeline commodity rates.

SoCal's proposed rates are based on the application of system average increase to the wholesale customers as has been the past practice in similar proceedings before this Commission.

The Commission staff's proposal provides for the elimination of the existing demand charges in the wholesale tariffs on the basis that with the declining supply of gas the demand component no longer exists and the demand charge should be eliminated. The proposed staff rate design puts forth a single commodity rate for Schedules G-60 and G-61 that will maintain the current revenue level. The staff allocated an increase to LB of 14.3 percent and SDG&E of 14.7 percent with an overall wholesale increase of 14.6 percent.

CMA proposed G-60 rate was maintained at the present rolled-in commodity rate rather than providing a $9,000 reduction as indicated by cost allocation studies. The G-61 rate was set at the indicated cost to serve SDG&E on the annual average-day cost allocation method.

SDG&E and LB presented evidence indicating that the increases, both past and proposed, to the wholesale customers are greater than for other customer groups. They advance a simplified cost-of-service allocation method as a vehicle for rectifying to some degree the disparity that presently exists between the retail rates to SoCal's customers and the rates to the retail customers of LB and SDG&E. According to the record, the utilization of such a method would result in an increase in the average retail rate for SDG&E customers of 10 percent as compared to 14 percent under the staff's methodology and 22 percent as proposed by SoCal, and a similar result would occur with respect to LB.

SoCal objects to SDG&E's and LB's proposals on the bases that (1) the proposed rates are based solely on allocated costs excluding all other considerations which is contrary to established practice; and (2) SDG&E's cost allocation formula is seriously deficient because it does not recognize the peak-day or seasonal-load equation requirements imposed on SoCal. Such requirements include the substantial storage cost in providing for extreme day deliveries and the costs associated with the ownership, operation, and maintenance of a transmission system which must have sufficient capacity to deliver such extreme peak-day and cold-year volumes.

The staff witness testified that lifeline allowances were included in the proposed wholesale rates to place SoCal in its treatment of wholesale customers on the same basis as PG&E's wholesale customers. SoCal argues that bifurcation of the wholesale commodity rate is not only needless, but that there is no practical way of determining the amount of sales to the subjected lifeline billing. While we are not persuaded that the amount of sales to be subjected to lifeline billing cannot reasonably be ascertained, we will not impose the dual rate for the billing of SoCal's wholesale customers.

With respect to LB's allegations that the spreading of SoCal's conservation costs to wholesale customers would be tantamount to requiring the customers of LB and SDG&E to pay for SoCal's conservation efforts, we refer to D.89316 dated September 6, 1978 on PG&E's A.57284 and A.57285 in which we stated:

> "First, as extensively discussed in Decision No. 89315, issued today in Application No. 55510 (Phase II), the resale rate is not based on a compilation of incremental costs from which one identifiable expense (such as conservation promotion) can logically be deducted." (Mimeo. p. 57.)

Consequently, our adopted conservation expenses were included in the nongas costs used for the allocation of the revenue increase to the wholesale class.

For the wholesale rates it is reasonable to maintain the existing demand charges and commodity charges.

Southern California Gas Company

ADOPTED RATES

Estimated Year 1979

Classification	Sales (Mth/M Bills)	Revenue at 7/19/77 Rates M$	Authorized Revenue M$	Authorized Rate $	Percent Incr. %	Tariff Rates (Includes GEDA & PGA) $
Residential						
Customer Charge	41,726.45 1/	129,352	129,352	3.10	0	3.10
Commodity - Tier I	1,995,335 1/	253,248 2/	320,990	.16087	26.7	.164
- Tier II	1,022,774	155,058 2/	205,445	.20087	32.5	.204
- Tier III	217,690	37,273 2/	54,758	.25154	46.9	.257
Total Residential	3,235,799	574,931	710,545	.21959	23.6	-
Nonresidential						
Customer Charge						
GN-1	2,279.2	6,537	11,412	5.00	74.6	5.00
GN-2	8.3	0	84	10.00	-	10.00
GN-3	10.5	0	156	15.00	-	15.00
GN-4	1.1	0	12	15.00	-	15.00
GN-5	0.25	0	24	100.00	-	100.00
Subtotal	-	6,537	11,688	-	78.8	-
Commodity Charge						
GN-1	1,049,690	187,788	220,571	.21013	17.5	.22220 3/
GN-2	1,232,340	229,759	246,701	.20019	7.4	.21226 3/
GN-3	231,660	43,363	46,376	.20019	7.0	.21226 3/
GN-4	0	0	0	.20019	-	.21226 3/
GN-5	32,102	6,040	6,426	.20019	6.4	.21226 3/
Subtotal	2,545,792	466,950	520,074	.20429	11.4	-
Total Nonresidential	2,545,792	473,487	531,762	.20888	12.3	-
Resale						
G-60	123,740	18,388	19,890	-	8.2	3/
G-61	510,195	71,545	77,655	-	8.5	3/
Total Resale	633,935	89,933	97,545	-	8.5	-
Total Sales	6,415,526	1,138,351	1,339,852	.20884	17.7	-

