

ORIGINALDecision No. 91269 JAN 29 1980

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into electric utility Energy Cost Adjustment Clause (ECAC) tariff and the changes, if any, that should be made to its provisions and procedures.

OII No. 56
(Filed August 14, 1979)

Malcolm H. Furbush and Bernard J. Della Santa, Attorneys at Law, for Pacific Gas and Electric Company; John R. Bury, David N. Barry, William E. Marx, and Richard K. Durant by Richard K. Durant, Attorney at Law, for Southern California Edison Company; Jeffrey Lee Guttero and William L. Reed, Attorneys at Law, for San Diego Gas & Electric Company; and Jack C. McElwee, for Sierra Pacific Power Company; respondents.

Boris H. Lakusta, David J. Marchant, and Thomas J. MacBride, Jr., Attorneys at Law, for Western Mobilehome Association and California Hotel and Motel Association; Michel Peter Florio and Edward M. Goebel, Attorneys at Law, and Sylvia M. Siegel, for Toward Utility Rate Normalization; Downey, Brand, Seymour & Rohwer, by Philip A. Stohr and Richard R. Gray, Attorneys at Law, for General Motors Corporation; Allen R. Crown and Glen J. Sullivan, Attorneys at Law, for the California Farm Bureau Federation; John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for the City of San Diego; Leonard Snaider, Deputy City Attorney, for George Agnost, City Attorney, City and County of San Francisco; and Harry K. Winters, for the University of California; interested parties.

Richard D. Rosenberg, Attorney at Law, for the Commission staff.

INTERIM OPINIONI. Introduction

By order dated August 14, 1979, this Commission instituted this generic investigation into the operation of the Energy Cost Adjustment Clause (ECAC). By Administrative Law Judge's rulings the scope of this proceeding has been defined and a schedule set for the taking of evidence.

One of the issues expressly included within the scope of this proceeding is the matter of the appropriate interest expense calculation to be applied to the ECAC balancing account balance. On November 15, 1979, Southern California Edison Company (Edison) filed a Notice of Motion and supporting papers for an order increasing the interest rate applicable to ECAC. Hearing on the motion was set for December 3, 1979, before Administrative Law Judge Patrick J. Power. Replies to Edison's motion were filed by Pacific Gas and Electric Company (PG&E) and San Diego Gas & Electric Company (SDG&E), each on November 21, 1979. Sierra Pacific Power Company (Sierra) did not reply or appear.

Additional evidence was offered by Edison and SDG&E on January 14, 1980. Sierra appeared at the January 14th hearing and announced its support for the motion.

II. Summary of Record

At the December hearing Edison offered two witnesses in support of its motion: John B. Adams, Director of Economics, and Warren E. Ferguson, Manager of Tariffs in its Revenue Requirements Department. SDG&E sponsored the testimony of Paul A. Williams II, its Manager, Financial Planning. PG&E offered the testimony of James T. Doudiet, its Treasurer. The Commission staff appeared at the hearing and sponsored the testimony of Teddy B. Christensen, a Public Utility Financial Examiner in its Revenue Requirements Division - Financial Analysis Branch. The cities of San Francisco and San Diego appeared at the hearing and participated by way of cross-examination.

At the January hearing Edison offered additional testimony by Adams and Ferguson. SDG&E offered additional testimony by Williams.

Edison proposes that the interest rate applicable to the ECAC balancing account should be increased from the present

fixed rate of seven percent to a variable rate tied to the interest rate applicable to commercial paper. It points out that its history with ECAC is characterized by substantial undercollections and forecasts carrying a \$300 million undercollection for the year 1980, even with timely operation of the clause. It contends that this condition is contrary to the anticipated operation of ECAC - periodic over- and undercollections. Edison argues that in these circumstances it is necessary that actual interest be recognized so that the utility may have the opportunity to earn its authorized rate of return.

