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Decision 98-01-040 January 21, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

Order Instituting Rulemaking to Review the Time Schedule for the Rate Case Plan and Fuel Offset proceedings.	Rulemaking 87-11-012 (Filed November 13, 1987)
In the Matter of Application of SOUTHERN CALIFORNIA GAS COMPANY to adopt Performance Based Regulation ("PBR") for Base Rates to be effective January 1, 1997.	Application 95-06-002 (Filed June 1, 1995)

OPINION

Background

In its performance-based regulation (PBR) proceeding (Rulemaking (R.) 87-11-012 and Application (A.) 95-06-002), Southern California Gas Company (SoCal) proposed that it be allowed to offer negotiated discount contract rates and optional tariffs to its core customers. SoCal shareholders would be at risk for any shortfalls resulting from any discounts to customers who contracted for negotiated discount rates and optional tariffs. Further, SoCal would apply any discount to the base rate portion of the default PBR rate, i.e., gas costs would not be discounted.

In Decision (D.) 97-07-054, the Commission agreed that SoCal's proposal to offer negotiated discount rate and optional tariffs was consistent with its PBR goals. However, the Commission found the proposal required greater detail from what was supplied in the PBR record. The Commission stated:

> "Allowing for negotiated rates and optional tariffs will provide SoCal with opportunities to increase utilization of its system, which benefits ratepayers. Under our adopted sharing mechanism, incremental revenues translate into benefits for both ratepayers and shareholders, providing SoCal with the incentive to more efficiently operate the system. Therefore, allowing SoCal to enter into negotiated contracts and offer optional tariffs is consistent with our PBR goals.

"We would prefer to authorize optional tariff offerings with more details than SoCal has provided in its application. However, because shareholders will be entirely at risk for the revenue shortfalls, we will allow SoCal to negotiate discounts and offer optional tariffs, provided that the price floor is above class average long-run marginal cost (LRMC) and allow the tariffs to be effective upon 20 days after filing unless protested on the basis that the price floor is below class average LRMC. If protested, the optional tariff filing will proceed through the normal advice letter process. The optional tariffs must be available to all similarly situated customers that meet the eligibility criteria. If SoCal wishes to offer rates that are customer specific or targeted at some subset of a class and therefore below the class average LRMC, then additional information must be submitted, consistent with information required for long-term contracts under the Expedited Application Docket (EAD), and the contract or tariffs will be subject to Commission approval through the EAD process. Contracts with terms of five years or longer must be approved by the Commission. Consistent with allowing SoCal to offer core customers discounts, we will also allow SoCal to offer firm noncore customers negotiated discounts of less than five years' duration. Negotiated contracts must be filed with the Commission, but the confidentiality provisions in place for noncore contracts will also apply for core contracts." D.97-07-054 at pp. 46-47.

The Commission further directed SoCal to submit an adjustment mechanism to its core fixed cost account (CFCA) to ensure that ratepayers were isolated from any risk of revenue shortfalls that may result from SoCal offering negotiated rates or optional tariffs to core customers. Therefore, shareholders are responsible for any reduction in core revenues that may occur under discounting, including any discounting of ITCS.

Procedural History

In compliance with D.97-07-054, on September 17, 1997, SoCal filed a proposed adjustment mechanism to its CFCA. SoCal proposed that on an annual basis, the CFCA will be credited with the base revenue of all participating customers, i.e., those choosing either negotiated discount rates or optional tariffs. Dependent on whether the base revenue is greater or less than the actual revenue, the difference will be either included in or excluded from SoCal's earnings for purposes of the PBR earnings sharing mechanism. SoCal also discussed the difference between optional tariffs and negotiated rates; load gain contracts, which included its proposed adjustment for temperature variations; the definition of existing versus new customers; load retention contracts; and its rationale as to why the CFCA should be adjusted on an annual basis. SoCal also proposed a procedural schedule for consideration of its proposed adjustment mechanism.

On October 7, 1997, a Joint Assigned Commissioners' Ruling was issued by Commissioners Duque and Neeper, approving SoCal's proposed schedule and inviting all interested parties to comment on SoCal's proposal. Comments were due by October 17, 1997, and SoCal could file its reply comments by October 27. The ruling also asked parties whether there is any reason to hold either of the above-referenced dockets open.

