

Application No: A. 11-11-002
Exhibit No.: _____
Witness: Gary Lenart

)
In the Matter of the Application of San Diego Gas &)
Electric Company (U 902 G) and Southern California)
Gas Company (U 904 G) for Authority to Revise)
Their Rates Effective January 1, 2013, in Their)
Triennial Cost Allocation Proceeding.)
_____)

A.11-11-002
(Filed November 1, 2011)

SUPPLEMENTAL DIRECT TESTIMONY
OF GARY LENART
SAN DIEGO GAS & ELECTRIC COMPANY
AND
SOUTHERN CALIFORNIA GAS COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

March 16, 2012

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1 **SUPPLEMENTAL DIRECT TESTIMONY**
2 **OF GARY LENART**

3 **I. PURPOSE**

4 The purpose of this supplemental direct testimony is to update my direct testimony in
5 response to the direction provided by Commissioner Florio in his February 24, 2012 Assigned
6 Commissioner’s Scoping Memo and Ruling (Scoping Memo).¹ Specifically, this supplemental
7 testimony: (1) explains and justifies the Transition Adjustment (Issue 1); (2) explains and justifies
8 our use of the “Rental Method” and not the “New Customer Only” methodology (Issue 5); and (3)
9 provides workpapers and a related explanation for using the New Customer Only method
10 consistent with the use of this method in D.00-04-060 (Issue 6).

11 **II. TRANSITION ADJUSTMENT**

12 The Scoping Memo, referencing the protest of Southern California Generation Coalition
13 (SCGC), directed SoCalGas and SDG&E to explain and justify in detail the Transition
14 Adjustment. In its protest, SCGC states that there was “no explanation or justification of the
15 methodology used to allocate the amounts that would be reallocated from EG-D, Gas A/C, Gas
16 Engine, and NGV customers to other classes.”²

17 **A. Justification**

18 Our justification for the proposed transition adjustment (Transition Adjustment) is that it
19 would help to avoid rate shock for particular customer classes that would otherwise face large
20 percentage rate increases in this TCAP. One must remember that this application is an allocation
21 proceeding; which, in theory, is an allocation of existing costs and is not introducing any changes
22 to authorized revenue requirement. Therefore, for an allocation proceeding, SoCalGas and

¹ Page 10 of the Scoping Memo identifies seven issues/topic areas where intervenors have requested additional justification and calculations, and directs SoCalGas and SDG&E to update and expand their testimony and workpapers to address the concerns identified in the protests.

1 SDG&E made a determination that rate increases greater than benchmarks of either seven or 10
2 percent could potentially result in rate shock for the affected customer classes, and therefore we
3 proposed a Transition Adjustment that would reduce the rate changes for the affected customer
4 classes to these benchmarks. Rate classes that would increase more than these benchmarks; and,
5 therefore, are subject to our proposed Transition Adjustment, were SoCalGas' Gas A/C, Gas
6 Engine, NGV, EG-D, and SDG&E's Residential and SDGE's NonCore C&I-D rate classes.

7 Adjustments of this type are not something new to the Commission or to SoCalGas' and
8 SDG&E's customers. In fact, the Commission has a long history of approving adjustments of this
9 nature. As I explained in my direct testimony:

10 The Commission has a history of approving "non-cost based
11 allocation adjustments" as indicated in the approval of the settlement
12 agreement in the 2009 BCAP Phase II decision (D.09-11-006) and
13 also as far back as 1986 with the approval of Core-Averaging
14 adjustments in D.86-12-009.³

15 **B. Explanation**

16 SoCalGas and SDG&E developed their Transition Adjustment in the following manner:

17 i) First, a benchmark was established for rate change that was used to evaluate all
18 class-average rates.

19 ii) Classes experiencing changes greater than the benchmark received some
20 transitory assistance in the form of an adjustment.

21 iii) These adjustments were then absorbed by classes that were showing rate
22 decreases.

² SCGC Protest at 3.

³ Lenart Direct Testimony at 33.

1 iv) Adjustments were made within the core class completely separate from
2 adjustments made within the noncore class. All adjustments to core rate classes had an offsetting
3 adjustment made to rate classes that are only within the core service category. Similarly,
4 adjustments to noncore rate classes had an offsetting adjustment made to rate classes that are only
5 within the noncore service category.⁴

6 SoCalGas and SDG&E initially established a benchmark of 7%, with the Transition
7 Adjustment applied to all customer classes having greater rate changes. This initial benchmark
8 was based upon the SoCalGas Residential class rate change of 7%. Since this is the largest
9 customer class, and since it is not subject to any proposed adjustments, we believed that the
10 proposed rate change for the SoCalGas residential class would serve as a reasonable and
11 appropriate benchmark for other classes. For customer rate classes with decreases or rate
12 increases of 7% or less, there would be no Transition Adjustment. For customer rate classes with
13 increases of greater than 7%, we propose a Transition Adjustment to shield them from potential
14 rate shock.

