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Decision 97-12-099 December 16, 1997

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's own motion to consider the line extension rules of electric and gas utilities.

Rulemaking 92-03-050
(Filed March 31, 1992)

Request by Pacific Gas and Electric Company to File New Form 79-875 for Temporary Service Agreements for both Gas and Electric Service.

Application 91-06-016
(Filed June 7, 1991)

(See Decision (D.) 95-12-013 for a list of appearances.)

OPINION

Summary

Since the applicant design pilot program for residential gas and electric distribution services was a success, the Commission concludes that the program should be implemented as a regular utility tariff option. Under the tariff option, the utilities would provide an applicant for utility service with a bid for designing the proposed system. The applicant could "shop" the utility's bid and have a third-party designer undertake the system design. If the applicant decided not to use the utility's design services, the utility will credit the applicant with the amount of the utility's bid less any appropriate charges such as for plan checking. This new tariff option will provide builders with a choice between utility design or design by third-party designers for residential gas and electric distribution facilities serving their projects.

Background

In D.95-12-013, the Commission approved a 24-month pilot program to test the feasibility of applicants designing distribution facilities for gas and electric service to their projects. The Commission stated:

"The pilot program should allow the Commission to identify the issues, collect data, and quantify the potential savings, if any, from 'unbundling' the design of distribution facilities, so that applicants have the option of designing facilities for their own projects." (D.95-12-013, mimeo. at p. 2.)

The applicant design pilot program commenced on January 1, 1996 with semi-annual workshops held to analyze data, determine what aspects of the program were working well, and what changes were necessary to improve the process. Semi-annual workshops were held on September 12, 1996 and January 10, 1997. Workshop reports were filed on September 20, 1996 and April 3, 1997, respectively. Additionally, several supplemental workshops and subcommittee meetings were held to address specific issues. These are addressed in the final workshop reported dated September 2, 1997. Comments on the workshop report were filed by Utility Design, Inc. (UDI). Comments and reply comments were filed by the utilities,¹ and the Coalition of California Utility Employees.

A total of 255 residential subdivisions were processed under the pilot program. The utilities and applicant designers agree that the pilot program was an unqualified success. Surveys conducted of major California builders confirm that:

- Applicant design works.
- Builders favor and will support the option of applicant design.
- Builders, design firms, and the utilities have successfully proven that they can coordinate the necessary resources to produce gas and electric designs acceptable to the utilities.
- With building activity increasing in California, the pilot program has proven to be a valuable time-saving option, saving builders as much as two months on an otherwise seven-month design process.

¹ The utilities are: Pacific Gas and Electric Company (PG&E), Southern California Edison Company (Edison), Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), Southwest Gas Corporation (Southwest), and PacifiCorp.

- Applicant design has also proven to be a valuable project planning alternative to exclusive utility control over system design.
- The availability of third-party designers through the applicant design pilot program has increased the pool of gas and electric design resources available to builders without ratepayer support or subsidies.

We commend the utilities and their design staffs for working with the third-party applicant designers to make the pilot program a success. We will continue applicant design as a regular utility tariff option, and in this decision we address the remaining issues.

Applicant Design Engineering Credit

Historically, the utilities had sole control over the design of distribution services, and the design service was provided at applicant's expense subject to refund. With the introduction of the pilot applicant design program, the utilities provided a credit when the applicant elected to design its own project:

"... . The utilities point out that the pilot program has been designed to generate a credit *to the applicant*, consisting of the costs which the utility avoids by not designing the facilities and instead engaging in more limited plan check activities. According to the utilities, this is the only 'immediate benefit of savings' that will be produced by the pilot program and such benefit, if any, flows only to the applicant. Thus, there are *no* immediate savings for ratepayers. Nonetheless, the utilities believe that, if the pilot program demonstrates that applicants may safely and reliably design utility projects in sufficient numbers, they may be able to make appropriate permanent adjustments to their design process. It is the utilities' belief that while there certainly is the potential for longer-term ratepayer savings, any such savings are far from 'immediate' and certain." (D.95-12-013, mimeo. pp. 5 and 6, emphasis in original.)

The issue now before the Commission is the continuation of the credit when applicant design becomes a regular utility tariff option. And with regard to calculation of the credit, applicant designers now have concerns over (1) the hourly rate, and (2) the time allocated by each utility for specific tasks.

During the pilot program, each utility gave applicant designers a credit representing the refundable value each utility placed on the design services. The credit

represented the utility's opinion of the hours required to design a particular gas and electric facility, multiplied by an hourly rate established by the utility. The applicant designers complain that the credits do not fairly compensate them for the services provided.