1/ Tier I sales reflect GS lifeline adjustment of 3,294 Mth.

2/ Tiers II and III revenues at 7-19-77 rates estimated.

3/ Tariff rates for GN-2 through 5 and resale are the current effective rates.

VIII. OTHER ITEMS

General

Additional issues detailed in the record of this proceeding were the "open account", the staff recommended management audit, the staff recommendations relating to SoCal's bid practices and procedures, SoCal's dual fuel conversion program, and the allowance for funds used during construction as it relates to LNG projects.

Open Account

The "open account" is simply an accounts payable, accounts receivable relationship between PLC and each of its subsidiaries. This issue surfaced during the cross-examination of witness McClure regarding the difference between 1978 test year estimates of "interest from associated companies" and "interest on debt to associated companies". The associated companies referred to one entity, PLC.

According to the record, when SoCal borrows money from PLC it pays interest based on the prime rate in effect on the first of the month. On the other hand, if SoCal has funds on deposit with PLC, it receives interest based on the rates for commercial paper in effect on the first of the month. The staff notes that the interest rates SoCal paid PLC range between 6-1/2 and 7-1/4 percent in 1976, whereas the rate paid by PLC to SoCal was in the range of 4-7/8 to 5-3/4 percent. The staff argues that the situation wherein a parent corporation operates a "free" service that controls a complex flow of funds to and from utilities and numerous nonutilities and oversees interest rates on "deposits" seems open for abuse and urges that SoCal be directed to furnish, at least at the time of the next rate case, a complete report on the "open account" for both SoCal's and PLS' participation.

In its reply brief SoCal states that the "open accounts" between the utilities and PLC have existed for many years and interest income and interest expense resulting therefrom have been recorded on each utility's books; and that the "open account" arrangement is completely aboveboard, can be easily audited, and is cheaper short-term financing for the utilities than would be the case if they were to obtain such financing on their own. SoCal notes that the staff's opening brief infers that the interest rates SoCal pays when it is in a payable position with PLC is substantially greater than when SoCal is in a receivable position. SoCal argues in 1976 the prime rate was greater than the rate for commercial paper but the reverse was true in certain months in 1974 and in 1975 when the prime rate was less than the rate for commercial paper. This matter does not appear to warrant immediate attention. However, we will expect both SoCal and the staff to review this matter thoroughly for the next rate increase application matter.

Management Audit

The staff project engineer, Bertram Patrick, recommended that SoCal be the subject of a management audit by an outside consultant. In support of his recommendation witness Patrick stated that such a study, among other things, might dispel the current belief among many ratepayers that utilities are operating on a cost-plus basis and that there is an obligation to go beyond the technique of translating cost increases into rate increases by making a determination of whether or not SoCal is efficient and economical. He noted that management audits had been recommended by the staff in PG&E and Edison rate cases.

SoCal does not take issue with the staff's recommendation that a management and operational audit be performed but states that should such an audit be required, the estimated $300,000 to

$500,000 cost of such audit should be included in the test year revenue requirements adopted in this proceeding.

In D.89316 we stated:

> "If we are to be more than a rubber stamp, translating cost increases into rate increases, we must scrutinize and exercise our investigatory ingenuity to insure utilities operate productively and efficiently. . . . We believe, however, it is necessary that the company precisely examine its efficiency and demonstrate to us that it is attempting to improve its efficiency and reduce costs. A management and operational audit by an independent consultant may accomplish this result." (Mimeo., p. 48.)

We further stated that the staff should devise specific areas of inquiry so that such an audit would not be a waste of resources. We will not require SoCal to have such an audit performed at this time, but place it on notice that such an audit will be required in the future should the results of the management audit to be performed on PG&E indicate its desirability.

<u>Bid Practices and Procedures</u>

The staff's financial examiner Mowrey recommended four changes in SoCal's bid practices and procedures as follows: (1) all potential bidders should receive a bid invitation package; (2) the opening of bids and the prices therein should be open to all bidders concerned; (3) any approved changes to bid sheets should be made known to all bidders before the bid is finished and the contract awarded; and (4) all contractors should be bonded.

SoCal notes that it currently performs a preinvitation screening of potential bidders by telephone and the additional mailings of bid invitation packages would result in unproductive additional expense to the ratepayers. With respect to the public opening of bids, SoCal notes that such used to be its practice but was discontinued because, in its opinion, the disadvantages out-

weighed any possible advantages. This aspect of the staff's recommendation was not developed on the record sufficiently to persuade us that the staff's recommendation should not be adopted. The third recommendation that any approved changes to bid sheets should be made known to all bidders before the bid is finished and the contract awarded is, according to the record, SoCal's current practice with the exception of any contractor-initiated, cost-reducing alternative. According to SoCal, its present policy is to require bondings only for those contractors who are likely to have difficulty in obtaining adequate bonds and notes that such a practice resulted in 1976-1977 bond payments of only $4,000. Under these circumstances, the bonding requirements recommended by the staff would, according to SoCal, cause a significant and needless expense to SoCal and could result in costly delays in starting construction work.

We will order SoCal to adopt only the staff's second recommendation regarding the opening of bids and disclosure of estimates.

SoCal's opposition to the adoption of the three remaining recommendations by the staff witness appears well founded and will be accepted.

Dual Fuel Conversion

Another recommendation of witness Mowrey was that SoCal phase out the compressed natural gas conversion program of new vehicles. According to the record, it is presently SoCal's policy not to purchase new conversion kits for vehicles.

Allowance for Funds Used During Construction (AFUDC)

In its opening brief SoCal notes that the staff takes exception to computing AFUDC on LNG project costs and argues that the treatment of AFUDC on these gas supply projects has no relevance in this general rate case as no expenses for such projects are included in the results of operation for test years 1978 and 1979 nor are such expenditures included in the rate base.

In its reply brief the staff admits that AFUDC on LNG projects is not a factor in determining rates in the instant case but expresses concern that since the AFUDC cost is continuing to accumulate, it most likely will eventually be passed on to ratepayers. The staff states this matter deserves close scrutiny in any future investigations of PLC's corporate financing matters.

We will expect SoCal and the Commission staff to review the matter in greater detail in connection with the next forthcoming rate increase application.

IX. FINDINGS AND CONCLUSIONS

Findings

1. SoCal is in need of additional revenues but the proposed increase of $334 million (33.5 percent) is excessive.

2. A rate of return of 9.73 percent on the adopted rate base of $1,079,620,000 is reasonable. Such a rate of return will provide a return on equity of approximately 13.49 percent, a times

interest coverage of approximately 2.53 for debt and a combined coverage factor for all interest and preferred stock dividends of 2.22 times. This return on capital is the minimum needed to attract capital at a reasonable cost and not impair the credit of SoCal.

3. The authorized rate of return on rate base and return on common equity (resulting in the increased revenue requirement found necessary herein) is expressly authorized in recognition that the next earliest test year to be used in establishing SoCal's revenue requirement will be 1981. Accordingly, the rates found reasonable herein are reasonable only if 1981 is the next earliest test year used to set rates for SoCal.

4. An adjustment in rate of return to reflect the "vigor, imagination, and effectiveness" of SoCal's conservation programs is not warranted. However, SoCal should direct its attention to the implementation of as many cost-effective programs as feasible so as to have its efforts receive favorable evaluation when the matter of such an adjustment is again considered in the next rate increase application.

5. The adopted estimates previously discussed herein of operating revenues, operating expenses, and rate bases for test year 1979 reasonably indicate the results of SoCal's and PLS' operations in the near future. Specific findings are as follows:

a. The sales revenues are $1,138,351,000.

b. The other operating revenues are $2,840,000.

c. The production expense estimate is $815,756,000.

d. The storage, transmission, distribution, supervision, and engineering expense (excluding customer service expense) is $4,336,000.

e. The expense for Account 863, Maintenance of Transmission Mains, is $1,369,000.

f. The expense for Account 878, Meter and House Regulators-Operation, are $17,930,000; for Account 879, Customers Installation, are $16,092,000; and for Account 893, Meter and House Regulators-Maintenance, are $6,232,000.

g. The expense estimate for Account 903, Customer Records and Collections, is $33,018,000.

h. The estimate for market services is $21,777,900

i. The estimate for administrative and general expenses is $102,902,000.

j. The expense estimate for depreciation is $60,302,000.

k. The weighted average depreciated rate base is $1,079,620.

6. The authorized increase in rates is expected to provide increased revenues for test year 1979 of approximately $201.5 million over base rates in effect in July 1977 which equates to an increase of approximately $82.9 million over the rates authorized by D.89208, which granted SoCal a partial general increase of $118.6 million and $102.8 million over rates effective September 1, 1978 from Advice Letter No. 1145 relating to a $19.9 million property tax reduction due to passage of Article No. XIII-A of the California Constitution. This amounts to an 8.2 percent increase over the rates authorized by D.89208.

7. Rates on the lifeline quantities for residential customers have not been increased (with the exception of a minor GEDA surcharge) since their adoption.

8. If lifeline rates are raised approximately one-half of the average system percentage increase occuring since January 1, 1979 residential customers will bear a more proportionate share of SoCal's revenue requirement.

9. The average system increase in cents per therm for SoCal since January 1, 1976 has been 53 percent.

10. The existing 5-tier usage blocks applicable to residential customers do not adequately apply higher incremental commodity charges for high use residential customers. The 3-tier usage blocks adopted herein will better provide that customers receive an economic signal that conservation will equate to savings on their bills.

11. The present rate for Priority 2 customers was established in 1978 (and increased more than 7 percent). Further commodity charge increases to this customer class at this time are not justified; however, the proposed $10 monthly customer charge is justified.

12. The commodity charges for Priority 3 and 4 customers of 24.20 and 27.00 cents per therm proposed by SoCal and the staff would tend to cause some of those customers to use alternative fuel. The 19.246 cents per therm charge proposed by CMA is insufficient and would tend to give a false economic signal that would discourage conservation. Maintaining the charge of 21.226 cents per therm will maintain SoCal's gas market while placing a proportionate share of the revenue requirement increase on Priority 3 and 4 customers.

13. Rates for SoCal's Schedules G-60 and G-61 have not been established based on a compilation of incremental identifiable cost of service expenses.

14. LB and SDG&E will benefit from SoCal's conservation expenditures and efforts in that through conservation efforts by SoCal gas supplies will be available longer and in greater quantitites to SoCal's resale customers.

15. The increase in rates and charges authorized by this decision is justified and is reasonable; the present rates and charges, insofar as they differ from those prescribed by the decision, are for the future unjust and unreasonable.

16. The apportionment of the authorized rate increase to the various customer groups as previously described is reasonable.

17. The adopted capital structure and cost factors previously discussed is reasonable.

18. A fixed rate of return of 9.73 percent on its rate base of $296,049,000 is reasonable for PLS for application in its cost of service tariff.

19. The following measures by SoCal would improve its existing conservation measurement methods:

a. Analyze and describe the impacts of price on gas consumption (especially for commercial and industrial gas use). Relate such price (rate increase) effects to the conservation projections for the various sectors. Identify reductions in gas consumption due to price (rather than conservation) as precisely as possible.

b. Use the GUESS simulation model with Monte Carlo simulation, a technique which is available within the GUESS program. This will allow evaluation of key conservation programs in terms of probability levels. SoCal can then make statements like: "The probability is 90% that this level of residential savings will be realized in the year 1979." Present this analysis along with ten-year cumulative conservation estimates.

c. Display a sensitivity analysis of the key variables affecting the conservation estimates. SoCal has already used the GUESS program to do such an analysis for its conservation estimates. Summarize, analyze, and display this information.

d. Improve the ten-year cumulative conservation estimates by adding data (to the GUESS program) about the actual effectiveness of SoCal's programs such as commercial and industrial energy audits. Attempt to make the computer-modeled savings account for the total estimates of savings. Avoid arbitrary adjustments aside from the modeled savings (e.g., setting conservation estimates at 125 percent of the previous year's estimates).

e. Alternatively, consider using a multiple regression approach to determine the overall impact of conservation programs. However, because of the limitations noted earlier with respect to a time series multiple regression approach (lack of data, etc.), methods a. through d. are likely to yield greater benefits per dollar spent, especially since they can be used within SoCal's operational GUESS program.

20. SoCal has included and the Commission has accepted $11,592,700 test year 1979 conservation expense for customer incentives. Those incentive programs were the subject of rehearing of D.88551 in Case No. 10032 held on October 30 and November 9, 13, and 14, 1978. It is reasonable for SoCal to implement its proposed incentive program subject to modification or termination after final determination of the rehearing of D.88551 in Case No. 10032. In the event the incentive programs are not authorized SoCal should be directed to develop a contingency plan for alternate conservation activities. If acceptable alternative programs are not developed, that portion of the $11,592,700 that SoCal proposed to apply to such programs should be refunded.