Witness Adams testified regarding the borrowing practices and consequences related to ECAC. He testified that Edison typically finances undercollection by use of commercial paper, up to the extent of its line of credit, as commercial paper offers the lowest of the short-term money rates. He originally supplied a table comparing Edison's actual short-term interest rate with the prime interest rate, banker's acceptance 90-day interest rate, and the commercial paper 4 to 6 months rate published by the Federal Reserve Board. From this table it appears that the published commercial paper rate most reliably approximated the rate that Edison pays. He points out that the Federal Energy Regulatory Commission (FERC) has recently issued Order No. 47 (Docket RM 77-22) establishing the prime rate as the interest rate applicable to refunds of differences in revenues between the resale rates filed by the utility and the resale rates later determined by FERC to be just and reasonable. The prime rate is shown by the evidence to be uniformly higher than the commercial paper rate.

Adams' subsequent testimony disclosed that the Federal Reserve was no longer publishing the 4-6 months Prime Commercial Paper Rate. He testified as to his analysis of alternative rates and recommended that the Federal Reserve Board 3-month Prime Commercial Paper Rate be adopted as a reasonable indicator.

Witness Ferguson sponsored specific tariff revisions that would implement the interest rate recommendation made by Adams. The language ultimately proposed is:

"...interest will accrue monthly to the Balancing Account on the average of the beginning and ending balance in the Balancing Account at the rate of 1/12 of the most recent month's interest rate on Commercial Paper (prime, 3 months), published in the Federal Reserve Statistical Release, G. 13. Should publication of the interest rate on Commercial Paper (prime, 3 months) be discontinued interest will so accrue at the rate of 1/12 of the most recent month's interest rate on Commercial Paper, which most closely approximates the discontinued rate, and which is published in the Federal Reserve Statistical Release, G. 13, or its successor publication."

The only substantive change intended is with respect to the interest rate.

SDG&E supports the motion and proposes that the ECAC interest rate be allowed to vary among the utilities to reflect the differences in actual financing costs. Witness Williams offered a table comparing SDG&E's short-term interest expense to the commercial paper rate and proposed that the commercial paper rate be adjusted upward by 50 basis points (.5 percent) to reflect SDG&E's higher borrowing costs associated with its lower financial credit rating. His January testimony expresses continued support for the motion.

PG&E supports the motion. Witness Doudiet concurs that commercial paper is the lowest cost form of short-term borrowing. He supports a variable rate as a better reflection of the cost of money over time and proposes that the variable rate be made applicable to other balancing accounts, in addition to ECAC.

Staff supports a change in the interest rate, with several material variations from the Edison proposal. Witness Christensen proposes that the applicable interest rate be determined quarterly and be either the average of three months' commercial paper rates or the authorized rate of return, whichever is lower. She also proposes that the interest not be compounded.

The basis for these differences is her concern that some incentive must be provided the utility to minimize its undercollection and interest expense. She warns of an incentive for the utility to invest in undercollections, to the extent that it can recover more than its authorized rate of return.

She characterizes the lag associated with her averaging method as not unreasonable, and the compounding of interest as a burden on the ratepayer or company, depending on under- or overcollection. She suggests that the principle at stake might also be applied to other balancing accounts or monies held subject to refund, such as customer deposits. She intends that her recommendation be considered as "interim" so that further consideration may be given.

Upon cross-examination of these various witnesses by counsel for the cities of San Francisco and San Diego, each utility identified several accounts that are currently calculated using seven percent interest. There was general agreement among the parties that a single interest rate should be applied on a company-wide basis.

III. Adopted Method

We adopt the basic recommendations of the utilities. We find that it is reasonable to apply a variable monthly interest rate to the ECAC balancing account based on the commercial paper, prime three-month rate derived by the Federal Reserve, with recognition of the higher cost of financing for SDG&E.

We are satisfied that the variable monthly interest rate derived in this manner provides sufficient incentive for the utilities to act to minimize undercollections and interest expense. This is because the adopted method does not remove the risk or opportunity to the utility associated with actual interest rates being higher or lower than the authorized. This point is illustrated by reference to the evidence showing that the utilities have previously been able to borrow at less than seven percent, indicating that they recognize the opportunity associated with this procedure.

This previous experience illustrates the basis for

changing the applicable rate. A fixed rate does not reflect variation in money market conditions. This might be tolerable if periods of overcollection balanced periods of undercollection. This has not occurred.

This problem demonstrates one of the fundamental concerns that precipitated this generic investigation - the reasonableness of ECAC procedures. The interest rate issue can best be resolved by reducing the amount at stake - by reducing the undercollection. We expect this issue to be addressed in more detail in the hearings to follow.