During the course of the pilot program an engineering credit subcommittee was formed to study and make recommendations on how to resolve this issue. At the committee meetings, applicant engineers and consultants discussed how each utility calculated the design credit's hourly rate as well as the number of hours required to design each project. The subcommittee made progress in defining the applicant designer tasks to be credited; however, no consensus was ever reached on what was a reasonable amount of hours to be credited for each task. Moreover, no agreement was reached concerning the hourly rate.

UDI argues that since the utilities are in competition to provide the same design services, the utilities have a self-interest in providing applicant designers low reimbursement for their services.

On the other hand, the utilities contend that applicant designers should only be compensated for the utility's "avoided cost." For example, applicant designers are reimbursed by PG&E, as follows:

Standard Hours X \$40.00

Standard Hours represent the amount of time determined by PG&E necessary to design specific jobs.

The \$40 per Applicant Design Credit rate is based on the average wage of a PG&E estimator/designer and includes the following overheads:

- Payroll additives
 - ⇒ Benefits such as medical, dental, vision, life insurance, etc.
 - ⇒ Taxes such as FICA, FUTA, Medicare, Social Security, Workers' Compensation, etc.

- Paid Absences

- ⇒ Such as vacation, sick leaves, personal business, safety and job training, jury duty, etc.

The \$40/hour Applicant Design Credit does not include the following overheads:

- Management and Supervision

- ⇒ Such as costs to direct, supervise, and support design personnel including supplies, computers, telecommunications, insurance, office space, etc.

- Corporate Overheads

- ⇒ Such as Human Resources, General Accounting, Legal, Corporate office expenses/salaries

The hourly rates of the other utilities, also based on avoided cost, are comparable.

Rather than argue over why the utilities should be allowed to recover all their overheads and applicant designers should not, UDI recommends that the Commission direct the utilities to pay applicant designers the market rate for such design services.

The Coalition of California Utility Employees (CUE) disagrees with UDI's proposal. CUE contends that the arguments of the third-party design firms and developers for larger credits are nothing more than an attempt to have the utilities or ratepayers subsidize private development. According to CUE, the applicant designers should receive no more than the utility's avoided cost, since any greater credit would come at the expense of the utility or the ratepayers.

CUE argues that the Commission should resist the invitation to use ratepayer or shareholder money to artificially subsidize third-party design firms in the name of "customer choice." According to CUE, the pilot program has clearly demonstrated that developers value the flexibility and time savings from designing their own line extensions. Any credits from the utility are secondary at most. Indeed, the total cost of line extensions is only a very small portion of the costs of a residential development. Time saved by the developer is far more valuable because the time it takes for designing

line extensions, not their cost, is usually the critical determining factor for developers in deciding who will perform the design, according to CUE.

CUE suggests that if the Commission wants to do more to foster customer choice than simply giving developers the choice, it should separate the design function from other project costs and require the utility to bid against third parties for the line extension design. The developer could choose the bid that best suits its needs. With this system, as proposed by CUE, the developer would pay for its design costs, but would not receive any refund from the utility.

We have carefully considered the arguments of the parties and do not find a perfect solution to the issue of credits. However, we are convinced that the Commission should not be involved in micromanaging applicant design when it becomes a tariff option. Specifically, we should not be involved in setting hourly rates and standard times for designer tasks.

We believe that rather than setting market-based rates for applicant design, there should be a bidding process established, as currently exists for construction of these facilities (Option 2). The utility should similarly provide the applicant with a bid for design of the project, and the applicant would have the option to shop the utility's bid (the same as in Option 2). Thus, the applicant would have a choice.

We now turn to the next question: If the applicant decides to do its own design, should there be: (1) no credit (as recommended by CUE), (2) a credit equal the utility's avoided cost as determined by the utility, or (3) a credit equal to the utility's bid?

We reject the first option since it would be premature, at this time, to delete all design credits for either applicant designed projects or make a charge for utility designed projects. A Public Utilities (PU) Code § 783 analysis may be required before we could do so. And there is no such analysis in the record.

Also, we reject the second option, since we do not wish to initiate debate in this proceeding as to the reasonableness of each utility's overheads, and which components of the overheads should properly be included in the avoided cost credit provided by the utility.

We are left with the third option, a credit equal to the utility's bid amount. Of the three options, we believe that this is the least problematic. CUE's argument opposing subsidies in the name of applicant choice is well taken. However, as discussed above, this is not the time to do away with all credits. Given the choices, we conclude that a credit based on the utility's bid is a reasonable compromise and would be a fair proxy for the utility's actual avoided cost. At least, this option would not require Commission involvement in setting hourly rates and would eliminate any argument regarding standard times for design tasks. Also, it avoids the need for debate on the utility's avoided cost.

