ORIGINAL

Decision No. 91032 NOV 20 1979

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into an adjustment mechanism for electric sales to reflect in rates changes in sales from adopted test year results for Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas and Electric Company, Sierra Pacific Power Company, CP National, Pacific Power and Light, Southern California Water Company, and Bay Point Power and Light, respondents.	OII No. 25 (Filed September 6, 1978)

(Appearances are listed in Appendix A.)

OPINION

On September 6, 1978 this Commission issued an Order Instituting Investigation (OII) to consider the adoption of an adjustment mechanism for electric sales (AMES) for electric utilities subject to its jurisdiction similar to the supply adjustment mechanism (SAM) adopted for natural gas utilities. The Commission ordered respondents Pacific Gas and Electric Company (PG&E), Southern California Edison Company (Edison), and San Diego Gas & Electric Company (SDG&E) to file a comprehensive report considering the adoption of an AMES, including proposed tariff filings within 60 days after the effective date of the order, and all other respondents a similar filing within 30 days thereafter. By Decision No. 89594 the filing date was extended to December 5, 1978 for PG&E, Edison, and SDG&E and within 30 days thereafter for all other respondents.

Responses were received from PG&E, Edison, SDG&E, Sierra Pacific Power Company (Sierra), CP National (CP), Pacific Power & Light Company (PPL), and Southern California Water Company (SoCal Water). Hearings were held in San Francisco on March 14 and April 4 and 11, 1979, and in Los Angeles on March 20, 1979 to receive the exhibits and testimony of the respondents, Commission staff, and interested parties. The matter was submitted on filing of concurrent briefs due May 11, 1979. Briefs were received from the Commission staff, PG&E, Edison, SDG&E, General Services Administration on behalf of the Executive Agencies of the United States Government (GSA), California Farm Bureau Federation (Farm Bureau), General Motors Corporation (GMC), and Toward Utility Rate Normalization (TURN).

In our OII of an AMES for electric utilities we quoted certain excerpts from Decision No. 88835 in which a SAM was adopted for natural gas utilities. We indicated in that decision that "we are convinced that a SAM could encourage conservation, a matter of highest priority to this Commission and to many parties to this proceeding" and "A SAM will remove the risk to the utility of promoting conservation, while not allowing for the recovery of additional operating expenses." We then stated in the OII that these same considerations appear equally applicable to electric utilities.

Statement of Issues

The issues raised in this proceeding are:

1. Is there a need for adoption of an AMES?

2. If adopted, what form of an adjustment mechanism should be adopted?

PG&E's Proposal

PG&E takes the position that an electric sales adjustment mechanism (ESAM)[1/] should be designed to maintain utility financial

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1/ PG&E suggests the use of ESAM rather than AMES to avoid confusion between the mechanism and a large PG&E customer and to parallel the acronym for the gas utility's SAM.

health throughout the period for which general rates are in effect by providing for rate adjustments to reflect conservation-induced changes in sales revenues from adopted estimates. PG&E believes that this can be best achieved should the Commission set rates in general rate cases by use of a two-year test period and adoption of two sets of rates, one to be applied in the first year and the second in the second year, and the establishment of a supplemental ESAM based on each of the years in question rather than on the single test year.

As an alternative methodology PG&E suggests the adoption of a mechanism combined with a balancing account to accumulate and amortize the difference between actual non-energy cost adjustment clause (ECAC) revenues obtained from base rates authorized by the Commission in a general rate decision and the corresponding revenue adopted by the Commission in that decision for the test year; and, secondly, to establish a new level of rates to produce non-ECAC revenue based upon estimated non-ECAC revenue requirements for the second year and to accumulate and amortize the difference between actual revenues obtained from such newly authorized base rates and the corresponding revenues for the year following the test year.

In addition, PG&E listed four other adjustment mechanisms that might be explored should the Commission desire some other mechanism: cost-of-service indexing with rate of return stabilization, revenue per kilowatt-hour (kWh) adjustment, constant revenue per customer, and interim base rate adjustment.

PG&E states that it does not find any of the other proposals made by other parties acceptable, nor would minimum changes of any of the proposals make them acceptable to PG&E. PG&E concludes that the basic problem of attrition in rate of return should be resolved in general rate decisions before further consideration is given to an electric adjustment mechanism.

Edison's Proposal

Edison modified its proposal for an AMES several times during the course of the proceeding. Edison proposes that the AMES clause should be implemented to reflect only the effect of sales levels below the level adopted in Edison's general rate case decision, adjusted to exclude the effect of changes in the number of customers due to growth. Witness R. Daniels for Edison testified that during the test year used in a rate increase application, the recorded sales level has usually fallen below the adopted sales level whereas in the year following, the recorded sales level usually exceeded the adopted level even after adjusting for an increase in the number of customers. Under these conditions Mr. Daniels testified that Edison does not receive appropriate revenues in the first year to realize the authorized rate of return, and in the second year, the impact of year-to-year inflation has more than offset the effect on earnings of sales above the test year adopted sales level. For these reasons the witness stated that the application of an AMES in the second year would result in revenue reductions when the earnings would be declining due to inflation in operating costs even though the effect of a negative AMES adjustment would not show up in operating revenues until the following year.