The Office of Ratepayers Advocate (ORA), The Utility Reform Network (TURN), and Southern California Edison Company (Edison) filed timely comments on SoCal's proposal. SoCal filed a timely response.

On November 21, 1997, SoCal, ORA, and TURN jointly filed a motion proposing a resolution of the issues raised by the parties. The motion requested that the Commission adopt the proposed adjustment mechanism to SoCal's CFCA, with modifications, to allow SoCal the opportunity to offer discounting for its core customers. On the same date, Edison filed a separate letter opposing SoCal's proposal to discount exclusions such as the Interstate Transition Cost Surcharge (ITCS), because it was neither addressed in the PBR proceeding nor authorized by the Commission.

On December 8, 1997, Edison filed a response to the motion of SoCal, ORA, and TURN to adopt the adjustment mechanism for SoCal's CFCA, which did not oppose it. However, Edison requested clarification as to the appropriate cost categories or revenues that may be discounted by SoCal. Also on December 8, with the Administrative Law Judge's consent, SoCal filed a reply to Edison's response to the joint motion. The reply states that if Edison's response is intended to support the Commission adopting the floor rate provision of the modified proposals, and indicates that Edison would take no action unless SoCal discounts below the floor, then SoCal has no objection to the reply. If, however, Edison is requesting that the Commission not adopt the discounting floor provision of the modified proposal, then SoCal responds that Edison's interpretation of D.97-07-054 would render meaningless the Commission's authorization for negotiated rates and optional tariffs, and does not concur with Edison.

Substantive Issues Raised by the Comments and Motion

A. Temperature Adjustment Method (TAM)

SoCal proposed the TAM as part of its adjustment mechanism to its CFCA to ensure that the difference in throughput between two periods resulting from a temperature variation is not the result of a customer receiving a discount or optional tariff. The TAM is applied to base volumes for the purpose of adjusting base volumes to reflect current heating degree days in order to estimate incremental volume and revenue. The purpose of this adjustment is to isolate the price-elasticity effect by removing the weather effect. SoCal asserts that without the TAM, the increased throughput resulting from colder weather would enhance the price-effect of the discount and result in a shareholder windfall.

ORA and TURN argue that the originally proposed TAM is overly complex and that class average temperature adjustment factors may distort base volumes of individual customers that are different from the class average, and that the TAM is too similar to the weather normalization mechanism rejected in D.97-07-054.

In the joint motion, the parties requested that the application of the TAM be restricted to residential customers, all core commercial and industrial customers with an annual consumption of less than 3,000 therms, and individual core commercial and industrial customers who have a seasonal load factor that equals or exceeds the residential load factor of 2.3. The parties also agreed that for the customers to be subject to the TAM, the TAM will be based on the temperature adjustment factor of the residential market, and that limiting the application of the TAM to the market segments where temperature sensitivity is most significant will reduce the complexity of the TAM. We must determine whether these features should be adopted in our order.

B. Load Retention

For load retention contracts, SoCal originally proposed that base volume be set according to a customer affidavit stating the volume that the customer would have used absent the agreement, and that incremental revenues be shared 75%-25% between ratepayers and shareholders respectively. SoCal's rationale is that because the customer is planning to reduce his consumption below the previous period, or eliminate it entirely, the customer may be induced by a discount to generate more revenues than he would otherwise generate in the current period. SoCal reasons that in this case it is beneficial to offer a discount, even if the revenues are less than in the previous period. Further, if SoCal does not attempt to retain the core customer through discounting, and that customer leaves the system, SoCal's earnings are unaffected because the CFCA is reallocated to the remaining core customers. Therefore, SoCal believes the remaining core customers will be better off if SoCal can offer a discount or optional tariff that will induce the customer to remain on the system and contribute some revenues, even if it is less than in previous periods.

