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Decision 04-12-018 December 2, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) for Authority to, Among Other Things, Increase Its Authorized Revenues for Gas Service for Santa Catalina Island in 2005, and to Reflect That Increase in Rates.	Application 04-01-031 (Filed January 23, 2004)

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James E. Scarff, Attorney at Law, for the Commission's Office of Ratepayer Advocates, protestant.

OPINION RESOLVING GENERAL RATE CASE

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OPINION RESOLVING GENERAL RATE CASE

1. Summary

Southern California Edison Company (SCE) is authorized to increase its gas distribution base rate revenue requirement in Santa Catalina Island (Catalina) to $984,500 to be phased in over a three-year period beginning in 2005. This equates to a 39.4% increase in 2005, a 28.2% increase in 2006, and a 22.0% increase in 2007 in authorized gas distribution expenses. SCE had sought an increase in base rate revenue to $1,157,482 in 2005 (an increase of 169% over the current rate), or $1,648,000 if phased in over four years (an increase that would total 283% over current base rates by the year 2008). The proposed increases are large because this is the first gas distribution rate increase that SCE has sought in Catalina in 17 years and because SCE is in the process of replacing its 30-year-old gas plant in Catalina.

The new rates authorized today will mean an increase in single-family gas bills, on average, of about 14.9% in 2005, 13.2% in 2006, and 11.5% in 2007. For commercial customers, the increase, on average, will be 20.3% in 2005, 15.6% in 2006, and 10% in 2007.

2. Background and Procedural History

Catalina, located 22 miles from the mainland, is a leading resort for the Los Angeles area. The island is 21 miles long and 8 miles wide, with Avalon the principal town. Tourism is the main industry, and the island attracts tens of thousands of visitors annually.

SCE provides all of the gas, water and electric service in Catalina and has done so since 1962.[1] Previous general rate increases for gas distribution costs were granted in 1980 and 1987.[2] In the 1980 general rate case, SCE was authorized to establish a Gas Cost Adjustment Clause (GCAC) that permits SCE to pass through to customers its wholesale cost of gas purchased for Catalina. Authorized distribution costs, however, have not changed since the 1987 general rate case.

SCE serves 1,300 commercial and residential gas customers in Avalon (as contrasted with 2,400 electricity customers and 1,900 water customers), delivering gas through 6.5 miles of underground distribution pipes. The gas production facilities are located at the Pebbly Beach Gas Plant in Avalon. Liquefied petroleum gas (LPG) is delivered to Catalina by barge and transported by tanker truck to five storage tanks. The LPG is heated and vaporized to change it from liquid to gas, then mixed with air and inserted into the underground distribution system supplying customers in Avalon and Pebbly Beach Village. Driving much of the increase in SCE's gas costs is the pending $1.3 million replacement of the 30-year-old gas vaporization plant.

SCE filed this general rate case on January 23, 2004. On February 26, 2004, the Commission's Office of Ratepayer Advocates (ORA) protested the request for increased rates. A Prehearing Conference was conducted on April 9, 2004, and Assigned Commissioner Loretta M. Lynch issued a Scoping Memo on April 21, 2004, in which she concluded that a hearing was required.

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[1] Decision (D.) 64420 authorized SCE to purchase all of the gas, water and electric service facilities in Catalina.

[2] *See* D.92059 and D.87-07-019.

Two public participation hearings attended by about 40 persons were conducted in Avalon on June 7, 2004. The Commission heard from 14 ratepayers, including Avalon Mayor Ralph Morrow and City Councilman Dan O'Connor. Most of the speakers were owners of restaurants and other small businesses in Avalon. While high in their praise for SCE's utility service on the island, they objected to a substantial increase in gas rates that will have to be borne by only 1,335 ratepayers.[3] One speaker, Cliff Keene, said that the estimated 74% increase in gas bills resulting from SCE's proposal would be devastating for restaurants because they must use gas to cook and can't raise meal prices by an equivalent amount. Another speaker, Debbie Avellana, described the already high costs of living for many Avalon residents who are service people earning $7 to $10 an hour. A number of speakers noted that SCE's electric rates in Avalon are normalized with mainland rates and asked why gas rates could not be similarly normalized. (Both SCE and ORA responded that Catalina is the only location in which SCE provides gas service and there are no mainland gas rates with which the island's rates can be normalized.)

An evidentiary hearing was conducted in Avalon on June 8, 2004. The Commission heard from four witnesses and received the testimony of four other witnesses by stipulation. Final briefs were filed on July 19, 2004, and reply briefs were filed on August 2, 2004, when the case was deemed submitted for Commission decision.

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[3] Mayor Morrow praised SCE and its Catalina utilities manager Rosemary Rohaley, stating "She's taken over, and she's straightening up our utilities and doing a great job. Except a 74 percent increase in rates is probably where we draw the line. We love you, Rosey, but not that much." (Transcript at 69.)