In its brief, Edison further modified its AMES proposal by recommending that positive (undercollection) or negative (overcollection) entries be made in the AMES balancing account during the test year; however, in the year following the test year, positive entries and negative entries only to the extent they are equalled or exceeded by positive entries be recognized for computing the AMES billing factor. Edison further recommended that AMES should become effective for Edison when rates based on test year 1981 become effective and that the rate decision include adopted monthly period customers, sales, and revenues to minimize distortions due to seasonal variations in sales patterns and changes in number of customers.

Edison does not support the adoption of any of the other proposals other than PG&E's two test year proposal as an acceptable alternate and that it would be preferable that no AMES proposal be adopted rather than the clauses suggested by the staff or other respondents excepting PG&E.

SDG&E's Proposal

SDG&E proposes an AMES which would provide for semiannual rate adjustments and also takes into account the effect on sales caused by changes in the number of customers served. Under SDG&E's proposal a base average revenue per customer would be established for each half of the test year from the most recently adopted test year zero base revenue from sales to system electric customers and the average number of system electric customers. Each month following the implementation of AMES, one-sixth of the product of the applicable base average revenue per customer and the number of customers billed for the month would be compared with the sum of the recorded revenue from base rates for the month and the amount of revenue billed during the month under the AMES rate. The difference would determine the amount of over- or undercollection for the month.

SDG&E argues that although it believes its AMES proposal is the most equitable and reasonable, it believes that the evidence in the proceeding has failed to unequivocably demonstrate a need for an AMES. SDG&E states that the OII limited itself to determine whether an AMES was necessary to remove any utility disincentive to promote conservation. SDG&E argues that there is no way to accurately predict conservation achievements since many factors including climatic fluctuations, customer growth, inflation, and innovative rate design have an impact on sales and revenues; therefore, it appears that the stated purposes of OII 25 may not be achievable.

Should the Commission still decide to proceed with the adoption of an AMES mechanism, SDG&E argues that a semiannual adjustment period be used rather than the one-year period suggested by the staff. SDG&E also objects to the staff proposal that should AMES be in an overcollect position such balances should be carried over into the next general rate case. SDG&E believes that adjustment mechanisms such as AMES should be handled separate and distinct from matters considered in a general rate case proceeding regardless of the collection status of the balancing account.

CP's Proposal

CP's proposed AMES mechanism is similar to CP's on-file gas SAM except that it utilizes a base revenue amount per customer and only the revenues from CP's "Basic Rates" rather than using system revenues. CP's proposal differs from the staff's plan in that it (a) provides for a semiannual revision date; (b) the base revenue per customer is refined to distinguish between single-family residential and all other customers; and (c) provides for adjustment rate changes at the revision dates regardless of whether the AMES account is in an overcollect or undercollect position.

CP states that it has experienced greater than average growth in its essentially rural service area and expects a continuance of this growth. Therefore, CP states that any AMES mechanism which would penalize CP for meeting its obligations to serve that customer growth would not be appropriate.

SoCal Water's Proposal

SoCal Water in its response to OII 25 states that the adoption of a sales adjustment mechanism for only the electric side of its operations without a corresponding mechanism for its water operations would be unfair to the company.

SoCal Water's response was identified as Exhibit No. 8. Attachment 2, relating to an adjustment mechanism for water companies, was not admitted into evidence. While we can understand SoCal Water's concern for a sales adjustment procedure for its predominant water operations, this OII is not the proper vehicle to consider the need for a sales adjustment mechanism for water companies. If SoCal Water believes that such a mechanism is essential for its water operations, it should more fully develop the issue in its next general rate case proceeding.

Sierra's Proposal

In its response to OII 25 Sierra proposed a mechanism which uses average recorded customers and average use per customer based on a 12-month moving average. Sierra also proposes that the AMES adjustment not be triggered without evaluating the utility's current rate of return. If the current rate of return did not exceed the last authorized rate of return, no refund of overcollections should be required. Sierra did not present a witness to offer any additional testimony or to answer questions regarding its proposal.

Commission Staff's Position

Ida Goalwin, the staff witness in this proceeding, presented a report on an AMES. Witness Goalwin testified that the necessity for an electric adjustment mechanism is not obvious. Revenue estimates are affected not only by conservation but also by weather, economic conditions, gains or losses in number of customers and use per customer, income level, price, industrial expansion, construction, local or regional no growth policies, and federal energy policies and regulations. She further testified that in spite of conservation and other effects, electric sales continue to rise, admittedly at a lower rate than they have risen historically, and that the easy conservation gains from lowering thermostats and reducing lighting have already taken effect.