Additionally, we will require the utility to book to its accounts the utility's bid amount, whether the design was done by the utility or an applicant. If the utility's actual cost was more than the bid amount, the utility would write off the excess. If the cost was less than the bid, the utility would credit the difference to revenues. Also, the utility would provide the applicant with a credit equal to the utility's bid amount less any appropriate charges such as for plan checking.

With regard to plan checking, as recommended by UDI, the procedure initiated by D.95-12-013 and maintained during the pilot program should continue. The utilities should charge ratepayers for the first plan check and charge applicants for subsequent plan checks.

In summary, we will require each utility to file a tariff option to implement applicant design for all residential gas and electric distribution facilities, including a bid procedure and credit provision, as discussed above.

The Scope of the Applicant Design Program

UDI argues that the Commission should allow applicant design of all commercial distribution systems and services of less than 60 KV for electric and up to 60 PSIG for gas, regardless of whether the facilities are new, temporary, or a replacement of existing systems.

UDI points out that at present, developers of commercial projects receive dissimilar treatment from different utilities. Applicant design is available for residential

facilities throughout California, yet is available for commercial projects only in Southwest's, SDG&E's and SoCalGas' service territories. A commercial project can be applicant designed in SDG&E territory, yet a similar project in Edison/SoCalGas or Edison/Southwest territories can only have its gas system applicant designed. The same type of commercial project in PG&E territory cannot be designed by the applicant.

According to UDI, sufficient experience has been developed from the pilot program to demonstrate that in addition to residential developments, private sector engineers can design other types of facilities that meet utility specifications, are completed timely, and evidence a high degree of quality.

The utilities disagree with UDI that the applicant design option should be made available for commercial projects.

The utilities state that by far, the majority of line extensions constructed in California are residential in nature. Even with this huge market available for third-party design, the projects completed under the pilot program represent an extremely small number compared to the number of projects that could be designed by third parties. Even though residential subdivision design is fairly consistent from project to project, the utilities contend that applicant designers have struggled, at times, to deliver an acceptable product. On the other hand, since commercial and industrial type projects can be extremely complex and vary significantly, the utilities believe that it is quite doubtful that any significant quantity of design work will be produced by applicant designers.

Further, the utilities point out that although applicant design for non-residential projects has been available for some utilities during the course of the pilot program, not one non-residential project has been completed in the State. Therefore, the utilities contend that despite the opportunity to produce non-residential projects, applicant designers have failed to develop non-residential project experience.

We agree with the utilities that it would be premature to require the immediate expansion of applicant design to include non-residential projects. Therefore, for the time being, applicant design may be limited to new residential line and service extensions throughout the State. Those utilities desiring to offer applicant design on

any new line or service extension should be allowed to do so. However, within three years all the utilities should open their programs to applicant design of non-residential projects by designers that have met the utilities' prequalification requirements for such projects. We require each utility to design its own program for phasing-in applicant design of non-residential projects.

Also, we agree with the utilities that applicant design should not be a utility tariff option in cases where there is no applicant for new line or service extension work (e.g., system replacement, system relocation).

Prequalification of Designers

In D.95-12-013, approving the pilot-program, the utilities were allowed to prequalify designers. The requirement is intended to help ensure a high quality of effort and reduce the number of additional plan checks. The Joint Utilities request that the prequalification requirement adopted in D.95-12-013 be continued. We agree. There have been no complaints during the pilot program that the utilities have been unreasonable in their requirements. Further, we believe prequalification of designers would be in the public interest. The applicant design program should continue to allow the utilities to administer reasonable prequalification requirements for applicant designers comparable to requirements imposed on utility designers and contract designers.

Residential Single Services

On April 3, 1997, pursuant to a motion filed by UDI, the utilities announced expansion of the pilot program beyond residential subdivisions and developments to include residential single services. Concurrently, SoCalGas and Southwest further expanded their programs to include commercial services served with medium pressure requiring three-inch plastic pipe or smaller.

Temporary Facilities

Application (A.) 91-06-016, which involves the design of temporary electric facilities, was consolidated with this proceeding (Rulemaking 92-03-050). Given that the applicant design pilot program focused on the higher volume and more complicated

gas and electric extensions in residential subdivisions, the applicant design pilot program has eclipsed the need for a separate proceeding. Accordingly, A.91-06-016 should be closed. The applicant design program should include design of temporary facilities.

Comments on Proposed Decision

On November 12, 1997, the Administrative Law Judge's (ALJ) proposed decision² was issued for comments pursuant to an ALJ ruling. Comments were filed by the utilities, PG&E, and UDI. Reply comments were filed by the utilities and UDI. We have carefully reviewed the comments and made changes to the ALJ's proposed decision where appropriate.

Findings of Fact

1. The applicant design pilot program for the design of residential gas and electric line and distribution systems has been a success.
2. The utilities, builders, and third-party designers agree that the pilot program should be implemented as a regular utility tariff option.
3. The new tariff option should encompass new residential gas and electric line extensions throughout the State.
4. If the applicant decides not to use the utility's design services, the utility should credit the applicant with the amount of the utility's bid less any appropriate charges such as for plan checking.
5. Applicant design should not be a utility tariff option in cases where there is no applicant for new line or service extension work (e.g., system replacement, system relocation).
6. Applicant design should become a utility tariff option for commercial and industrial programs within three years.

² This is not a Section 311 matter.

7. The applicant design program should continue to allow the utilities to administer reasonable prequalification requirements for applicant designers comparable to requirements imposed on utility designers and contract designers.

8. Those utilities desiring to offer applicant design for non-residential projects, or projects where there is no applicant, should be allowed to do so.

9. The applicant design pilot program and the new utility tariff option include residential single services.

10. A.91-06-016, which involves the design of temporary facilities, is no longer necessary and should be closed.

Conclusions of Law

1. It is in the public interest to implement an applicant design utility tariff option for residential gas and electric line and distribution systems as proposed in this decision.

2. A credit equal to the utility's bid for design of a project is a reasonable proxy for the utility's avoided cost.

3. For applicant designed systems, the utilities should provide credits equal to their bids.

4. A Section 783 analysis is not required to implement the applicant design program as a regular utility tariff option since applicants still have the opportunity to have distribution systems designed by the utility at the applicant's expense, as part of the total job cost, subject to refund.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company, Southern California Gas Company, San Diego Gas & Electric Company, Southwest Gas Corporation, Southern California Edison Company, and PacifiCorp. shall file an applicant design utility tariff option for new residential gas and electric line and distribution systems with an applicant credit

provision, as discussed in this decision. These tariff filings shall become effective on July 1, 1998.

2. The applicant design pilot program shall remain in effect until the filed tariff options for each utility become effective.

3. Applicant design shall be a utility tariff option for temporary facilities.

4. The utilities shall within three years make the applicant design tariff option available for all projects where there is an applicant requesting commercial or industrial service less than 60 KV for electric and up to 60 PSIG for gas.

5. The applicant design phase of this proceeding is closed. Also, Application 91-06-016 is closed.

This order is effective today.

Dated December 16, 1997, at San Francisco, California.

P. GREGORY CONLON

President

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEPPER

RICHARD A. BILAS

Commissioners

I will file a concurring opinion.

/s/ JESSIE J. KNIGHT, JR.

Commissioner

Commissioner Jessie J. Knight, Jr., Concurring:

The design of distribution services is clearly not a natural monopoly. The pilot program proved that the design of distribution systems to serve residential customers can be performed by a wide variety of firms and that given the chance, these alternative providers can deliver a final product that is more affordable or otherwise better meets the needs of the customer.

Eventually competition will develop for the construction and maintenance of distribution facilities. In my opinion, the construction of distribution facilities does not exhibit any of the characteristics of a monopoly function. Also, the maintenance of such systems may not be a naturally monopolistic function. This commission will have to re-visit the concept that the provision of distribution service is a natural monopoly. We have taken the first tentative steps toward allowing distribution competition. The provision of over-the-fence generation, allowing the unbundling and the competitive provision of meters and meter services, and allowing the competitive procurement of distribution system design that is part of this decision, all begin to chip away at the facade of natural monopoly which the utility distribution companies argue and claim exists. The industry was slow to see the advent of competition in generation and retail provision of electricity. Now it is starting to grasp the eventual reality that competition in transmission services is coming and will become a forgone conclusion as part of the evolution of competitive energy markets. Soon they will have to come to grips with competition within the bastion of distribution. It is only a matter of time.

All previously regulated industries believed that their industry was special and that normal rules of economics and business did not exist in that particular market. Experience over the past 30 years has shown that markets can be opened to competition and that the a natural monopoly situation is transitory and temporal in nature. The time of the natural monopoly over distribution services will, in my estimation, be over much sooner than the conventional wisdom in this industry would have us believe.

Dated December 16, 1997 in San Francisco, California.

/s/ Jessie J. Knight, Jr.

Jessie J. Knight, Jr.
Commissioner

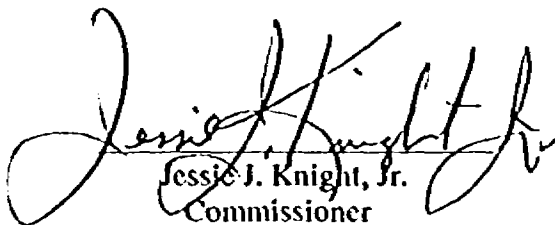
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Dated December 16, 1997 in San Francisco, California.


Jessie J. Knight, Jr.
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