ORA and TURN objected to SoCal's proposal as being unnecessarily generous to its shareholders. ORA believes that the adjustment for potential load retention contracts goes too far and offers rewards for shareholders which were not granted in D.97-07-054, which allows shareholders to be rewarded if SoCal attracts new load through the offering of special contracts for new customers, but not for maintaining its current customer base. TURN believes that the process suggested by SoCal is unreliable and overly complex. Further, TURN believes SoCal's proposal also relieves shareholders of their risk by defining base volume as zero and therefore eliminating any revenue "shortfall."

The parties have agreed that the customer must provide an affidavit stating the amount of throughput that would be lost absent the load retention agreement, or the discount will not apply. Of the actual revenues received under load retention contracts, 95 percent will be credited to the CFCA and 5 percent will be treated as a shareholder incentive for the lesser of the contract duration or five years. We must determine whether to adopt this portion of the agreement.

C. Duration of Contracts and CFCA Adjustment Mechanism

The joint motion raised an issue of what contracts SoCal may enter into with Commission approval. SoCal asserts that the CFCA adjustment mechanism should apply over the full duration of the contracts, but ORA and TURN are concerned whether discounts to customers and incentives to utility shareholders may be provided for longer than was needed to attract or retain loads.

The parties agreed that through December 31, 1999, SoCal will not enter into any load retention contract with a duration of more than seven years. As required by D.97-07-054, SoCal will need Commission approval for any contract with a duration of five or more years. After December 31, 1999, SoCal will not enter into any load retention contract with a term of five or more years. The parties also agree that, once a load retention contract has been entered into for a particular load, it cannot be extended or renewed for a period longer than the permissible maximum contract length at the time the original load retention contract was signed. For load growth contracts and optional rates, including both new and existing customers, SoCal will have the option of seeking prior Commission approval for contracts of five or more years through the Expedited Docket Application process if such duration can be justified. For all other kinds of core contracts, the revenue sharing aspect of the adjustment mechanism will terminate after five years of each contract's duration and thereafter, 100% of the actual revenues will be credited to the CFCA for the remainder of the contract.

D. New Customers

For new customers who are added to SoCal's system because of negotiated rates or optional contracts, SoCal proposed to set the base volume equal to zero if the customer provides an affidavit declaring it became a customer because of negotiated rates or optional tariffs. SoCal further proposed that new customers who do not provide an affidavit would have their base volume equal 50 percent of actual volume.

ORA and TURN did not object to SoCal's proposed treatment of new customers who submitted affidavits. However, for customers without affidavits, they proposed that base volume equal 100 percent rather than 50 percent of actual volume.

SoCal has agreed that customers without affidavits should have their base volume equal 100 percent. SoCal also agreed to use the following definition of "new customer":

> "A new customer is a new meter measuring volumes not previously served, or a reconnected meter measuring load that has been off the system for at least 12 months."

Customers who have been off the system for less than 12 months will be treated as existing customers for purposes of pricing flexibility and the CFCA adjustment mechanism.

E. Optional Rates with Special Circumstances

The parties agreed that in the case of optional tariffs where special circumstances exist that may cause the CFCA adjustment mechanism to be clearly inappropriate or inaccurate, SoCal or any other party may propose an alternative adjustment mechanism that fits the special circumstances of the optional tariff. It was further agreed that SoCal may propose optional tariffs applicable to new residential customers only if SoCal also proposes an alternative adjustment mechanism.

F. Long-Run Marginal Cost (LRMC) Floor Rate

Edison has raised the issue of whether SoCal intended to discount cost categories or revenues, other than base margin, not authorized by the Commission. The only element of core transportation rates that Edison accepts for discounting was the "scaling" factors used to adjust LRMC to the embedded cost rate and the limited amount of marketing costs included in base margin but not included in LRMC. Edison's proposed discount would permit approximately 1.5 cents per therm out of the average residential transportation rate of 45.5 cents and less than one cent per therm for most non-residential volumes. SoCal responded that D.97-07-054 defines the floor rate as only class average LRMC, and not LRMC plus all other elements of core transportation rates other than base margin.

