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Decision 97-09-052 September 3, 1997

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company to
Establish an Experimental Performance-Based
Ratemaking Mechanism. (U 902-M)

Application 92-10-017
(Filed October 16, 1992)

OPINION ON MOTION TO SUSPEND INCENTIVES

Summary

The motion by the Office of Ratepayer Advocates (ORA) to suspend the incentives in San Diego Gas & Electric Company's (SDG&E) experimental base rate performance-based ratemaking (PBR) mechanism is granted in part. In view of the electric rate freeze approved for SDG&E pursuant to Assembly Bill (AB) 1890 (Stats. 1996, Ch. 854), the mechanism's electric price performance rewards and penalties are suspended. Other aspects of ORA's motion are denied without prejudice.

Background

Decision (D.) 94-08-023 dated August 3, 1994 established an experimental PBR mechanism for setting SDG&E's base rates. The experiment is scheduled to run through the end of 1998. Among other things, it includes a system of shareholder rewards and penalties which are intended to provide SDG&E's managers with incentives to improve the company's performance relative to benchmarks established for the company's electric rates, employee safety, electric system reliability, and customer satisfaction. ORA takes the position that AB 1890 renders the rewards obsolete, and it has filed a motion to suspend the incentives, at least for the duration of the uneconomic asset recovery period established by Section 368.¹

¹ All section references are to the Public Utilities Code.

SDG&E, Utility Consumers' Action Network (UCAN), and the Independent Energy Producers' Association (IEP) filed responses to the motion. SDG&E opposes the motion. UCAN and IEP support ORA's position.

Discussion

SDG&E argues that we should summarily reject ORA's motion on the grounds that it should have been filed as a petition for modification of D.94-08-023. SDG&E contends that suspending the PBR rewards would modify the decision substantively, and that a petition for modification is required under the Rules of Practice and Procedure. Moreover, SDG&E points out, when the Commission approved the experiment it addressed the possibility of future alterations to the PBR mechanism to deal with changing circumstances. In particular, it provided that petitions for modification or applications would be filed to initiate such alterations. (D.94-08-023, slip op. at 58-59.) SDG&E claims that these provisions of D.94-08-023 serve to preclude our consideration of ORA's motion.

Since we began considering SDG&E's PBR proposals in this docket, we have given considerable weight to their experimental nature. Among other things, this led us to adopt a policy of maintaining program stability during the term of the base rate experiment. (D.94-08-023, slip op. at 38.) On the other hand, we did not rule out the possibility that we would need to change the program for reasons not known at the time it was adopted. (*Id.*) In fact, we were careful to note that a decision in our electric industry restructuring proceeding could, "...for any number of reasons, prompt us to revisit the base rates mechanism during the term of the experiment." (*Id.*, Footnote 7, slip op. at 17.) It follows that action by the Legislature with respect to industry restructuring could also prompt us to revisit the base rate PBR.

Accordingly, if we become aware of significant problems with the experiment, we should not hesitate, either on procedural or substantive grounds, to consider appropriate modifications. In this case, we will exercise our discretion to consider the substance of the relief sought by ORA even though the request was not filed as a

petition for modification. In so doing, we note that parties have been given notice of and opportunity to be heard on the proposed modifications.

SDG&E's reliance on D.94-08-023's provision for applications and petitions for modification as grounds for rejecting ORA's motion ignores a portion of the decision's language governing alterations to the mechanism. We did not contemplate that changes to the PBR mechanism would be limited solely to those initiated by petitions for modification and applications for relief due to material external events. To the contrary, we stated that:

"In addition to these explicit provisions [for applications and petitions for modification] in the Joint Proposal, SDG&E recognizes that the Commission has the jurisdiction to modify its own regulations at any time." (D.94-08-023, slip op. at 58-59.)

ORA contends that the imminence of competition brought about by AB 1890 has eliminated the need for the mechanism's rewards for employee safety, system reliability, and customer satisfaction. ORA proposes that we suspend these nonprice rewards and penalties. We are not persuaded by this aspect of ORA's motion. The nonprice incentives may remain useful for the time being because they should encourage SDG&E to maintain and improve overall system quality during the transition to a more competitive electric market. In addition, the employee safety and customer satisfaction benchmarks apply to gas as well as electric service, and we are reluctant to eliminate these incentives on the basis of changed circumstances affecting only the electric industry.