Staff witness Goalwin further testified that if the Commission were to look solely at the conservation question, then her recommendation would be that no AMES mechanism should be authorized. However, if the Commission desires to protect the utilities as well as customers from revenue overcollections or undercollections as it experiments with innovative rate designs, an AMES may be the device which may enable the Commission to do so without jeopardizing utility service and earnings. Should the Commission decide to adopt an AMES the staff recommends a mechanism similar to that proposed by SDG&E except for an annual adjustment date instead of a semiannual adjustment and any over- or undercollection be held in an AMES account until the next rate case unless such undercollection causes cash flow problems or overcollections cause the rate of return to exceed the authorized level.

Under cross-examination Witness Goalwin admitted that the staff mechanism could go beyond smoothing revenues for the effects of innovative rate techniques but will also smooth out weather and long- and short-term economic changes.

GSA Position

The GSA representing the Executive Agencies of the United States Government takes the following positions:

1. Submittals of PG&E and Edison are nonresponsive and should be disregarded.
2. SDG&E and staff proposals are general revenue stabilization proposals and not a specific conservation adjustment mechanism.
3. Current measuring techniques are inadequate to accomplish the stated purpose of the Commission.

The GSA concludes that the adoption of a general mechanism for variances in electric sales must await the development of better techniques for measurement of various variables than are presently available. It recommends that the Commission adopt a policy that a specific adjustment mechanism will be considered in the context of implementation of a precise conservation-oriented ratemaking device such as time-of-use pricing, load limiting devices, etc., wherein it may be possible to adequately determine the effect of the device in isolation from the impact of other circumstances such as weather and economic conditions.

GMC's Position

In arguing for rejection of all AMES proposals, GMC points out that AMES cannot be justified by analogy to SAM for gas utilities. Whereas the adoption of SAM could be justified for gas utilities because of the declining supply of natural gas there is no similar decline in supply forecasted for electricity.

GMC further argues that the AMES concept treats symptoms rather than the cause of revenue instability. Although the OII was issued to consider an adjustment mechanism to reduce or eliminate the risk to the utilities of promoting conservation, GMC points out that the staff witness admits that from the point of the conservation premise alone the necessity of an electric adjustment mechanism is not obvious.

GMC argues that should the Commission adopt an AMES in order to facilitate further experiments with innovative rate designs this would be at best a "bandaid" approach to the utilities' revenue instability problems. It argues that the root cause of revenue instability is the vast discrepancy between electric rates and cost of service to various classes of customers.

Finally, GMC argues that PG&E's proposal is outside the scope of OII 25 and unnecessary because of the Commission's adoption of a rate of return in the context of a two-year rate life.

Farm Bureau's Position

Farm Bureau argues that an AMES for electric utilities is not needed because (a) there is no forecast for a long-term decline in electric sales, (b) electric sales can be adequately estimated, (c) electric utilities have incentive to encourage conservation because of the threat of an imposition of a possible rate of return penalty, (d) the increasing incremental cost of new facilities require sale of additional common stock below book value thereby diluting shareholder's interests, and (e) there is no evidence that innovative rate designs have caused revenue swings.

Farm Bureau further argues that an AMES would do more than is desirable by shielding utilities from other factors that may affect revenues, thereby shifting these risks from shareholders to ratepayers. It further argues that the proliferation of adjustment mechanism is a movement toward total recorded ratemaking which again shifts the burden of risk entirely on the ratepayer and is a disincentive to maximizing efficiencies.

In conclusion, Farm Bureau believes that the Commission should declare that it will allow the introduction of evidence regarding second-year expenses in the next-filed general rate case of each major electric utility to recognize the escalation of operating costs affecting electric utilities.

TURN's Position

Mrs. Siegel testified for TURN against the adoption of any adjustment mechanism for electric sales on the grounds that no showing was made to prove the need for adoption of such a mechanism. Mrs. Siegel further testified that she considers automatic adjustment clauses of any kind to be contrary to good regulation of monopoly investor-owned utilities.

Discussion

In Decision No. 88835, in which we authorized a SAM for natural gas utilities, we expressed certain policy reasons for the adoption of such a mechanism. In our OII 25 we quoted certain pro-conservation reasons stated in Decision No. 88835 for the adoption of an adjustment mechanism. We also stated that these same considerations appear equally applicable to electric utilities and that we should consider the adoption of an adjustment mechanism for the electric utilities as well.

While these pro-conservation effects provided certain rationale for adoption of a SAM for gas utilities, the difficulties gas utilities had in developing reasonable gas supply estimates, and the resulting significant revenue effect caused by the Commission's innovative rate design were other more compelling reasons for adoption of SAM.