3. Jurisdictional Question

At hearing, the assigned Administrative Law Judge (ALJ) asked the parties to brief the question of whether this Commission will continue to have jurisdiction over SCE's gas operation in Catalina once SCE replaces its gas vaporization plant. The replacement will convert the operation from blended propane/butane liquefied gas to all-propane gas. The question arises because Pub. Util. Code § 221 defines "gas plant" in a manner that appears to exclude all-propane gas plants from Commission jurisdiction.

The Commission addressed the jurisdictional question in the 1980 general rate case, concluding that since butane at that time was the principal ingredient in the butane/propane mix, the § 221 exclusion would not apply to SCE's Catalina gas operation. Since that time, the Commission in four cases involving very small gas operations has deemed a utility's all-propane service unregulated, except for safety requirements.[4]

In response to questions raised by the Assigned Commissioner here, the ALJ questioned the parties as to the possibility that SCE's change to an all-propane operation could in the future be converted back to an LPG mix if circumstances so warrant (i.e., availability of supply of propane and butane, substantial difference in cost of propane and butane). SCE responded that it has in its new plant retained the possibility of using a propane-butane fuel mixture, although the conversion would require adjustments in the gas production plant that would take several weeks.

[4] Decision (D.) 83-03-004, D.93-06-089, D.95-02-026, D.01-04-031.

In analyzing the jurisdictional question, ORA notes significant policy considerations. SCE's gas operations on Catalina appear to be closer to an effective monopoly than may be the case for other propane plants. Catalina customers are unlikely to buy tanks of propane rather than accept delivery of gas through SCE's pipelines. Even if they were to do this, Edison at this time is the only retail vendor of tanks or propane refills on the island. ORA comments:

> The Commission was established to protect ratepayers from market power abuses associated with monopolies. Here we have a clear monopoly. (ORA Opening Brief, at 8.)

Moreover, SCE operates electricity, water and gas services in Catalina, and it apportions its rate-based costs for manpower, construction, equipment and general expenses among those three utility operations. In this case, for example, SCE allocated the cost of a Pebbly Beach pipeline replacement between its gas operation ($200,000) and its water operation ($65,000). If in the future two of these utilities were regulated by the Commission and one utility was not, the ability to monitor the allocation of costs would be impeded.

In view of these considerations – in particular, the monopolistic nature of the utility service and the possibility that the gas plant will be converted back to an LPG mix if prices or other conditions warrant – we conclude that SCE's Catalina gas service is distinguishable from other propane operations that would be deregulated under Pub. Util. Code § 221. Therefore, we apply the reasoning of Decision 92059, 1980 Cal. PUC LEXIS 786, and find that the Commission continues to have rate jurisdiction over SCE's gas plant service on Catalina Island.

4. SCE's Application

SCE's initial request for an overall rate increase and increases in its authorized expenses are shown on the following table. Also shown are ORA's initial recommendations for the rate increase and operating expenses. The third column shows the adopted increases authorized by this decision.

Southern California Edison
Catalina Gas Operations
Test Year 2005
Proposed Rates

	(Thousands of Dollars)		
	SCE	**ORA**	**Adopted**
Total Operating Revenues	1,157	888	984.5
Operating Expenses			
Escalation			
Production	351	249	297
Distribution	215	141	181
Customer Accounts	10	10	10
Uncollectibles	1	0	0
Administrative $ General	58	44	44
Franchise Requirements	12	9	7
Revenue Credits	(62)	(62)	(62)
Subtotal	585	391	477
Escalation	60	41	49
Depreciation	128	120	123
Taxes Other Than on Income	60	43	43
Taxes on Income	89	81	71
Total Taxes	149	124	114
Total Operating Expenses	922	676	763
Net Operating Revenue	235	212	222
Rate Base	2,419	2,177	2,276

Rate of Return	9.71%	9.74%	9.75%

SCE's authorized rate of return is set in annual cost of capital proceedings before the Commission. The 9.75% rate of return was set for 2003 in D.02-11-027. This rate of return was extended through December 31, 2004, when the Commission excused SCE from a 2004 cost of capital application. (D.03-08-063.) SCE's rate of return for 2005 is to be determined in Application 04-05-021, which is pending before the Commission.

In the discussion that follows, we will first address SCE's proposed capital expenditures. When the capital additions are in service, the expenditures are added to rate base, and a rate of return on those expenditures is included in ratepayer bills. We also deal with SCE's proposed operations and maintenance proposals and resolve disputes in that category. Finally, we turn to SCE's proposal for a new gas adjustment mechanism, attrition increases for years after 2005, and a phase-in plan.