21. Customers would better understand the effect of conservation on their bills, and conservation would be encouraged, if SoCal revised its billing format to include report card billing and rate design information on the face of the customer's bill.

22. SoCal's proposal to offer its multiple priority customers the option of repiping their plants or entering into contracts providing for the allocation of gas consumption to end-use priorities based on their connected load and curtailment experience during the billing period is reasonable and should be authorized.

23. The opening of bids and the prices therein should be open to all bidders concerned.

24. SoCal should commence at the earliest date in compliance with the following order. Therefore, the following order should be effective the date of signature.

Conclusions

1. The Commission concludes that the application should be granted to the extent set forth in the order which follows.

2. SoCal should improve its conservation measurement methods as set forth in Finding 19 above.

ORDER

IT IS ORDERED that:

1. After the effective date of this order, Southern California Gas Company (SoCal) is authorized to file the revised rate schedules attached to this order as Appendix A and concurrently to cancel and withdraw the presently effective schedules. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be January 1, 1979 but not less than four days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date thereof.

2. Within one hundred twenty days of the effective date of this order, SoCal shall implement improved conservation measurement methods as described in Finding 19 above.

3. SoCal is hereby directed to file with this Commission within sixty days contingency plans for alternate conservation activities, with expenses budgeted at an annual rate of $11,592,700 in the event that its proposed incentive programs are not approved upon rehearing of Decision No. 88551.

4. SoCal shall offer customers having multiple priorities of service the option of repiping their plants or entering into contracts providing for the allocation of gas consumption to end-use priorities based on their connected load and curtailment experience.

5. SoCal is hereby directed to revise its billing format to include more information on its bills within one hundred eighty days. SoCal should coordinate revision of its bills with the staff of our Energy Conservation Branch before it is finalized. The adopted billing format will be approved by the Commission by way of a Commission resolution.

6. SoCal is hereby directed to insure that the opening of bids and the prices therein are open to all bidders concerned.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 12th day of DECEMBER, 1978.

I will file a dissent.
William Symons, Jr.

Robert Batinovich
President

Vernon L. Sturgeon
Richard D. Gravelle
Claire T. Dedrick
Commissioners

A.57639 /dz/ai/dz **

Southern California Gas Company

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

Schedules GR and GS	Per Meter Per Month
Customer Charge	$3.10

Commodity Charge

Billing Code 1 (Space Heating Only)

	Summer	Winter				
	All Zones	Zone 1	Zone 2	Zone 3		
First	0	55	80	115	Therms, per therm . . .	$0.164
Next	100	100	100	100	Therms, per therm . . .	0.204
Over	100	155	180	215	Therms, per therm . . .	0.257

Billing Code 3 (Basic plus Space Heating)

First	26	81	106	141	Therms, per therm . . .	$0.164
Next	100	100	100	100	Therms, per therm . . .	0.204
Over	126	181	206	241	Therms, per therm . . .	0.257

Billing Code 2 (Basic Only)

Same as summer for Billing Code 3, except applicable all year.

Schedule GM

Same structure and rates as for Schedule GR except with appropriate modifications to reflect lifeline quantities.

Schedule G-30

Rates to be increased commensurately.

Schedules GN-1 through GN-5

	Customer Charge Per Meter Per Month	All Deliveries Per Therm
GN-1	$ 5.00	$.22220
GN-2	10.00	.21226 1/
GN-3	15.00	.21226 1/
GN-4	15.00	.21226 1/
GN-5	100.00	.21226 1/

1/ Current effective commodity charge of November 21, 1978.

Wholesale Schedules, G-60 and G-61

No change from current tariff sheets effective on the date of this order. ✓

NOTES

(1) The above tariff rates include the following adjustments:

CEDA @ + 0.313¢/therm for all commodity rates

PGA

Residential @ + 0.233¢/therm for Tier III only
Nonresidential @ + 0.894¢/therm
Wholesale @ 0.583¢/therm

(2) The adopted 1979 test year summary of earnings reflects estimated reductions in ad valorem taxes resulting from the passage of Article XIII-A of the California Constitution. Accordingly, the current TCAC rate can be eliminated upon the effective date of the applicant's tariffs authorized herein. Any over- or undercollection resulting from rate decreases or estimated tax savings adopted herein as compared to actual tax savings, when known, will be reflected in the balancing account established pursuant to OII 19, and corresponding rate changes can be made as appropriate.

