

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**RESOLUTION G-3227 *
NOVEMBER 19, 1997**

RESOLUTION

RESOLUTION G-3227. SAN FRANCISCO THERMAL, LIMITED PARTNERSHIP, SEEKS AUTHORITY TO REVISE ITS STEAM SERVICE TARIFFS TO ALLOW IT TO CHARGE A FORM OF MARKET-BASED RATES TO ITS CUSTOMERS AND TO ENTER INTO SPECIAL CONTRACTS. APPROVED AS MODIFIED.

BY ADVICE LETTER 8 FILED ON JULY 22, 1997.

SUMMARY

1. By Advice Letter (AL) 8, San Francisco Thermal, Limited Partnership (SF Thermal) seeks authority to revise its tariffs to eliminate the fuel adjustment clause (Section B) and the tax change adjustment clause (Section C) from the preliminary statement of its tariffs in favor of greater pricing flexibility. SF Thermal believes that its proposed new regulatory structure is more appropriate given the competition it faces from alternate heating and cooling sources.
2. SF Thermal requests that it be allowed to enter into special contracts with customers and to have those contracts go into effect automatically upon filing with the Commission. The special contracts could have rates that were less than or more than the rate set forth in its General Service Rate Schedule. This provision would allow the utility flexibility to offer discount contracts to attract customers that require a lower rate than that set forth on the default schedule. Or, SF Thermal could enter into a contract with higher rates but provide additional services, such as helping finance extensions of steam equipment.
3. SF Thermal would continue to offer a general service rate schedule (Schedule S-1). The proposed design would be simplified to combine the fuel charge with the base rate into one commodity charge. Thus the Schedule would consist of a monthly customer charge and a single commodity charge. The commodity charge would also include the CPUC reimbursement fee. This schedule would be available to the general public and would operate as a default rate schedule. That is, the schedule would be open to anyone taking steam service.
4. SF Thermal also proposes changes to the procedures used to modify rates. Under its proposal, the Schedule S-1 commodity charge component could be adjusted to reflect cost changes. The new rate would go into effect automatically 30 days after it was filed with the CPUC. These automatic rate changes are of two types, those tied to a change in fuel or regulatory costs and those characterized as discretionary because they reflect costs over which the utility might exercise more control. No limit would be placed on either the

number of times rates could be changed due to fluctuating fuel or regulatory costs, or the total amount of such changes in any one calendar year. The rationale for allowing such costs to be automatically flowed through to ratepayers is that fuel represents such a large proportion of SF Thermal's costs. Moreover, fluctuations in regulatory costs and even fuel costs are in large part, outside the utility's control, and balancing account treatment for these items would be eliminated. Changes to Schedule S-1 for any other reason would be allowed automatically up to two times per year, and not to exceed a total increase of 15% in any calendar year.

5. Finally, Rate Schedule S-2, which provides discounted service for cooling equipment, would be eliminated. The two customers currently served on this schedule would be offered special contracts which contain the same rates and conditions as they presently receive under Rate Schedule S-2.

6. SF Thermal requested that this advice filing be effective September 20, 1997.

7. No protests of AL 8 were received

8. This Resolution approves SF Thermal's AL 8, with certain modifications. First, The fuel cost component of Rate Schedule S-1 will be retained as a separate charge, instead of being combined with other commodity charges. Customers should be able, as much as possible, to associate charges on their bills with particular services. Secondly, increases and decreases in Schedule S-1 rates will become effective automatically 40 days after filing. Except for this automatic feature, all other Advice Letter procedures will apply. Third, to prevent rapid automatic rate increases, a 10% cap per calendar year will be adopted for any automatically effective commodity rate change not based on changes in fuel or regulatory costs. Changes that exceed this cap may be filed by Advice Letter with appropriate documentation and approved by resolution.

BACKGROUND

1. SF Thermal supplies steam directly to approximately 180 end-users in the financial district and downtown sector of San Francisco for space heating, water heating, laundries, etc. SF Thermal purchases natural gas and burns it at a central facility to make steam. The steam is then transmitted through steam pipes to individual customers.

2. SF Thermal purchased Pacific Gas and Electric Company's (PG&E) district steam generation and distribution business in 1993 for \$8.8 million. As part of the decision authorizing the purchase, Decision (D.) 93-06-038, the Commission authorized SF Thermal to increase its rates by \$1,089,000. This increase was the last part of a phased rate increase previously proposed by PG&E and authorized by the Commission in D. 90-03-036. One of

the conditions of D. 93-06-036 was that SF Thermal would forego any general rate increases for 1994 and 1995.

3. The Commission regulates SF Thermal's rates on a cost-of-service basis, although at the present time, those rates are specifically based on PG&B's costs, not SF Thermal's. SF Thermal's tariff also provides for a fuel cost adjustment clause and a tax change adjustment clause that track changes in the cost of fuel and taxes, respectively. SF Thermal became eligible to file for new general rates in 1996.

4. Under traditional cost-of-service ratemaking, SF Thermal believes it would be entitled to increase its rates to reflect its new capital additions and its decreased sales. Since SF Thermal's acquisition of the steam heat system, it has added over \$3 million in new capital facilities to the system (from 1993 to 1996). During these years when SF Thermal was making significant investments of capital to upgrade its facilities, sales decreased from 661,189,216 pounds (LB) of steam in 1994 to 592,966,200 LB in 1995 and 632,000,000 LB in 1996. SF Thermal's AL 7 filing projects some recovery, based on last years sales having exceeded the forecast level.

5. SF Thermal has not filed for a general rate increase because of its belief that higher rates would reduce its market share. Competition from alternative fuels and self-service form a natural ceiling for the amount that SF Thermal believes it can charge for its services, precluding full cost-based rates. SF Thermal's customers have the choice of purchasing steam from SF Thermal, or purchasing natural gas from PG&B or an independent supplier and operating their own boilers. A significant proportion of SF Thermal's customers own their own boilers. The cost of natural gas is approximately the same for SF Thermal and its larger customers. A limited number of formerly larger SF Thermal customers have in fact left the system to operate their own boilers with the intent of reducing their total costs for thermal energy. Three of these former customers alone had annual sales averaging 50,000 MLBS per year, representing about 8% of SF Thermal's annual sales.

6. For a customer to purchase steam from SF Thermal, rather than purchasing natural gas to run its own boiler to generate steam, SF Thermal must convince the customer that it should take other costs into account (such as labor, maintenance, insurance, water and sewer, as well as boiler plant replacement and environmental costs). SF Thermal has prepared a cost comparison which identifies and estimates the costs associated with ownership and operation of a customer's own boiler versus taking steam service from SF Thermal. Both SF Thermal and a customer running its own boiler consume natural gas and the cost of gas to both are about the same. In fact, when the losses that occur in delivering steam and SF Thermal's cost of operations and overheads are taken into account, the utility bill for steam is almost always more than the customer's bill for natural gas alone.

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7. SF Thermal has also lost customers for various other reasons usually related to the building's closing or changing operation, which eliminated the desire for district heating. Some of these buildings had electric heating installed as needed. Space converted into retail stores with high incandescent lighting loads have very minimal heating needs since the lighting itself produces its own heat. Others went through major renovation with the new developer electing to install roof top HVAC units rather than use the existing steam service into the building.

NOTICE

1. Notice of AL 8 was made by publication in the Commission's calendar and by mailing copies of the filing to adjacent utilities and interested parties, as well as summaries of AL 8 to its customers.

PROTESTS

1. No protests of AL 8 were received

DISCUSSION

1. The reasonableness of SF Thermal's proposal is contingent upon the premise that competitive pressure is operative on steam prices. SF Thermal maintains that competition, rather than regulatory oversight, has kept the base rate at its present level (less than full cost-of-service). Since SF Thermal has not filed a general rate case, this assertion has neither been examined nor verified. Furthermore, in assuming PG&E's public utility rights and obligations, SF Thermal obligated itself to offer steam service to the public within its territory at fair and nondiscriminatory rates.

2. SF Thermal's position is supported by the fact that substitutes for steam service are reasonably available to customers. SF Thermal has identified a number of customers' reasons for departure, as discussed in a previous section. To retain customers which own their own boilers and can acquire natural gas at comparable rates, the efficiency of SF Thermal's operations would have to more than compensate for steam distribution losses. In other cases, SF Thermal might have less ability to compete for business where substantial renovation or change in focus is planned.

3. SF Thermal has demonstrated that competition is a factor in pricing decisions. Therefore, we grant SF Thermal's request that it be allowed to enter into special contracts with customers that will become effective upon filing with the CPUC. The purpose of

allowing SF Thermal this additional latitude to negotiate special contracts is to improve its ability to compete for the business of new and potentially departing existing customers.

4. Allowing special steam contracts is also consistent with Commission precedent in the electric and gas industries. PG&B, for example, the prior owner of SF Thermal's system and operations, has been allowed to negotiate special contracts with its electric and gas customers, under certain conditions, related to competitive pressures.

5. Although SF Thermal has successfully demonstrated that competition is a factor in steam pricing, there are still cases where substantial barriers to heat source substitutes exist. Regulatory oversight is necessary to protect the substantial numbers of customers with no realistic substitute to steam service from SF Thermal. In granting SF Thermal the right to negotiate special contracts, we are most concerned that the captive steam customer not be harmed. In theory, pricing flexibility can improve a company's ability to maximize revenues without harming other customers as long as rates offered in special contracts at least cover the marginal cost of the services they include. The regulatory features implemented in this order are aimed at assuring that the captive steam customer suffers no negative impact from the additional pricing flexibility granted herein.

6. We will therefore require SF Thermal to continue to offer general service rates as it has proposed to do. Consistent with the pricing flexibility granted herein, revisions will be authorized to SF Thermal's tariffs to eliminate the fuel adjustment clause (Section B) and the tax change adjustment clause (Section C) from the preliminary statement. Certain modifications to SF Thermal's proposed general service Schedule S-1 will also be adopted in order to protect the general service steam customer.

7. First, SF Thermal's request to implement automatic changes to its Schedule S-1 commodity charges will be granted with several modifications. SF Thermal may file new commodity charges that go into effect automatically 40 days after being filed. The cost basis for the rate change should be noted and quantified in the filing.

8. Secondly, we adopt a 10% cap on automatic commodity charge increases not related to fuel and regulatory costs per calendar year. That is, the 10% cap is not intended to limit the ability of SF Thermal to flow its fuel and regulatory costs through to customers. Rate changes exceeding the cap in any calendar year may be adopted by resolution.

9. We adopt a 10% cap instead of SF Thermal's proposed 15% cap on discretionary rate increases in order to assure that rapid rate increases are properly justified. To protect general service customers, we need to assure that SF Thermal avoids large discretionary rate increases in years that fuel and regulatory costs are rising without limiting its ability to cover

these nondiscretionary costs. We will place no limit on the number of rate changes that SF Thermal implements per year, since the magnitude of the change is likely to be more relevant to customers than the number of changes. Further, we would like to encourage SF Thermal to adjust its rates for competitive reasons in the event that costs decline for any reason.

10. Allowing SF Thermal to automatically flow fuel price changes through to ratepayers could arguably worsen SF Thermal's bargaining position and/or drive in the fuel market since fuel costs would be automatically recoverable by higher rates to potentially captive customers. SF Thermal however, presently has balancing account treatment for fuel costs. Eliminating the balancing account and allowing for automatic rate changes to reflect changes in fuel prices is not likely to yield a substantially different outcome. The 40-day period required for new rates to become effective might tend to result in more sluggish cost-recovery when costs change than balancing account treatment. However, SF Thermal has executed year-long contracts for the commodity portion of gas costs, which would tend to dampen this effect. SF Thermal might arguably respond more slowly when costs decline. However, it is fair to assume that SF Thermal customers have sufficient opportunity to become informed about their alternatives.

11. The final modification we will adopt to SF Thermal's Schedule S-1 rate proposal is to preserve the existing rate design. That is, we will not authorize SF Thermal's request that all commodity related costs be combined into one commodity charge. The separate charge for fuel costs provides customers with data they need to make informed choices about alternatives.

12. Granting SF Thermal's request for automatically effective rate changes is likely to have a positive impact in terms of streamlining the regulatory process and still maintaining necessary consumer protection. Noncontroversial rate changes would not have to undergo the resolution process. Customers would retain the right to complain to the CPUC with their concerns. The Commission could act to halt automatic effectiveness in response to valid customer concerns.

13. Finally, we grant SF Thermal's request to eliminate Schedule S-2. Schedule S-2 was implemented to allow SF Thermal to offer competitive arrangements to customers with a particular unique situation, namely cooling needs. The authority we grant SF Thermal today to enter into special contracts would perform this function for a wide variety of circumstances including cooling needs. The two customers presently served on Schedule S-2 are to be offered special contracts with identical terms as they now receive on this schedule.

FINDINGS

1. SF Thermal filed AL 8 on July 22, 1997 requesting authority to revise its tariffs to eliminate the fuel adjustment clause (Section B) and the tax change adjustment clause (Section C) from the preliminary statement of its tariffs in favor of greater pricing flexibility.
2. Advice Letter procedures are appropriate for consideration of SF Thermal's filing. Similar accommodations are made for other small utilities that provide telephone and water service.
3. Based on its demonstration that competition is a factor in steam pricing, SF Thermal should be allowed to enter into special contracts with customers that will become effective upon filing with the Commission.
4. Allowing special steam contracts is consistent with Commission precedent in the electric and gas industries.
5. Because there are still cases where substantial barriers to heat source substitutes exist, regulatory oversight is necessary to protect the interests of customers with no realistic substitute to steam service from SF Thermal. In granting SF Thermal a measure of pricing flexibility, certain protections for general service steam customers are necessary.
6. SF Thermal should be required to continue to offer general service rates as it has proposed to do.
7. SF Thermal should be authorized to file rate changes that, unless disallowed by resolution, become effective automatically forty days after filing. The cost change forming the basis for the rate revision should be noted and quantified in the filing.
8. To avoid unjustified rapid rate increases, automatic rate increases not associated with fuel or regulatory cost increases should be subject to a 10% cap in any calendar year. Given this rate cap, no limit is necessary on the number of allowable rate changes in any calendar year.
9. Because of the pricing flexibility authorized herein, SF thermal's tariffs should be revised to eliminate the fuel adjustment clause (Section B) and the tax change adjustment clause (Section C) from the preliminary statement of its tariffs.

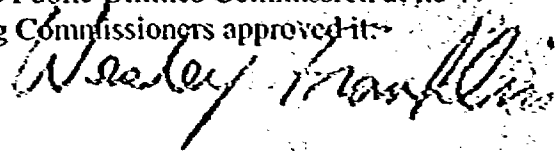
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10. Schedule S-2 should be eliminated. The two customers presently served on this schedule should be offered special contracts that provide for identical terms.
11. SF Thermal requests that this advice filing be effective September 20, 1997. SF Thermal should be authorized to file a supplemental Advice Letter within 30 days, containing all adopted modifications.

THEREFORE IT IS ORDERED THAT:

1. Advice Letter 8 is authorized with the conditions contained in Ordering Paragraphs 2 and 3.
2. Within 30 days, SF Thermal may file a supplemental advice letter with the following modifications: (a) The Fuel cost component of Rate Schedule S-1 will be retained as a separate rate to allow customers to associate charges on their bills with particular services; (b) Increases and decreases in Schedule S-1 rates, subject to the cap, will become effective automatically 40 days after filing, and; (c) to prevent rapid automatic rate increases, a 10% cap per calendar year will be adopted for any automatically effective commodity rate change not based on changes in fuel or regulatory costs.
3. A supplemental advice letter filed in accordance with ordering paragraph 2 shall become effective upon filing.
4. This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on November 19, 1997. The following Commissioners approved it:



WESLEY FRANKLIN
Executive Director

P. Gregory Conlon, President
Jessie J. Knight, Jr.
Henry M. Duque
Josiah L. Neeper
Richard A. Bilas
Commissioners