5. Capital Expenses

5.1 LPG Vaporization Plant Upgrade

SCE proposes to replace its gas vaporization system and upgrade the fuel supply and storage tank facilities. The estimated total cost of this project is $1,303,000. The estimated useful life of the vaporization plant is 30 years. SCE's request for a significant increase in the Test Year 2005 revenue requirement is attributable primarily to the vaporization plant upgrade.

The existing LPG system uses a blend of 60% propane and 40% butane, which is delivered to Catalina by barge and transported to Pebbly Beach by tanker truck to four 30,000-gallon propane/butane storage tanks and one 16,000-gallon propane storage tank. The blended LPG is heated and vaporized into a gas-air mixture that ultimately is delivered into the distribution system.

SCE acquired the LPG butane-propane storage and processing system in 1962 and has made many additions and replacements to the system since that time. The company states that the facilities have begun to degrade to the point that reliability is compromised. Inspections have revealed leaks in water bath vaporizers and extensive corrosion. The upgrade includes replacement of water bath vaporizers, mixers, a mix tank, air compressor equipment and an LPG tank. The project will enable SCE to switch from a propane/butane mix to 100% propane, and this is expected to lower costs of gas because propane is available from more sources and is mechanically easier to vaporize.

SCE states that upgrading and relocating the existing LPG processing facilities within the current site is the least-cost alternative in addressing the obsolescence of the equipment and complying with safety requirements. The project is targeted for completion late this year.

ORA in its analysis agrees with SCE that the upgrade is necessary, noting that the existing facility is more than 30 years old and is out of compliance with a number of national fire safety standards. Because the cost will more than double the fixed capital component of SCE's rate base in Catalina, and because rates will reflect a return on that investment, ORA recommends that no rate increase be allowed to go into effect until the project is completed and the new plant is fully operational. SCE has agreed with that position, and our order today so provides.

5.2 Basement Upgrade

The building used by SCE for its electric, water and gas operations has a deteriorating floor that precludes use of heavy equipment because of danger that the floor could collapse into the basement. ORA examined the facility and the concrete integrity evaluation conducted for SCE, and ORA agrees that upgrading is necessary. Estimated cost of the project is $400,000, of which 15% or $60,000 is allocated to the gas operations. Because there has been some delay in completion, ORA recommends that the $60,000 allocation be effective July 1, 2005 rather than April 1, 2005 as originally requested by SCE. Our order today makes this amount effective on July 1, 2005.

5.3 Bird Park Line Extension

Edison has completed a Bird Park line extension that involved installation of new gas distribution service in conjunction with the City of Avalon for a new city-subsidized low-income building development. The project provided gas service to 24 new customers. ORA reviewed the project, its cost, alternatives considered and vendor selection and recommends approval of the estimated $95,000 cost of the project. We agree that the record supports this addition to rate base as the least-cost alternative to providing this new service.

5.4 Pebbly Beach Village Line Replacement

SCE proposes to replace 500 feet of gas distribution pipeline to 20 existing residences in Pebbly Beach Village, contending that the line was installed in the 1960s and now has exceeded the 40-year useful life of underground steel pipeline. Cost of the work would be $265,000, with $200,000 attributed to SCE's gas operations and $65,000 attributed to SCE's water utility.

ORA initially opposed this work on grounds that SCE has provided no engineering studies or other evidence that the line, despite its age, is in need of replacement at this time. At hearing, however, SCE presented evidence that it will be sharing the cost of this project with Santa Catalina Island Company, which plans to install a new fire flow line in Pebbly Beach at the same time the gas pipeline is installed. SCE was unable, however, to estimate how much it will save because of the joint project. Mark Bumgardner, ORA's project coordinator, testified that ORA would support a $100,000 allocation for the pipeline work if its costs are shared with the fire flow work.

In the absence of any revised estimate of cost because of the participation in the work by the Santa Catalina Island Company, our decision today approves $100,000 for this gas pipeline replacement.

6. Operations and Maintenance

SCE seeks a 68% increase in what has been budgeted in the past for its operations and maintenance expenses, citing a need for increased maintenance, employee training and compliance with numerous federal and state regulatory reporting requirements. Based on extensive discovery and a site visit, ORA objects to most of these increases. Both parties used a five-year average to estimate expenses, but SCE then sought additional amounts in several accounts to meet what it termed new "regulatory, safety, and reliability requirements."[5] ORA contested this, stating:

> In many instances, when pressed to identify what was the source of the 2005 budget in data requests, Edison witnesses repeatedly answered that the budgets that were "determined reasonable by SCE management, evolved during a series of discussions between SCE management and line employees" and that Edison did not maintain any "notes or calculations used to develop these forecasts."
>
> ORA's investigation also found that in the very recent past Edison had substantially over-estimated its O&M expenses. For example, Edison in its application estimated that its O&M expenses would be $750,000 in 2003. However, recorded 2003 O&M expenses were only $456,000. (ORA Opening Brief, at 14; footnotes omitted.)

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[5] SCE rebuttal testimony, Ex. 2 at 2.

What follows are the positions of the parties as to each of the operations and maintenance accounts in dispute and our resolution of those disputes.

6.1 Additional Employee

SCE proposes $75,000 for a full-time equivalent employee to perform additional maintenance and inspection tasks.[6] ORA claims that SCE has failed to justify this additional position, and that the new gas plant should obviate the need because of its increased efficiency.

SCE presented evidence showing that the new LPG plant will require an expanded preventative maintenance program to test and inspect the additional safety features in the new plant. SCE also testified that the additional staffing is required for a major pipeline testing and repair program that the company has begun. Hiring of an additional employee, SCE contends, will reduce SCE's reliance on more costly staff overtime to complete inspection and training requirements.

SCE has shown the need for an additional employee to augment its small staff on the island, and this addition should reduce SCE's need for additional overtime costs to accommodate employee training. We grant the requested increase of $37,500 in FERC Account 844.2 and $37,500 in FERC Account 874.[7]

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[6] The cost is split at $36,000 each between FERC Account 844.2 (LPG Processing Terminal Labor and Expenses) and FERC Account 874 (Mains and Service Expense).

[7] All utilities use a standard system of plant accounts mandated by the Federal Energy Regulatory Commission (FERC), hence the term FERC accounts. However, FERC has no jurisdiction over SCE's gas rates on Catalina. FERC regulates natural gas transmitted in interstate commerce, which does not include SCE's service to Catalina.

6.2 Additional Training

For Test Year 2005, SCE requested a total of $280,000 in FERC Account 844.2, $77,000 in Account 874 and $58,000 in Account 920/921. ORA recommended a disallowance of additional training costs of $2,000 in Account 844.2, $2,000 in Account 874 and $5,000 in Account 920/921 for a total disallowance of $9,000. ORA also would disallow $60,000 in additional overtime costs for training purposes ($30,000 in Account 8442 and $30,000 in Account 874).

SCE's witness stated:

> Federal regulations require that gas distribution operators and maintenance personnel be able to perform specific tasks to ensure the safe operation of the gas distribution system. To comply with these requirements, SCE is implementing a comprehensive formalized operator qualification training program and developing and maintaining "critical task" operating procedures to support this effort. (SCE Opening Testimony, at 39-40; footnotes omitted.)

ORA argues that all work required by the regulations that govern Catalina's gas distribution operation were in effect during 2002 and were reflected in historical rates. The evidence shows that during 2002, SCE conducted significant training that cost $83,000, and this amount was included in Catalina's base costs.

We agree with ORA that the record does not support a doubling of training and training overtime costs ($167,000) from the recorded training costs incurred in 2002 ($83,000). Our approval of SCE's request for an additional employee at Catalina also serves to reduce added costs in these categories. We adopt ORA's recommended amounts in Account 844.2, Account 874, Account 920/921, Account 844.2 and Account 874.

6.3 Preventative Maintenance

SCE seeks an additional $22,000 in preventative maintenance expenses in Account 847.1 (LPG Processing Terminal Maintenance Supervision and Engineering). The company testified that the revenue is necessary for inspection and maintenance requirements in the new LPG facility. In response to an ORA data request, however, SCE identified no testing and inspection tasks that are not currently required. ORA urges that a five-year average be used in calculating the 2005 test year cost for this account. We conclude that SCE has not met its burden of showing the need for this increase, and we disallow it.

We will, however, allow a requested $10,000 increase in Account 847.1 for corrosion protection of pipelines attaching to the new LPG plant. While ORA opposed this increase on grounds that no significant leakage or corrosion has been reported, SCE showed that the pipes in question are more than 40 years old and require additional protection during the plant construction.

6.4 Work Management System

SCE sought an additional $10,000 for an automated work management system and an additional $18,000 for a formalized training program, all part of Account 920/921 (Safety Training and Other Non-Operating Expenses). ORA recommends that a five-year average be used in calculating Test Year 2005 costs for this account. ORA testified that SCE's new automated management system would replace one that currently works well and costs less. On cross-examination at hearing, ORA showed that an internal audit report by SCE had only one recommendation for new training (handling of compressed gas), and that was to be completed by July 2002. We find that SCE has not justified these increased estimates for the small workforce it maintains in Catalina. We adopt ORA's recommendations for this account. Of course, this does not preclude SCE from developing a new automated work management system if it believes such a system will improve efficiency.

6.5 Uncontested SCE Proposals

SCE has applied to the Commission for an exemption from General Order 58A to implement a statistical meter-testing program. ORA supports this on grounds that the program probably will save ratepayers money. We adopt Edison's estimate for Account 878/879 (Meter & House Regulator & Customer Installation Expense).

SCE seeks an expense increase in Account 887 (Maintenance of Mains) of $65,000 for a major new pipeline testing and repair program. The evidence shows that the rate of underground leaks on SCE's system in 2003 was dangerously high – nearly 1.5 leaks per mile, or 6 leaks on 4.5 miles of steel pipe. ORA testified that the leaks were distributed throughout the system and were not isolated to any one section of pipe, and that it is prudent to begin a thorough testing of the system.

ORA also supports as reasonable SCE's forecast expenses for Account 893 (Maintenance of Meters and House Regulators Expense) and Account 902 (Meter Reading Expense). Testimony at hearing showed the likelihood of the forecast expenses. We adopt these forecasts.

7. Forecast of Gas Sales

ORA forecast gas sales for 2004 through 2008 based on average weather conditions, expected customer growth, economic conditions and phase-in price levels. SCE forecast very small growth in the number of residential customers and no growth in the number of business customers. Given the limited amount of development occurring in Avalon, ORA concluded that SCE's forecasts of customer growth were reasonable. We adopt SCE's customer growth estimates.

The parties differed, however, on their forecasts of gas sales per customer. While both used similar statistical and mathematical models to forecast gas sales, SCE assumed that the rate increase it seeks will cause reduced gas usage. ORA's analyst presented a regression analysis of recorded gas usage that found no significant relationship between rates and usage for residential customers and only a minor effect for business customers. While the forecasts of both parties reflect a decline in sales for 2005, ORA forecasts a somewhat smaller decline. ORA's analysis was based on the methodology that SCE used for projecting gas sales in its 1986 gas case. We will adopt the ORA analysis of gas sales, in part because the rate increase we authorize today is smaller than that sought by SCE and presumably will not result in decreased usage to the extent forecast by the company.

7.1 Gas Sales Adjustment Mechanism

For the first time in its rebuttal testimony, Edison proposed that the discrepancy in forecast sales between ORA and Edison could be handled through the creation of a balancing account. Called the Gas Revenue Adjustment Mechanism (GRAM), the balancing account would be used to calculate the difference each month between authorized gas base rate revenues and actual gas base rate revenues. If the monthly measure showed an over-collection, the amount would be credited to the GRAM; if it showed an under-collection, the amount would be debited. Rates would be adjusted annually to reflect the GRAM balance, including interest.

Like ORA, we question whether the cost and administrative burden of monitoring and reviewing this balancing account is worth the small amounts of money that would be involved. The difference in SCE and ORA sales forecasts for 2005 is relatively small. The proposed balancing account was presented late in the game and has not been subjected to extensive analysis of costs and benefits. We decline to adopt a GRAM balancing account at this time.

8. Depreciation Expense and Reserve

ORA reviewed and considers reasonable SCE's method of calculating depreciation rates, net salvage value, depreciation expense and weighted average depreciation reserve. The differences in the estimates are due primarily to the $100,000 difference in the capital cost of the Pebbly Beach Village line replacement. In addition, there is a timing difference in the calculation of weighted average balances for plant-in-service. ORA also excludes Construction Work in Progress from rate base on grounds that accounting principles call for this amount to be booked to Allowance for Funds Used During Construction, and these expenses are recovered only after the new plant comes into service. We adopt ORA's estimates, adjusted to recognize $100,000 for the Pebbly Beach work.

9. Rate Base

The major components of rate base include utility plant, working cash, reserve for depreciation, and deferred income taxes. SCE and ORA agree on the methodology for these calculations. However, ORA's recommended amount for total rate base is some $244,000 less that SCE's, primarily because of differences in the Pebbly Beach line replacement projections and the exclusion of $13,000 for Construction Work in Progress. A difference in working cash requirements is due to the differences in Test Year operations and maintenance estimates. We adopt ORA's rate base calculations, adjusted to reflect $100,000 (instead of $0) for the Pebbly Beach work.

RATE BASE	Edison	ORA	Adopted
FIXED CAPITAL			
Plant-in-service	3,809	3,564	3,664
Construction Work in Progress	13	0	
Total Fixed Capital	3,822	3,564	3,664
Working cash	87	61	61
DEDUCTIONS			
Accumulated Depreciation Reserve	(1,082)	(1,079)	(1,079)
Accumulated Deferred Taxes - Plant	(432)	(391)	(391)
Accumulated Deferred Taxes - Plant Capitalized Interest	25	21	21
RATE BASE	2,420	2,176	2,276

10. Attrition

SCE demonstrated at hearing that it will experience very little growth in gas sales on Catalina. Customer growth is also limited. It follows that SCE cannot rely on increased sales of gas to recover increased operations and maintenance expenses after 2005. SCE therefore seeks attrition increases for the years 2006, 2007 and 2008 of about $20,000 per year. ORA opposes the request for attrition increases as unnecessary and inappropriate, stating:

> Edison can and presumably would come back to the Commission with a new rate case application in three years if it turns out that inflation or other costs increase faster than productivity. If at that time the Commission concludes an increase in the company's rate is justified, the Commission can grant the requested relief then. Given that context, the issue is whether Edison has demonstrated that it will suffer hardship if the Commission does not grant it automatic attrition increases each year for three years. ORA submits that Edison has not demonstrated such hardship. (ORA Opening Brief, at 30.)

SCE argues that the lack of customer growth and the normal effects of inflation make attrition increases necessary. ORA argues that depreciation and retirement of obsolete plant will tend to reduce rate base over the next three years, and the new propane system and pipeline training program are likely to produce lower operations and maintenance costs.

We are not persuaded that burdening 1,300 gas ratepayers with attrition increases is justified, especially since cost increases are not certain to occur. Both SCE and ORA forecast increases in gas sales after a temporary decline next year, and this additional revenue will help offset increases in operating costs. The Commission did not provide for attrition increases in SCE's last general rate case in Catalina. Historically, the Commission has not granted attrition increases to smaller utilities, such as PacificCorp,[8] Bear Valley Electric[9] and Mountain Utilities.[10] In those cases, the utilities were provided balancing accounts for potentially volatile fuel expenses. Similarly here, SCE has a procedure in place for recovering increases in the wholesale cost of propane and passing those costs on to customers. For these reasons, we decline to adopt the proposed attrition increases.

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[8] *See* D.03-11-019.

[9] *See* D.96-05-033.

[10] *See* D.99-12-006, Advice Letter 15-E-A.

11. Rate Phase – In

SCE's preferred proposal for an increase in rates is to implement the full Catalina gas revenue requirement in 2005, with no rate phase-in. Recognizing that the Commission would be reluctant to authorize so large an increase in a single year, SCE offered a proposal that would phase in the increase over four years, with a substantial carrying charge for the deferred amounts. If SCE's proposed increases were implemented in 2005, ratepayers would pay rates based on an additional $727,482 over current base rates. Under its phase-in suggestion, rates would reflect an increase of $1,218,000, much of it in carrying charges for the deferred increases after 2005.

ORA urges that the authorized increase be phased in over a three-year period to mitigate rate shock and that no carrying charges be assessed against the deferred amounts. ORA notes that even under this proposal, Catalina ratepayers would incur an increase of about 100% over the next three years, and it argues that this is the maximum the local economy can absorb.

SCE comments:

> Based on the cumulative losses to SCE over the 2005-2008 period, ORA's rate phase-in proposal can be summarized as "free gas for the summer." ORA's proposals are simply unreasonable. After years of losses on Catalina operations, ORA takes the view that SCE's shareholders should continue to shoulder the burden of even more losses. While it is true that these losses are not large in the context of SCE's entire utility operations, adoption of ORA's proposals contradict cost of service ratemaking principles. (SCE Opening Brief, at 21; footnotes omitted.)

There is logic in SCE's position. If SCE is not permitted to recover its revenue requirement on a forecast basis, then on a forecast basis SCE's investors will not earn their authorized return. If the deferred revenue requirement does not earn SCE's full cost of capital during the recovery period, then SCE's investors will be receiving a lower return than they could earn on comparable investments. This Commission has long been guided by the principle enunciated by the United States Supreme Court that utility investors must have a reasonable opportunity to earn a return on their investment that is comparable to other investments of similar risk.[11]

On the other hand, we are dealing here with substantial costs that can be recovered only from a small group of 1,300 ratepayers. Unlike electricity rates, which have been "normalized" with mainland rates, the gas distribution rates in Catalina stand alone, since SCE operates no other gas services. A slavish application of investor earning principles in this case would work obvious harm on these few Catalina customers while having virtually no effect on SCE shareholders, given the size of the Catalina gas operation relative to the utility's overall operations.

As the Supreme Court said in its seminal *Hope Natural Gas* decision:

> We held in Federal Power Commission v. Natural Gas Pipeline Co…. that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of "pragmatic adjustments." And when the Commission's order is challenged in the courts, the question is whether that order "viewed in its entirety" meets the requirements of the Act. Under the statutory standard of "just and reasonable" it is the result reached and not the method employed which is controlling. (*Federal Power*

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[11] *See Federal Power Commission et al. v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603; *Duquesne Light Company v. Barasch* (1989) 488 U.S. 299, 307-308.

Commission v. Hope Natural Gas Company (1944) 320 U.S. 591, 602; citations omitted.)

We note that in 1987, the Commission in SCE's last Catalina gas rate case phased in an increase in installments over three years, without a carrying charge.[12] As here, the three-year phase-in was deemed necessary to avoid rate shock. SCE has waited 17 years to file this general rate case, apparently undeterred by a low or even negative rate of return during those years.[13] Under these circumstances, we conclude that SCE has not made a persuasive case for attaching carrying charges to the deferred portion of its revenue increase.

At the public participation hearings, customers pointed out that SCE electric rates are normalized with mainland rates, and they asked why some similar arrangement could not be made for gas. The answer is that SCE has no other gas customers who can share in the Catalina costs. Nevertheless, we encourage SCE to consider other approaches that might ease the burden on SCE gas customers, up to and including statutory changes.

12. Rate Design

12.1 Baseline Quantities of Gas

Under Pub. Util. Code § 739(d)(1), the Commission must set baseline quantities of gas for residential customers at an amount between 50% to 60% of average residential use in the summer and 60% to 70% in winter. The current baseline quantities are calculated for Catalina gas customers at 60% summer and 70% winter, consistent with SCE's last general rate case. ORA proposes, and SCE does not object, that the Commission continue to use the existing baseline quantities for the next three years. Our order today so provides.

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[12] *See* D.87-07-019.

[13] The record shows that SCE lost money on Catalina gas operations in four of the five years from 1998 through 2002.

12.2 Allocation of Rates

SCE proposes that increased rates be spread equally over the fixed meter charge and volume rates. ORA recommends that the increase be allocated 15% to the fixed portion of the bill and 85% to volume. ORA contends that this allocation will give customers – particularly residential customers – more control over gas charges, since reduced use will result in a reduced bill. In the absence of evidence challenging the reasonableness of this approach, we adopt ORA's allocation of rates between fixed meter (customer) charge and volumetric rates.

12.3 Domestic CARE Rates

Both SCE and ORA support extension of the California Alternate Rates for Energy (CARE) discounts for Catalina low-income domestic gas service. Under the program, customers qualifying for the CARE program for electric service are enrolled automatically for the proposed CARE schedule for gas service, Schedule G-CARE. Such customers receive a 20% discount in service rates. Approximately 160 Catalina gas customers who participate in the electric CARE program will be eligible for G-CARE. The low-income program reallocates the approximately $16,000 cost, and there is no impact on overall revenue requirements.

13. Comments on Proposed Decision

The principal hearing officer's proposed decision was filed with the Commission and served on all parties in accordance with Section 311(d) of the Public Utilities Code and Rule 77.1 of the Rules of Practice and Procedure. In its comments, SCE points out certain errors in tax calculation, which were not adjusted in all cases to recognize actual capital additions and operating expenses authorized by this decision. To the extent SCE has adequately explained the errors, those errors have been corrected, and the tables accompanying this decision now reflect those corrections.

SCE objects that, because of the three-year phase-in requirement, it will not collect its full distribution base rate revenue requirement for two years. As the decision explains, the phase-in requirement is intended to lessen rate shock for the relatively few gas ratepayers in Catalina. A similar phase-in was adopted in SCE's last general rate case for Catalina gas operations in 1987. In both cases, these were pragmatic adjustments balancing the need to increase SCE revenue while reducing the burden on the relatively small ratepayer base.

Moreover, contrary to SCE's assertions, this decision does not contravene Supreme Court decisions on ratesetting. As ORA points out, the decision looks to the overall return on investment that the Commission has provided to SCE, and it finds that overall return reasonable. There is no Supreme Court requirement that separate utility districts, like Catalina, must earn at the same rate as the entire utility, so long as the utility as a whole earns a fair rate of return. In a worst case scenario here, the revenue shortfall in Catalina will be less than $350,000 in 2005 and less than $175,000 in 2006. In the context of the revenue requirement set in SCE's last general rate case (D.04-07-022), the effect of the Catalina decision in 2005 would be a decrease in SCE's authorized rate of return of only 0.004%. Neither SCE nor its shareholders are likely to be harmed by so minute a difference.

SCE also challenges disallowances recommended by ORA and adopted by the decision, but SCE raises no arguments that were not raised in briefs and considered by the Commission. Under Rule 77.3 of the Rules of Practice and Procedure, comments that merely reargue positions taken in briefs are accorded no weight.

ORA in its comments generally supports the ratesetting decisions reached in this decision. It clarifies its position on the Commission's safety jurisdiction over SCE's gas operations in Catalina, noting the distinct statutory basis (Pub. Util. Code §§ 4451, *et seq.*) for safety jurisdiction.

14. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Glen Walker is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SCE provides all of the gas, water and electric service in Catalina and has done so since 1962; there are 1,335 commercial and residential gas customers in Avalon.

2. The last general rate case for gas distribution costs occurred in 1987, and SCE has not sought an increase in its authorized distribution costs since that time.

3. Through a Gas Cost Adjustment Clause, SCE is permitted to pass through to customers its wholesale cost of liquefied petroleum gas used in Catalina.

4. In this application, SCE seeks an increase in its gas distribution costs from current base rate revenues in Test Year 2005 of $430,000 to $1,157,482 in Test Year 2005.

