

Decision No. 92303 OCT 8 1980**ORIGINAL**

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)
 for gas service until rates to be)
 authorized in Application No. 59316)
 are made effective.)

Application No. 59832
 (Filed July 25, 1980)

O P I N I O N

Southern California Gas Company (SoCal) has filed an application for emergency interim increase in its rates or its gas margin to produce \$45 million for calendar year 1980.

Position of SoCal

SoCal requests that this Commission issue its order finding that:

1. Its existing rates produce a rate of return unacceptably below the rate of return authorized for 1980 and are insufficient to provide a fair, just, and reasonable return to SoCal for 1980.
2. SoCal be authorized to increase the gas margin for the calendar year 1980 by \$45 million or to increase its rates by \$45 million to be collected over the remainder of the year or alternatively,
3. SoCal be authorized on an immediate basis to increase its gas margin or its rates by \$45 million on an annualized basis.
4. The rates requested in this application are necessary, just, and reasonable.
5. The relief requested will terminate on the effective date of the rates to be authorized for test year 1981 in Application No. 59316.

The application does not include a cost of service increase for Pacific Lighting Service Company (PLS) since PLS' earnings remain static due to its tariff.

SoCal asserts that the requested relief is essential to ameliorate the severe deterioration in the financial and operational

attrition of SoCal which is, and has been, occurring due to extraordinary economic circumstances which were unforeseeable and beyond the control of the Commission and SoCal, namely the debilitating effect of rampant inflation throughout the economy.

SoCal alleges that both its labor and nonlabor costs have outstripped the allowances made to the last rate decision due to levels of inflation which substantially exceed the seven percent provided for in rates.

It notes that it was authorized rates in Decision No. 89710 to produce a rate of return of 9.73 percent with a corresponding return on equity of 13.49 percent. It contends that the erosion due to inflation is occurring so swiftly and with such significance that for the 12 months ended June 1980, it was earning 7.06 percent rate of return with a return on equity of 10.79 percent. SoCal seeks the rate increase for the remainder of 1980 to enable it to have an opportunity to try to earn the rate of return presently authorized. The requested revenue increase will increase SoCal's rate of return in 1980 by approximately 12 percent and the corresponding improvement in return on equity is approximately 30 percent.

SoCal does not propose that its entire test year 1979 results of operations be reviewed to reflect all inflationary pressures but has limited its request for relief to four areas with the hope of getting a speedy review and prompt decision authorizing increases in these areas:

- 1. Nonlabor inflation on such items as plant, materials and supplies, and other items (\$12.5 million).
- 2. Wage increase to reflect present wage levels negotiated in March 1980 (\$14.6 million).
- 3. Financial attrition to reflect the increased interest expense in excess of the levels adopted in Decision No. 89710 (\$12.8 million based on the staff financial exhibit in SoCal's current general rate case, Application No. 59316).
- 4. Gas in storage to reflect the cost of gas stored underground which, because of the mechanics of the PGA procedure, does not reflect

the actual cost of such supply until it is withdrawn and sold (\$5.1 increase in annual gross revenues).

SoCal requests an exemption from the Regulatory Lag Plan set forth in Commission Resolution No. M-4706 dated June 5, 1979, due to the sudden, significant, and unforeseen change in operating conditions. It alleges that immediate rate relief is imperative but is unavailable under existing procedures.

Position of the Commission Staff

On August 14, 1980, the Commission staff (staff) filed a motion for an order dismissing Application No. 59832. Staff asserts that SoCal is precluded under the Regulatory Lag Plan from requesting rate relief for 1980, the year between test years 1979 and 1981. It points out that the Commission expressly authorized a higher rate of return than it ordinarily would have for 1979 conditioned on use of 1981 as the next earliest test year for establishing SoCal's base rates.

Staff contends that interim rate relief is an extraordinary remedy justified only if a utility faces financial emergency and that inability to achieve the last authorized return is not grounds for extraordinary relief since regulation does not guarantee a return. It notes that SoCal's allegations, even if accepted as true, do not contain a showing of emergency and therefore do not warrant rate relief.

Position of City of Los Angeles, City of Santa Monica, and City of San Diego

The City of Los Angeles, City of Santa Monica, and City of San Diego (Cities) filed a joint memorandum in opposition to SoCal's request for interim rate relief. Cities basically agree with the staff position that SoCal has not demonstrated that an emergency exists sufficient to justify interim rate relief, particularly in view of the fact that Application No. 59316 requesting rate relief for test year 1981 has been submitted with decision expected before the start of the test year.

SoCal filed a response to the staff motion on August 28, 1980 asserting that the application on its face presents a prima facie showing of financial emergency which must be investigated by this Commission. It takes issue with the staff position that the Regulatory Lag Plan effectively prevents the Commission from granting the requested relief and notes that certain other applications for rate relief between test years have recently been approved.