A.57639, D.

H-8

SoCal Gas Company- General Rate Application--Final Increase Increment of $115 million

COMMISSIONER WILLIAM SYMONS, JR., Dissenting

Over the past two years the California Public Utilities Commission has adopted gas pricing schemes like a drunken sailor. The majority lurches from one extreme to another.

1. Sensible Rate Stability is Needed. In the summer of last year, the CPUC abruptly turned the entire pricing system of gas on its head. Natural gas rates were "inverted" (D.87587, July 19, 1977). There, in the face of system increase of 13%, the Commission raised residential rates barely 1%. The Commission dumped the burden of the increase on the business community, jacking-up interrupible rates over 25%.

Today, seventeen months later, the bankruptcy of that policy is apparent. It bursts with a bang in today's 115 million dollar rate increase.[1/] Unfortunately, the Commission put off coming to grips with its policy error until today (significantly to me, one month after the general election). Finding itself in a deteriorating condition, the Commission now socks it to Priority 1--the small business and residential user.

1/ Today's Increase: Under sales adopted in this decision, SoCal Gas Company's revenue under existing July 19, 1977 rates would be 1,138 million dollars. In the course of this general rate increase application (A.57639) the Commission has already granted SoCal a net 85 million dollars partial increase (interim increase of 8/10/78 less subsequent insulation and property tax adjustments). This brought authorized revenues to 1,223 million dollars. Today's additional increase is 115 million dollars: it is a substantial 9.4% increase over current rates.

Today's order requires that Priority 2, 3, 4, and 5 gas users shoulder only $277,000 of the increase (0.2%); Priority 1 ratepayers will pay the remaining $114,314,000 (99.8%). Since the residential customer is the bulk of P-1 use, 78% of the increase (or 90 million dollars) falls on the residential customer.

This erratic pricing policy on the part of the California Public Utilities Commission helps no one. How can anyone plan ahead with any assurance? First the Commission held residential rates unduly low, discouraging sensible conservation. Now the Commission jumps residential rates 24% over what they were, and catches the householder flat-footed. A steady approach to rate setting is called for -- not a policy of fits and starts, nor of ideology and politics.

2. The CPUC Orders Discriminatory Pricing Within Residential Rates. The Commission not only orders substantial raises in residential rates, the Commission unjustifiably distorts price levels within the residential class. The Commission gives lip-service to pricing gas in accordance with what it costs to serve a customer but the Commission clearly abandons the principle in practice. "Conservation" is a buzz word the Commission uses to cover a multitude of sins, and here it is used with a vengeance. I would call these rates "scorpion rates"--rates which are low at the start, then rise up and in the tailblock deliver the residential consumer a vicious sting.

Under the "Scorpion rates" for SoCal, the Commission orders three levels of customer usage. Usage in the first tier is priced at 16.1¢ per therm, just about at the commodity cost of the sold gas In the next tier the customer pays 20.1¢; in the final tier

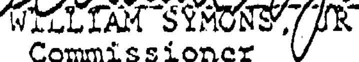
he pays 25.2¢.

Prices unreasonably above the cost to provide service are discriminatory. The consumer, who can only buy from a state-protected gas monopoly, should be defended by the Commission from discriminatory rates, not forced by the Commission to pay such rates. In this case, 25¢ per therm for gas is, on its face, at least 56% over the commodity cost of gas and is clearly price gouging.

The fact that we are dealing with "essential" energy is no excuse for the suspension of elementary justice. Food, as well as energy is an essential, yet what housewife would stand for a government pricing policy that charged her family 6¢ per egg for the first nine eggs in a dozen, and 18¢ a piece for the last three?

3. The CPUC Cannot Arbitrarily Limit a Utility's Legal Right to Seek a Necessary Rate Increase. Finding #3 seeks to condition the granted 13.49 rate of return only if the SoCal does not reapply till 1981. We cannot forsee all the possible developments between now and 1981. Under the law, we should be open to receive applications if conditions are such that the utility's invested property is earning a grossly inadequate return. Such a Commission-originated, artificial rule is without legal basis. Further, it will likely be honored only in the breach with a flurry of offsets and balancing mechanisms. The rule only serves cosmetic purposes and ought not to be promulgated.

December 12, 1978
San Francisco, California



WILLIAM SYMONS, JR.
Commissioner

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DEPARTMENT OF CORRECTIONS
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