The current proposal is that SoCal may discount core transportation rates as follows:

	Full Transportation Rate	LRMC Floor Rate
residential rates:	45.5 cents	39.6 cents
G-10, 0 to 3 Mth:	75.4 cents	66.7 cents
G-10, 3-50 Mth:	33.4 cents	21.0 cents
G-10, 50-250 Mth:	20.6 cents	14.1 cents
G-20:	16.4 cents	11.6 cents
gas air conditioning:	19.2 cents	12.7 cents
gas engines:	20.3 cents	13.7 cents

The full transportation rate includes: customer related, medium-pressure distribution, high-pressure distribution, transmission, seasonal storage, load balancing, company use transmission, unaccounted for gas, interstate pipeline demand charges, non-marginal costs in base margin, ITCS, PITCO/POPCO transition costs, core averaging costs and other exclusion costs, i.e., hazardous waste costs. The rate is for transportation only, and SoCal may not discount the cost of gas. The LRMC floor rate includes: customer related, medium-pressure distribution, high-pressure distribution, transmission, seasonal storage, load balancing, company use transmission, unaccounted for gas, and interstate pipeline demand charges. Attachment A contains all of the LRMC transportation components for the applicable core schedules.

With prior Commission approval under the EAD, SoCal may discount to a floor of customer-specific LRMC, which includes the full interstate pipeline reservation charges allocated to core customers. Shareholders will be responsible for all discounting under the EAD process as well as for the negotiated rates or optional discounted tariffs.

Discussion

We find that the proposed adjustment mechanism should be adopted with modifications conforming to the moving parties' agreement. The proposed adjustment mechanism is reasonable because the CFCA would be credited with the base revenue of all participating customers, i.e., those choosing either negotiated rates or optional tariffs. Depending on whether the base revenue is greater or less than actual revenue, the difference will either be included in or excluded from SoCal's earnings for purpose of PBR earnings sharing mechanism.

The proposed modifications are reasonable. The limitations upon application of the TAM and limitations of the TAM to the market segment where temperature sensitivity is most significant will reduce the TAM's complexity. The restrictions requiring customers to provide an affidavit in load retention situations will give SoCal an incentive to retain load but insure that there is adequate documentation before SoCal can claim any incentive. The restriction on the duration of contracts is reasonable in light of the experimental nature of SoCal's PBR. The agreement that customers without affidavits would have their base volume equal to 100 percent of actual volume is reasonable because it eliminates the risk to ratepayers, and the definitions of "new customer" and "existing customer" provide clarity and reinforce the incentive for SoCal to find customers who are actually new to its system.

We do have concerns with the rate treatment of new customers to the system in deference to existing customers. We are concerned about whether the affidavit will reasonably deter free riders from signing up for the program. There are no restrictions limiting the participation other than that the customer be "new." This is a new program and should be subject to critical review on an annual basis to ensure that customers do not game the system.

The parties suggest that any party may propose an alternative adjustment mechanism that fits the special circumstances of optional tariffs where the CFCA mechanism is clearly inappropriate or inaccurate, and we will consider any such mechanism at that time.

We will also look to review the entire program if new customer participation approaches 5% of the total core volumes adopted in the last BCAP (D.97-04-082). We will establish that the program for new customers is subject to an annual Base Rate PBR review and will track participants' discounts and volumes.

Finally, we are mindful of anticipated program changes referenced in the BCAP to unbundle core transportation rates. Should this occur and if the changes conflict with the proposed adjustment mechanism to the CFCA, this program will be modified. SoCal must add a condition which reflects GO 96-A sections XI and X which authorizes the Commission to modify tariff schedules and contracts. This is an important consideration given the changes that may be proposed as a result of our gas strategy.

Where the CFCA adjustment mechanism is inappropriate or inaccurate, SoCal may propose an alternative mechanism that fits the special circumstance of the optional tariff, affording reasonable flexibility in the adopted mechanism. Finally, the proposed discount core transportation rates are reasonable, and will provide SoCal with a marketing tool in this competitive environment. In short, the modified adjustment mechanism will accomplish the Commission's policy goal of isolating ratepayers from the risk of revenue shortfalls associated with rate flexibility, and that of sharing any benefits between ratepayers and shareholders. We will adopt the modified adjustment mechanism proposed by the parties.