SoCal also argues that the return on equity figure staff characterizes as "artificially high" was in fact far too low, in part because it focused only on operational attrition and ignored financial attrition.

Discussion

After careful review of SoCal's application and response to the staff motion to dismiss, we have come to the conclusion that the showing in the application is vague, general, and incomplete, and that the conditions alleged by SoCal are not sufficient to consider interim rate relief at this time.

The showing in the application is vague, general, and incomplete

We read many references to an "emergency" in SoCal's application but we notice that the hard facts which would indicate a true emergency are never adduced. Basically what SoCal is saying is that inflation has increased its costs and that its embedded cost of debt has risen. These are not sudden or unexpected changes; we pointed out nearly two years ago that we expected such to happen. Neither is the effect of these changes significant. A return on equity for the 12 months ended June 30, 1980 of 10.79 percent, while lower than we authorized, is simply not the disastrous decline SoCal would have us believe, especially in view of the fact that the figures are as of a date 18 months into the rate life of a two-year decision.

With respect to SoCal's request that financial attrition be recognized to reflect the effect of increased interest expense, SoCal

is in effect asking that we change a cost component of the adopted capital structure from Decision No. 89710. It is unclear whether SoCal wishes the capital structure itself changed or not. Similarly, it is not clear, when SoCal states in its application that it is earning 7.09 percent rate of return (and 10.79 percent return on equity) for the 12 months ended June 30, 1980, whether it is using the capital structure and cost components set out in Decision No. 89710 or the actual capital structure as of June 30, 1980 or some hybrid of the two. We note that SoCal shows a rate of return in Table B of its application of 7.78 percent for test year 1979 adjusted but we have no idea what the resulting return on equity is since we do not know what capital structure SoCal is using. This 7.78 percent figure does not compare with the 12 months ended June 30, 1980 figure of 7.09 percent cited earlier. No explanation is given that would allow us to tie the two together.

SoCal asks the Commission to authorize rates to reflect the impact of inflation on nonlabor items such as plant, materials, and supplies, and other items, amounting to \$12.5 millions. It goes on to say, in the proposed testimony submitted with the application, that it is virtually impossible to identify each item that has increased above the allowed cost level because of inflation. It assumes a 16 percent average inflation rate for 1980 for a gas utility such as SoCal. No effort is made to show that SoCal is actually incurring this rate of inflation or, if it is, what steps management is taking to mitigate the effects of it. It is not good ratemaking practice to allow recovery on expenses based on what a utility such as SoCal might incur based on various inflation indices which may or may not reflect expenses actually being incurred by SoCal itself.

SoCal also proposed that the Commission authorize it to increase rates to reflect the cost of gas stored underground which does not reflect the actual cost of such supply until it is withdrawn and sold to customers. There is no explanation as to why SoCal has excess gas in storage, how much excess gas it has in storage, what

the cost of the gas was, what circumstances surrounded its purchase, where it was purchased, and whether there were alternatives to storing such gas underground. SoCal alleges no test year deficiency in the treatment of gas or valuation of gas stored underground in Decision No. 89710 and we are uncertain whether SoCal believes that rates authorized in that decision were insufficient or whether conditions surrounding the purchases and storage of gas have changed since issuance of the decision. The application is silent on all issues except the requested \$5.1 million increase in annual gross revenues.

We expect that given adequate time for review and separate analysis, our staff could have answered the questions we pose and could have developed a showing either through cross-examination of SoCal's witnesses or presentation of its own witnesses sufficient for us to issue a decision. The burden to do this, though, is clearly on the applicant and SoCal has failed to carry that burden. In the face of the clear warning in Decision No. 89710 that this Commission was not staffed to process rate cases with back-to-back test years, SoCal has filed an application which would, in our opinion, require extensive staff work to analyze if we were to have anything on which to base our decision other than SoCal's bare assertion that it needs rate relief in four particular areas. We simply do not have the time to develop the kind of presentation applicants should be making as a matter of course, particularly in view of the fact that we have committed a large amount of manpower to work with SoCal's pending general rate Application No. 59316.

Conditions alleged in the application do not justify emergency interim rate relief

The return on equity in Decision No. 89710 was authorized with the recognition that expenses would tend to increase generally as would the utility's embedded cost of debt. While inflation at rates higher than estimated for the 1979 test year has occurred we

are not convinced that the effect has created an emergency sufficient to justify the interim rate relief SoCal requests.

We note that SoCal's application does not allege that it has any problem with adequate interest coverage which would preclude issuing new debt (which was the basis on which we authorized emergency interim relief for San Diego Gas & Electric Company in Decision No. 85108 cited by SoCal in its application), nor do we find any allegation that construction necessary to serve new customers cannot be financed (which was the basis on which we authorized emergency interim relief for Pacific Telephone in Decision No. 91495, also cited by SoCal in this application).

Further, we are now only three months from the beginning of a new test year and have every expectation that new rates will be in place at the beginning of that test year unlike the situation which prevailed for both SoCal and Southern California Edison Company (Edison) when interim rate relief was authorized in Decisions Nos. 89208 and 89130, respectively. In those decisions we noted that the utilities had employed dual test years, and were partially into the first test year of 1978, for which full evidentiary showings had been made. At that time we were in the early stages of implementing the Regulatory Lag Plan and had we not authorized interim relief, neither utility could have hoped to earn the return authorized for the first test year.

Finally, the remaining recent instance of interim relief cited by SoCal was Decision No. 92166 which was an offset proceeding to consider Edison's Load Management Program authorized by the California Energy Commission under Public Resources Code Section 25403.5. That section requires that we authorize recovery of prudent expenses incurred for these programs. This matter is so totally inapposite that we are surprised SoCal cited it in this application as support for emergency rate relief.

SoCal notes in its response to the staff motion to dismiss that "everyone is well aware that, standing alone, 'inability to achieve the last authorized return is not grounds for extraordinary relief'." It goes on to say "Such a representation is nothing more than an irresponsible attempt by the staff to detract from the seriousness of SoCal's present economic circumstances." (p.5)

Reading the application and related testimony, however, gives us no clue to the specific economic circumstances to which SoCal refers. Is it unable to issue debt? The application does not say so. ✓ Is it unable to finance needed construction? The application does not say so. ✓ Does it have an interest coverage problem or face an imminent downgrading of its securities? The application is silent. Is there a cash flow deficiency, or an inability to meet current expenses? We do not know. The only allegation that comes through loud and clear ✓ from the application is that SoCal is not currently earning its last authorized rate of return. Under these circumstances we are unable to find any financial emergency and are unwilling to construe one based on the application SoCal has filed.

We are concerned that SoCal has apparently misconstrued our intentions in authorizing an unprecedented 13.49 percent return on equity in Decision No. 89710 vis-a-vis the two-year rate life we expected our decision to have. In authorizing such a high return we recognize that it is bound to decline in the second year. We also recognize that there is substantial likelihood of higher earnings in the first year due to use of a year-end capital structure. SoCal's application comes perilously close to requesting a guaranteed rate of return. We will discuss the matter of financial and operational attrition thoroughly in the decision in Application No. 59316 pending before us, particularly as it affects our adopted rate of return. We will also include further elaboration of the circumstances under which we may entertain applications for rate relief between test years.

We are aware of the comparison which will undoubtedly arise between our dismissal of this application and our decision to go to

hearing on PG&E's Application No. 59902 which requests an increase of approximately \$315.7 million in gas and electric rates to offset the effects of financial and operational attrition. We feel constrained to point out the obvious differences. PG&E is only 9 months into its test year and, under the Regulatory Lag Plan, could not expect general rate relief again until January 1982, some 15 months away. SoCal can expect general rate relief in approximately four months, in January 1981. Additionally, while SoCal alleges an earned rate of return for 1980 of 7.06 percent and a return on common equity of 10.79 percent, PG&E alleges an earned rate of return of 7.02 percent (electric) and 7.77 percent (gas) with resulting returns on common equity of 5.03 and 6.86 percent. These returns on equity are about half of what SoCal is currently earning. Again, the relative position of the two utilities in the continuum of the rate life of their last general rate decision has a strong bearing on our consideration of the need to act on their respective applications for interim rate relief.

Findings of Fact

1. The application is vague as to its basis and contains only a generalized request for rate relief based on failure to earn the last authorized rate of return.
2. The application does not contain sufficient information to make an informed decision on the issues of financial attrition, gas in storage, or nonlabor inflation.
3. The application does not allege facts which indicate a financial emergency.
4. The application indicates that SoCal earned a rate of return for the 12 months ended June 30, 1980 of 7.06 percent and a return on equity of 10.79 percent.
5. SoCal was authorized a rate of return of 9.73 and a return on equity of 13.49 in its last general rate case.
6. SoCal presently has submitted a general rate case for test year 1981.

Conclusions of Law

1. SoCal has failed to allege sufficient facts to constitute a financial emergency.

2. SoCal has failed to allege sufficient facts of any kind to enable the Commission to make an informed decision on certain matters contained in the application.

3. The application is at variance with the Regulatory Lag Plan without good cause being shown for the variance.

4. The application for emergency interim rate relief should be dismissed.

O R D E R

IT IS ORDERED that the application of Southern California Gas Company for an emergency interim increase in rates is hereby dismissed.

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

Dated ~~_____~~ 8 OCT 8 1996, at San Francisco, California.

John E. Byrne
President

Richard D. Howell

Thomas W. Smith
Commissioners

*I dissent
applicant should
have been allowed
a hearing*

Vernon L. Sturgeon

Commissioner Claire T. Dedrick, being necessarily absent, did not participate in the disposition of this proceeding.