We do not now impose the limitations proposed by staff. We consider that compounding reflects actual market conditions in the same way that a variable monthly rate reflects the market. We see no basis for imposing a rate of return ceiling on the interest rate in this context.

The staff proposal to apply a rate of return ceiling does reflect recognition that each company has different costs of capital, as each company has a different rate of return. Therefore, we authorize SDG&E an interest rate 50 basis points higher, a conservative estimate of the premium at current high interest rates. But we are concerned that rate of return as a ceiling would unfairly discriminate against a utility that has prudently managed funds over time so as to require less investment, thereby yielding lower capital costs. A lower rate of return based on lower embedded cost of debt may not translate into much of a savings in the short-term money market.

We are impressed that the same considerations that support this decision apply to the other interest-bearing accounts of these utilities, as well as others. Therefore the authority granted by this order is expressly tied to a recalculation of interest rates applicable to each of these accounts. As to customer deposits, the record indicates that interest is not presently

compounded. We think that utilization of a monthly interest rate, with compounding, for other accounts supports compounding of interest on customer deposits.

Findings of Fact

1. Substantial undercollections have been incurred by utilities through the operation of ECAC.
2. The present interest rate of seven percent allowed on the ECAC balance does not fairly compensate the utility or the ratepayer, depending on under- or overcollection.
3. An interest rate that varies monthly most reasonably reflects actual money market conditions.
4. Compounding of interest best reflects the actual burden on the ratepayer or utility, depending on over- or undercollection.
5. Commercial paper is the lowest cost form of short-term borrowing available to the utilities for financing undercollections.
6. The Federal Reserve Statistical Release, G-13, is a reliable indicator of the interest rate applicable to commercial paper, prime three months.
7. The interest rate published monthly in the Federal Reserve Statistical Release, G-13, is a reasonable interest rate to apply to utility balancing accounts, plus 50 basis points to recognize higher financing expenses for SDG&E.
8. The interest rate applicable to various utility accounts ought to be uniform. No change in the interest rate should be authorized except on a companywide basis.
9. Timely implementation of the new interest rate requires that this order be effective the date hereof, so that respondents may apply the rates for the entire year 1980, by applying the rate to January month-end balances.

Conclusions of Law

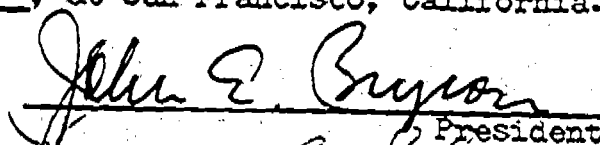
1. A change in the interest rate applied to various utility accounts is reasonable.
2. A variable rate compounded monthly is reasonable and should be authorized.
3. The interest rate should be uniformly applied on a companywide basis.

INTERIM ORDER

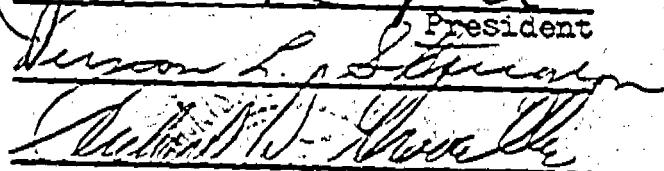
IT IS HEREBY ORDERED that the interest rates applicable to the various accounts of the respondent utilities shall be changed to conform to the published Federal Reserve Board three months Prime Commercial Paper rate (plus 50 basis points for San Diego Gas & Electric Company) on a companywide basis, effective January 31, 1980. Advice letter filings to modify appropriate tariff provisions shall be made within fifteen days of the effective date of this order. This authority is interim; the interest rate calculation is subject to recalculation and refund.

The effective date of this order is the date hereof.

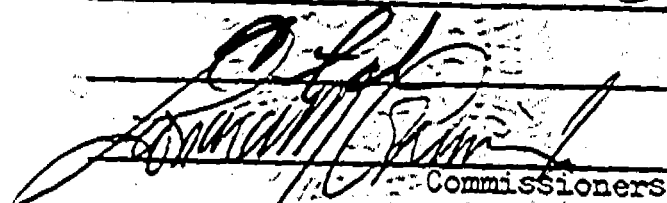
Dated JAN 29 1980, at San Francisco, California.



President



Secretary



Commissioners