The order in D.97-07-054 sets out a number of conditions to be fulfilled by SoCal to carry out the transition to performance-based ratemaking. With the exception of periodic reporting requirements and the filing of an annual advice letter, those conditions have already been satisfied. There is no pending application for rehearing or petition for modification. SoCal has entered the new era. Ordering paragraph 10 technically closed A.95-06-002 already. There is no reason to hold it open, and we therefore close it with this decision.

Findings of Fact

1. In its PBR proceeding, R.87-11-012/A.95-06-002, SoCal proposed that it be allowed to offer negotiated discount contract rates and optional tariffs to its core customers.

2. In D.97-07-054, the Commission agreed that SoCal's proposal to offer negotiated discount rates and optional tariffs was consistent with its PBR goals, and directed SoCal to file an adjustment mechanism to its CFCA to ensure that ratepayers were isolated from any risk of revenue shortfalls that may result from it offering negotiated rates or

optional tariffs to its core customers. Therefore, shareholders are responsible for any reduction in core revenues that may occur under discounting.

3. On September 17, 1997, SoCal filed a proposed adjustment mechanism to its CFCA. SoCal proposed that on an annual basis, the CFCA will be credited with the base revenue of all participating customers, e.g., those choosing either the negotiated discount rate or optional tariffs.

4. In a motion filed jointly by SoCal, ORA, and TURN, the parties agreed to the following:

a. that the application of the TAM be restricted to the following: residential customers, all core commercial and industrial customers with an annual consumption of less than 3000 therms, and individual core commercial and industrial customers who have a seasonal load factor that equals or exceeds the residential load factor of 2.3.

b. that for the customer to be subject to the TAM, the TAM will be based on the temperature adjustment factor of the residential market.

c. that limiting the application of the TAM to the market segment where temperature sensitivity is most significant will reduce the complexity of the TAM.

d. for load retention contracts, that the customer must provide an affidavit stating the amount of throughput that would be lost absent the load retention agreement, and that SoCal will not provide a discount in a load retention situation without the customer first providing an affidavit.

e. that 95 percent of the actual revenues received under load retention contracts will be credited to the CFCA, and 5 percent will be treated as a shareholder incentive for the contract duration or five years.

f. that through December 31, 1999, SoCal will not enter into any load retention contract with a duration of more than seven years.

g. that after December 31, 1999, SoCal will not enter into any load retention contract with a term of five years or more, and that, once a load retention contract has been entered into for a particular load, it cannot be extended or renewed for a period longer than the permissible maximum contract length at the time the original load retention contract was signed.

h. that for load growth contracts and optional rates, including both new and existing customers, SoCal will have the option of seeking prior Commission approval for contracts of five years or more through the expedited application docket process if such duration can be justified.

i. that for all other kinds of core contracts, the revenue sharing aspect of the adjustment mechanism will terminate after five years of each contract's duration, and thereafter 100% of the actual revenues will be credited to the CFCA.

j. that the definition of new customer would be, "A new customer is a new meter measuring volumes not previously served, or a reconnected meter measuring load that has been off the system for at least 12 months," and that customers who have been off the system for less than 12 months will be treated as existing customers for purposes of pricing flexibility and the CFCA adjustment mechanism.

k. that, in the case of optional tariffs where special circumstances exist that may cause the CFCA adjustment mechanism to be clearly inappropriate or inaccurate, SoCal or any party may propose an alternative adjustment mechanism that fits the special circumstance of the optional tariff. SoCal may propose optional tariffs applicable to residential customers only if SoCal also proposes an alternative mechanism.

5. SoCal currently proposes that it may discount core transportation rates as follows:

	Full Transportation Rate	LRMC Floor Rate
residential rates:	45.5 cents	39.6 cents
G-10, 0 to 3 Mth:	75.4 cents	66.7 cents
G-10, 3-50 Mth:	33.4 cents	21.0 cents
G-10, 50-250 Mth:	20.6 cents	14.1 cents
G-20:	16.4 cents	11.6 cents
gas air conditioning:	19.2 cents	12.7 cents
gas engines:	20.3 cents	13.7 cents

The full transportation rate includes the following costs elements: customer related, medium pressure distribution, high pressure distribution, transmission, seasonal storage, load balancing, company use transmission, unaccounted for gas, interstate pipeline demand charges, non-marginal costs in base margin, ITCS, PITCO/POPCO transition costs, core averaging costs and other exclusion costs, i.e., hazardous waste costs. The rate is for transportation only, and SoCal may not discount the cost of gas.