In contrast the various parties to this proceeding, including the staff, agree that the need for an electric adjustment mechanism is questionable. Electric sales, unlike gas sales, continue to show growth in spite of conservation measures, although at a reduced rate compared to historic growth rates. Furthermore, unlike gas utilities, the problems associated with a declining or unpredictable supply does not exist for the electric utilities nor is there anything in the record to suggest any drastic change in this historical pattern.

PG&E in its response proposed a mechanism that would attempt to resolve the problem of earnings erosion in the year following the test year. After proposing an all inclusive adjustment mechanism in its response to the OII, PG&E concludes that the basic problem of attrition in rate of return should be resolved in general rate decisions before consideration is given to an electric adjustment mechanism.

Only SoCal Water made a strong plea for the adoption of an adjustment mechanism provided, however, that such adjustment mechanism would equally apply to its water operations in which conservation practices introduced during the drought continues to have a strong impact on water sales and revenues. As we have indicated earlier, sales problems of water utilities are outside the scope of this OII and is a matter that SoCal Water and the staff should address in a future general rate increase proceeding.

While the staff witness has testified that new or emergency technologies and innovative rate designs may have a decided impact on electric utility revenues and that an electric adjustment mechanism may be the very device which may allow the Commission to experiment with new technology and rate design without major short-term dislocations in electric utility company service and earnings, we do not currently believe that these reasons provide sufficient justification for the adoption of an AMES.

Findings of Fact

1. An investigation was conducted to determine whether an AMES for electric utilities should be adopted to resolve the apparent inconsistency between traditional ratemaking and a utility's incentive to promote conservation.

2. The problems of declining supply and unpredictable sales and revenues which plagued the natural gas utilities and resulted in the adoption of SAM are not serious problems for the electric utilities.

3. At the present ~~there is no way to~~ it is difficult to accurately predict conservation achievements, as many other factors including climatic fluctuations, customer growth, changes in customer usage, inflation, as well as innovative rate designs all have an impact on sales and revenues. KB

4. Contrary to the proceedings in which SAM was considered for natural gas utilities, the respondents generally did not support the adoption of an adjustment mechanism patterned after SAM, except for SoCal Water which was primarily concerned with the effect of conservation on its water operations.

5. The adoption of a modest AMES for electric utilities which would shield utilities from the effects of conservation measures on sales and revenues would also shield the utilities from risks associated with various other factors such as weather and economic fluctuations which also affect sales and revenues.

6. No convincing showing has been made as to the necessity for the adoption of an AMES.

Conclusion of Law

Based on the above findings we conclude that sufficient justifications for the adoption of an AMES do not currently exist; therefore, OII 25 should be discontinued.

OII 25 rr

ORDER

IT IS ORDERED that Order Instituting Investigation No. 25 is hereby discontinued.

The effective date of this order shall be thirty days after the date hereof.

Dated NOV 20 1979, at San Francisco, California.

John E. Bryson
President
Vernon L. Sturgeon

Claire T. Dedrick
Leonard M. Grimes, Jr.
Commissioners

Commissioner Richard D. Gravelle, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

LIST OF APPEARANCES

Respondents: Malcolm H. Furbush, Robert Ohlbach, and Bernard S. Della Santa, by Robert Ohlbach, Attorney at Law, for Pacific Gas and Electric Company; John R. Bury, David N. Barry, III, William E. Marx, and Richard K. Durant, Attorneys at Law, for Southern California Edison Company; Jeffrey Lee Guttero, Steve Edwards, and Randall W. Childress, Attorneys at Law, for San Diego Gas & Electric Company; Patrick T. Kinney, Attorney at Law, for Sierra Pacific Power Company; John P. Vetromile, for CP National; and O'Melveny & Myers, by Guido R. Henry, Jr., Attorney at Law, for Southern California Water Company.

Protestant: Sylvia M. Siegel and Ann Murphy, Attorney at Law, for Toward Utility Rate Normalization.

Interested Parties: Thomas S. Knox, Attorney at Law, for California Retailers Association; Allie G. Lattimer, General Counsel, Spence W. Perry, Assistant General Counsel, and John L. Mathews, Western Area Chief Counsel, for the U.S. General Services Administration on behalf of The Executive Agencies of The United States; Graham & James, by Boris H. Lakusta, David J. Marchant, and Thomas J. MacBride, Jr., Attorneys at Law, for Western Mobilehome Association and California Hotel and Motel Association; John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for the City of San Diego; George P. Agnost, City Attorney, by Leonard Snaider, Deputy City Attorney, for the City and County of San Francisco; Glen J. Sullivan, Attorney at Law, for California Farm Bureau Federation; and Downey, Brand, Seymour & Rohwer, by Richard R. Gray, Attorney at Law, for General Motors Corporation.

Commission Staff: Patrick J. Power, Attorney at Law.