We recognize that the midterm evaluation of the base rate PBR experiment which is now in progress could reveal a need for further adjustments to the mechanism. Accordingly, we deny ORA's request to suspend the nonprice incentives but preserve the right of ORA and other parties to further address modification or suspension of these incentives.

We find one area of the experiment which warrants modification at this time. Section 368, added by AB 1890, requires electrical corporations to propose plans for recovering certain uneconomic generation-related costs. It effectively requires utilities

to freeze their electric rates at June 10, 1996 levels and then to reduce rates for residential and small commercial customers by no less than 10% beginning in 1998.² By D.96-12-077 the Commission approved cost recovery plans for SDG&E and the other major electric utilities which include the required rate freeze and rate reduction provisions.

ORA believes that the rate freeze and rate reduction thwart the PBR reward mechanism with respect to achieving the experimental objective of reduced rates. We agree. The PBR mechanism provides shareholder incentives, in the form of a reward or a penalty of up to \$10 million, which should encourage SDG&E's management to take actions that reduce the ratio of its system average electric rate to a national price index. It makes little sense, and therefore contravenes sound policy, to maintain this incentive while electric rates are frozen generally, and residential and small commercial rates must be reduced by 10% in 1998. It is true that Section 397 allows certain electric rate changes if natural gas prices change by more than 10%, but management actions cannot affect the gas price indices that can give rise to electric rate changes. AB 1890 and the cost recovery plan approved by D.96-12-077 generally constrain management's ability to affect the system average rate.³ Yet, under the base rate PBR mechanism, SDG&E's shareholders could be rewarded or penalized depending on how the system average rate compares to the national price index. For the duration of the cost recovery plan, the price performance incentive cannot work effectively to further our objective of reduced rates, and it could be unfair to shareholders, ratepayers, or both. We conclude

² Section 397 establishes a limited exception to the rate freeze for SDG&E. It authorizes SDG&E to file a rate cap mechanism which includes a Fuel Price Incentive Mechanism that requires limited adjustments in its authorized System Average Rate in effect on June 10, 1996. Such adjustments may occur only if the 12-month rolling average index price of natural gas, as defined, changes by more than 10% from the January 1, 1996 starting point.

³ SDG&E claims that rate reductions are possible, but it acknowledges that "rate reductions are more difficult to achieve" under AB 1890. (*Response of San Diego Gas & Electric Company (U 902-M) to Motion of the Office of Ratepayer Advocates to Suspend the Incentives in SDG&E's Base Rate PBR Mechanism*, p. 14.)

that it should be suspended for 1997 and as long as the rate freeze is in effect.⁴ In D.96-12-077, SDG&E's electric rates were frozen on January 1, 1997, at the rates as of June 10, 1996. We suspend the electric price incentive component of the SDG&E PBR as of January 1, 1997.

Findings of Fact

1. Parties have been given notice of and opportunity to be heard on the modifications under consideration herein.
2. It has not been shown that suspension of the nonprice incentives is necessary or appropriate at this time.
3. Subject to the exception provided in Section 397, SDG&E's electric rates are generally frozen at June 10, 1996 levels, and in 1998 SDG&E must reduce its residential and small commercial rates by 10%.
4. For the term of the cost recovery plan which was approved by D.96-12-077, the price incentive component of SDG&E's base rate PBR mechanism cannot work effectively to further our objective of reduced rates.

Conclusions of Law

1. The price performance incentive of SDG&E's base rate PBR mechanism should be suspended as of January 1, 1997.
2. ORA's motion should be granted to the extent provided in the following order. In all other respects the motion should be denied without prejudice.

⁴ If there is a net penalty for nonprice performance, any otherwise applicable price reward is reduced accordingly. If there is a price performance penalty, any otherwise applicable net nonprice reward is reduced accordingly. This two-way conditionality provision will be effectively suspended along with the price incentive.

O R D E R

IT IS ORDERED that:

1. The motion of the Office of Ratepayer Advocates for suspension of San Diego Gas & Electric Company's (SDG&E) base rate performance-based ratemaking (PBR) mechanism is granted in part as provided in Ordering Paragraph 2. In all other respects the motion is denied without prejudice.

2. The rewards and penalties associated with the price performance indicator described in Section V. D. of Exhibit 101, and Appendix P of Exhibit 102 are and shall remain suspended until further order of the Commission. SDG&E shall file an advice letter to implement this suspension within 15 days of the effective date of this decision.

This order is effective today.

Dated September 3, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners