PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION AND COMPLIANCE DIVISION
ACCOUNTING AND FINANCE BRANCH

RESOLUTION G-2739
SEPTEMBER 10, 1987

R E S O L U T I O N

SOUTHERN CALIFORNIA GAS COMPANY (SOCAL). ORDER AUTHORIZING SOCAL TO MODIFY ITS PROCEDURES REGARDING CALCULATION OF ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC). Advice Letter No. 1711, filed May 22, 1987.

SUMMARY

On May 22, 1987, Southern California Gas Company (SoCal) filed Advice Letter No. 1711. It seeks authority to modify its procedure for calculating its AFUDC formula. The present AFUDC formula was established by D. 89578, when the Commission adopted FERC orders 561 and 561-a. Those orders explicitly assume that short-term debt is the first source of capital funding for construction. SoCal wishes the Commission to recognize that short-term debt is used by the company to finance other assets, such as its balancing accounts and gas in inventory. Given that recognition, the company believes it is appropriate to subtract short-term debt so used from the total short-term debt of the utility before attributing the remaining short-term debt to the capital structure used in the AFUDC formula.

The company thus seeks a deviation from the FERC formula to exclude short-term debt associated with balancing accounts and financing gas-in-storage inventories from its AFUDC formula. It also requests that the adjustment be effective beginning January 1, 1986. It estimates that the revised methodology will increase AFUDC for 1986 by $1.6 million and could impact 1987 by a similar amount.

The Commission's Public Staff Division (PSD) filed comments on the advice letter on June 9, 1987. It does not object to SoCal's request to exclude balancing account amounts from short term borrowing in the AFUDC formula, but expressed reservations with respect to the retroactive application of the revised formula and the attribution of a component of short-term debt to gas-in-inventory for the purpose of excluding short-term debt from the AFUDC formula.

This Resolution grants SoCal's request to modify the computation of its AFUDC rate as of the effective date of this Resolution for all Commission authorized balancing accounts and to exclude short-term debt used to finance gas-in-storage inventories from the AFUDC formula effective January 1, 1988.

SoCal's request to restate its AFUDC formula retroactive to January 1, 1986 is denied.

BACKGROUND

FERC Orders 561 and 561-a ("Order 561") assume that short-term debt is the first source of capital funding for construction work in progress. After applying all short-term debt to finance construction, the remainder of the capital used in the AFUDC formula is assumed to consist of long-term debt and equity on a pro rata basis. The Commission reviewed Order 561 as part of its investigation into whether the Commission should adopt the uniform system of accounts for electric corporations prescribed by the Federal Power Commission, the predecessor to the FERC. By D.89578, dated Oct. 31, 1978, the Commission adopted Order 561 to prescribe a uniform formula for all California gas and electric companies for computing the maximum AFUDC rate a utility may apply to construction work in progress.

PG&E sought and obtained a deviation from Order 561 from the FERC, effective January 1, 1980. In PG&E's general rate case proceeding, the Commission reviewed and granted PG&E's proposal to include in its AFUDC formula only short-term debt in excess of that used to finance undercollected balancing accounts.

The cost of gas inventory stored underground was ordered to be removed from rate base effective January 1, 1988 by the Commission's decision adopting a stipulation and agreement (Stipulation) to postpone SoCal's next general rate case from test year 1988 to test year 1990. (D.87-05-027). SoCal is to pass on a corresponding decrease in base rates effective with its January 1, 1988 attrition adjustment. Current gas inventory is to be transferred to the Consolidated Adjustment Mechanism (CAM) effective January 1, 1988 and receive the short-term debt rate as the authorized carrying cost.

DISCUSSION

Modification of AFUDC formula to exclude short-term debt used to finance balancing accounts.

The Commission has previously considered whether the short-term debt attributable to a utility's balancing accounts should be excluded from the computation of the AFUDC rate. It granted PG&E's request to do so in D. 93887. In its comments, the PSD stated that "SoCal's request to exclude its balancing account amount from the short term debt component in the AFUDC formula is justified and will put the company at par with PG&E". We discern no difference between SoCal's proposal and the authority granted PG&E, so SoCal's request with respect to this item should be granted.

Exclusion of short-term debt attributable to gas-in-inventory from AFUDC formula.

The PSD does not agree that gas-in-storage should justify an additional exclusion of short-term debt from the AFUDC formula. It believes that the removal of gas-in-storage from rate base should be implemented by revising the utility's capital structure to include the required short-term debt. The preferred forum for this adjustment would be a general rate case.

This issue was not addressed in D.87-05-027, and SoCal's next general rate case is scheduled for Test Year 1990. In order to carry out the Commission's intent to remove gas-in-storage from inventory and recognize that the same short-term borrowings cannot be imputed to finance more that one asset without creating the risk that the utility will be denied a fair return on its investment, SoCal's request should be granted.