5. A major factor driving SCE's proposed increase is a $1.3 million replacement of the 30-year-old gas vaporization system and plant in Avalon.

6. Among SCE's other major capital expenditures affecting gas rates are a basement upgrade in SCE's Avalon building, a new gas distribution line to serve 24 new customers, and replacement of gas pipeline in Pebbly Beach Village.

Conclusions of Law

1. The adopted summaries of earnings and the quantities and calculations that underlie them are reasonable for ratemaking purposes and should be adopted.

2. Because SCE's Catalina gas service is distinguishable from other all-propane gas operations, the Commission should retain jurisdiction over the Catalina gas service.

3. No rate increase should go into effect until SCE's new gas vaporization system and upgrade have been completed and the new plant is fully operational.

4. The $60,000 allocation for a basement upgrade should be effective July 1, 2005, rather than April 1, 2005, as originally requested by SCE.

5. SCE has not met its burden of proof at this time in showing the necessity of a Gas Revenue Adjustment Mechanism balancing account.

6. Attrition increases in operations and maintenance expenses after 2005 have not been justified.

7. Because of the limited number of customers who must bear these costs, ORA's three-year rate phase-in proposal is more reasonable than the four-year phase-in plan proposed by SCE.

8. The rate increase should be allocated 15% to the fixed portion of a customer's bill and 85% to volume so that customers will have more control over their gas costs.

9. Low-income customers should receive a 20% discount in gas service rates under a CARE schedule for gas service.

10. SCE should be authorized to implement the rate changes set forth in this order.

11. This decision should be made effective immediately to allow SCE opportunity to earn the return found reasonable for it in Test Year 2005.

O R D E R

IT IS ORDERED that:

1. Southern California Edison Company (SCE) is authorized to file in accordance with the General Order 96 series, and make effective on not less than five days' notice, the revised tariff schedules for gas rates for 2005 included as Appendix A to this order. The revised tariff schedules shall apply to service rendered on and after their effective date.

2. Advice letters for authorized rate increases for 2006 and 2007 may be filed in accordance with the General Order 96 series no earlier than November 1 of the preceding year, to be effective January 1 of the following year, subject to Energy Division review for compliance. The filing shall include appropriate work papers. The increase shall be the amount authorized in Appendix A.

3. The summaries of earnings and the quantities and calculations that underlie them, as set forth in this decision, are adopted.

4. The Commission has jurisdiction over SCE's Catalina gas service.

5. This proceeding is closed.

This order is effective today.

Dated December 2, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
Commissioners

I dissent.

/s/ SUSAN P. KENNEDY
Commissioner

APPENDIX A
SANTA CATALINA ISLAND GAS SYSTEM

RATE DESIGN

		2005		2006		2007	
RESIDENTIAL							
		Baseline	Nonbaselir	Baseline	Nonbaselir	Baseline	Nonbaselin
	BASE	0.39744	0.72076	0.53239	0.87595	0.66482	1.02826
	GCAC	0.84538	0.71395	0.84538	0.71395	0.84538	0.71395
	PUCRF	0.00076	0.00076	0.00076	0.00076	0.00076	0.00076
TOTAL RESIDENTIAL		1.24358	1.43547	1.37853	1.59066	1.51096	1.74297
COMMERCIAL							
	BASE	0.94040		1.19462		1.44506	
	GCAC	0.97266		0.97266		0.97266	
	PUCRF	0.00076		0.00076		0.00076	
TOTAL COMMERCIAL		1.91382		2.16804		2.41848	

MONTHLY SERVICE CHARGE

Meter Size		Present	Proposed Phase - In Y2005	Y2006	Y2007
175	cubic feet	4.00	$5.46	$6.83	$8.20
305	cubic feet	6.97	$9.51	$11.90	$14.29
400	cubic feet	9.14	$12.47	$15.61	$18.73
675	cubic feet	15.43	$21.06	$26.36	$31.62
1000	cubic feet	22.86	$31.20	$39.04	$46.85
2000	cubic feet	45.57	$62.20	$77.84	$93.40
3000	cubic feet	68.36	$93.32	$116.76	$140.11
4000	cubic feet	91.14	$124.42	$155.67	$186.81
5000	cubic feet	113.93	$155.52	$194.60	$233.51

IMPACT ON AVERAGE CUSTOMER BILLS

	2004	Increase	2005	Increase	2006	Increase	2007
Single Fam	**$27.42**	14.88%	**$31.50**	13.22%	**$35.66**	11.53%	**$39.78**
Multi Famil	**$170.09**	12.00%	**$190.50**	11.33%	**$212.08**	10.00%	**$233.28**
Commercia	**417.67**	20.26%	**$502.31**	15.62%	**$580.78**	9.99%	**$638.78**

(END OF APPENDIX A)