6. As adopted, the LRMC floor rate includes the following elements: customer related, medium-pressure distribution, high pressure distribution, transmission, seasonal storage, load balancing, company use transmission, unaccounted for gas, and interstate pipeline demand charges.

7. SoCal may discount to a floor of customer-specific LRMC, which includes the interstate pipeline reservation charges allocated to core customers.

8. Shareholders will be responsible for all discounting under the EAD process, as well as for the negotiated rates or optional tariffs.

9. "New" customer participation may be limited to 5% of core customer volumes as adopted in the last BCAP decision.

10. "New" customers are subject to a program under the base rate PBR proceeding.

11. The program may be modified if the Commission adopts a program which conflicts with the negotiated rate or optional tariff for new customers.

Conclusion of Law

The motion should be granted, and SoCal's proposed mechanism for adjustment to its CFCA should be adopted, in accordance with the findings of fact and the opinion herein.

O R D E R

1. The Motion of Southern California Gas Company (SoCal), Office of Ratepayers Advocates, and The Utility Reform Network for Adoption of an Adjustment Mechanism for SoCal's Core Fixed Cost Account is granted.

2. SoCal shall file an advice letter by Monday, December 22, 1997, containing tariff sheets for the optional tariffs and a pro forma contract for the negotiated rates. The filing shall conform to this decision and shall be approved, pending written confirmation for compliance with this order by the Energy Division.

3. SoCal shall track and submit its documentation of any negotiated contracts and optional tariff customers, who participated in the program, in its next base rate performance-based regulation proceeding to support its revenue sharing mechanism.

4. Application 95-06-002 is closed.

This order is effective today.

Dated January 21, 1998, at San Francisco, California.

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

ATTACHMENT A

Components of Average Core Rates
Cents Per Therm Basis

	Residential	G10 0-3 Mth	G10 3-50 Mth	G10 50-250 Mt	G20	Gas AC	Gas Eng
Customer Related	22.430	49.226	7.624	2.340	0.200	4.298	7.938
Medium Pressure Distribution	8.771	9.271	6.350	5.161	4.709	2.483	0.314
High Pressure Distribution	0.921	0.979	0.671	0.545	0.624	0.427	0.081
Transmission	1.020	1.007	0.994	0.947	0.959	0.917	0.917
Seasonal Storage	1.534	1.756	0.948	0.666	0.862	0.227	0.061
Load Balancing	0.019	0.019	0.019	0.019	0.019	0.019	0.020
Company Use Transmission	0.122	0.121	0.121	0.121	0.121	0.122	0.122
Unaccounted For Gas	0.594	0.080	0.080	0.080	(0.126)	0.051	0.057
Subtotal	35.410	62.460	16.807	9.901	7.368	8.545	9.611
Interstate Pipeline Demand Charges	4.197	4.197	4.197	4.197	4.197	4.197	4.197
Subtotal - Proposed LRMC Floor Rate	39.607	66.657	21.004	14.097	11.565	12.741	13.708
Non-Marginal Costs in Base Margin	1.499	2.906	0.892	0.684	0.494	0.313	0.399
ITCS	0.339	0.339	0.339	0.339	0.339	0.339	0.339
Pitco/Popco Transition Costs	1.192	1.192	1.192	1.192	1.192	1.192	1.192
Core Averaging Costs	(1.036)	-	5.700	-	-	-	-
Other Exclusions Costs	3.869	4.270	4.270	4.270	2.857	4.623	4.618
Total Transportation Rate	45.470	75.363	33.397	20.582	16.448	19.208	20.257

NOTE: Customer Related Costs have been revised from responses on October 27. The costs shown in the October 27 filing were based on the incorrect allocation of customer related costs. The rates shown here reflect the currently adopted cost allocation.

(END OF ATTACHMENT A)