Application of the modified AFUDC formula to balances beginning January 1, 1986.

SoCal has requested a January 1, 1986 effective date for the modified AFUDC formula. It claims that beginning in 1986, SoCal's AFUDC rate was distorted by the inclusion of short-term debt in the formula and the AFUDC rate was understated. According to SoCal, retroactive application of the modified AFUDC formula is needed to remedy this distortion. SoCal cites the Commission's action with respect to PG&E's AFUDC modification in support of its request.

The PSD suggests that the approval of SoCal's request would result in retroactive ratemaking. It distinguishes SoCal's position from that of PG&E based on the fact that the FERC had approved PG&E's request to modify its AFUDC formula retroactively to the date of its request in 1980. The Commission conformed its approval to that granted by the FERC.

In response, SoCal claims that the FERC amendment was not the only reason behind the Commission's decision to allow PG&E to apply the revised formula to a period prior to the decision. It points out that the Commission referred to the fact that it had tied the interest rates on balancing accounts to the commercial paper rate. SoCal, of course, is subject to the same treatment.

In addition, SoCal alleges that the effect of its request does not amount to ratemaking because it is not seeking a retroactive adjustment of rates collected since January 1, 1986 - the accruals of AFUDC are only an accounting entry until the associated construction is included in rate base.

It is not necessary to decide whether or not the adoption of SoCal's proposal would constitute retroactive ratemaking, as there are other compelling reasons for us to deny SoCal's proposal to apply the revised AFUDC formula beginning January 1, 1986.

As a general rule, we only authorize utilities to collect in rates the amounts that we previously have authorized them to book. SoCal itself is well aware of this principle. (See, A.87-07-081, SoCal Motion for Interim Relief). Although Order 561 has been in effect for SoCal since 1978 and PG&E has employed an amended AFUDC formula since 1981, SoCal filed its request only this May. If the inclusion of short-term debt in the formula was causing a distortion in the AFUDC rate in 1986 as alleged, then the company should have taken note of the revenue impact and sought relief at that time. The retroactive adjustment of the AFUDC formula is tantamount to giving the utility's cost of financing construction balancing account treatment. That is not our policy.

PG&E's case is distinguishable from the case at hand. There, "The staff recommend(ed) a $21.5 reduction in AFUDC capitalization in 1979 and 1980 to conform with the AFUDC formula prescribed by Order 561 of the FERC. The staff contend(ed) that PG&E's computation was in error since it included only short-term borrowings in excess of balancing account undercollections and short-term investments." (D.93887). PG&E had excluded short-term debt from its AFUDC formula without the Commission's prior authorization. This resulted in an overbooking of AFUDC, which the staff challenged and the Commission reduced for 1979. The Commission did, however, authorize use of the amended AFUDC formula for 1980, the year in which PG&E was first required to use the short-term commercial paper rate on balancing accounts. PG&E requested this change in its first general rate case following the Commission's order to use short term debt to finance its balancing accounts.

SoCal could have sought consistent treatment for its AFUDC formula when its costs of financing its CAM were reduced to the short-term rate years ago, but it did not. Since the precedent existed well before 1986, the date for which SoCal now seeks retroactive application of the amended AFUDC formula and well before SoCal's last general rate case, but SoCal did not take action at either of those times, it should not be able to change its AFUDC formula retroactive to January 1, 1986 at this time.

In reviewing the PG&E decision, we are reminded that the cost of short-term debt is sometimes offset by the earnings on excess balancing account funds. At times, the balancing accounts are overcollected. The utility then has a duty to invest the funds in short-term issues. Ratepayers thus earn the short-term rate on the overcollections. To the extent that the net average daily balance in SoCal's total balancing accounts is a net overcollection, there should be no reduction in the short term debt used to compute the AFUDC. Indeed, there should be an increase in the short term debt in the AFUDC formula commensurate with the overcollection. SoCal should use its actual cost of short term debt to compute the AFUDC rate.

FINDINGS AND ORDER

The following changes in accounting are in the public interest and will result in just and reasonable rates:

1. SoCal is hereby authorized to modify its calculation of the FERC formula for AFUDC to exclude the short-term debt related to CPUC regulatory balancing accounts before attributing any remaining short-term debt to the AFUDC formula.

2. To the extent that the net average daily balance, computed monthly, in SoCal's total balancing accounts is a net overcollection, there shall be no reduction in the short term debt used to compute the AFUDC formula. In the case of such overcollection, SoCal shall increase the short term debt component in the AFUDC formula commensurate with the overcollection.

3. SoCal shall amend its AFUDC formula to account for the use of short-term debt to finance its CPUC regulatory balancing accounts effective on the date of this resolution.

4. Commencing January 1, 1988, and consistent with the implementation of 1988 attrition rates, SoCal is authorized to