15 However, when we went to implement this benchmark, we discovered that limiting rate
16 increases to 7% was impractical because it pushed rate normalization out too far into the future.
17 Our goal throughout this process is to have costs ultimately match up with rates, and we did not
18 want to put this off for too long for a certain limited number of rate classes experiencing
19 substantial percentage increases. The three rate classes falling within this category are: (1) the
20 Sempra-Wide NGV rate; (2) the Sempra-wide EG-D rate; and (3) the SDG&E NonCore C&I-
21 Distribution (NCCI-D) rate. Unadjusted, these rates would increase under our proposed cost
22 allocation by 14%, 118%/67%,⁵ and 59%, respectively. Limiting rate increases to 7% for these

⁴ Lenart Direct Testimony at 34 to 36.

⁵ 118% for the Sempra-wide EG-D Tier 1 rate; and 67% for the Tier 2 rate.

1 three particular rate categories would have put off the move to cost-based rates for too long.
2 Accordingly, for these three rate classes we used a benchmark of 10% rather than 7%. This
3 adjustment is then able to be phased-out in a straight-line fashion over 6 years until fully cost
4 based rates are achieved.⁶

5 In its protest, SCGC also stated, “Thus, it appears that the burden of the transition
6 adjustment would be imposed substantially if not entirely on TLS customers.”⁷ This statement by
7 SCGC is not accurate. The proposed transition adjustment occurs separately between core
8 customers and noncore customers. Put another way, the burden of the transition adjustment to
9 core rates is shared by other core customers, and the burden of the transition adjustment to
10 noncore rates is shared by other noncore customers. Noncore customers are not asked to make up
11 for the transition adjustments to core rates, and vice versa. This means that the \$2.235 million in
12 adjustments made to SoCalGas’ Gas A/C, Gas Engine, and NGV core rates is completely offset by
13 the \$2.235 million offsetting adjustment made to the core C&I rate class. Similarly, the
14 adjustment made to SDG&E’s core classes of \$10 million occurs completely between SDG&E’s
15 core residential and core C&I rate classes. It is not paid for by SoCalGas ratepayers. The
16 Transmission Level Service (TLS) rate does not participate in any of the core adjustments. Notice
17 the total of adjustments within the core classes sums to zero; and, the total of adjustments within
18 the noncore classes sums to zero. At SoCalGas, the \$3.125 million in adjustments made to the
19 noncore EG-D Tier 1 and Tier 2 classes is offset by the \$3.125 million adjustment to the TLS rate
20 class; and, at SDG&E the \$1.650 million in adjustments made to the noncore EG-D Tier 1 and
21 Tier 2 classes is offset by the \$1.650 million adjustment to the TLS rate class. Since the TLS rate

⁶ Lenart Direct Testimony at 35.

⁷ SCGC Protest at 3.

1 is a Sempra-Wide rate, the total adjustment made to TLS customers is \$4.775 million which is
 2 only a small portion of the total of \$17 million in transition adjustments we are proposing.

3 The following table (Table 16 from my direct testimony) illustrates each of the transition
 4 adjustments we are proposing.

	2011 Current	2013TCAP No Adj		Transition Adjustment \$000	2013TCAP w/ Adjustment	\$/th Change	% Change
<u>SCG:</u>							
Res \$/th	\$0.525	\$0.559	7%	\$0	\$0.559	\$0.034	7%
CCI CA \$/th	\$0.305	\$0.253	-17%	\$2,235	\$0.256	(\$0.050)	-16%
Gas A/C	\$0.075	\$0.097	30%	(\$10)	\$0.080	\$0.005	7%
Gas Engine	\$0.096	\$0.122	27%	(\$1,475)	\$0.102	\$0.006	7%
NGV Uncompressed post-SW \$/th	\$0.068	\$0.077	14%	(\$750)	\$0.072	\$0.004	6%
Core Class Average \$/th	\$0.449	\$0.455	1%	\$0	\$0.455	\$0.006	1%
NCCI-D CA \$/th	\$0.065	\$0.051	-21%	\$0	\$0.051	(\$0.014)	-21%
EG-D Tier 1 post-SW \$/th	\$0.056	\$0.122	118%	(\$1,625)	\$0.062	\$0.006	10%
EG-D Tier 2 post-SW \$/th	\$0.024	\$0.040	67%	(\$1,500)	\$0.026	\$0.002	10%
TLS CA Rate csitma/efba exempt	\$0.016	\$0.011	-29%	\$3,125	\$0.014	(\$0.002)	-13%
TLS CA Rate csitma/efba non-exempt	\$0.016	\$0.012	-24%		\$0.015	(\$0.001)	-8%
UBS \$1,000/yr	\$26,470	\$26,425	0%		\$26,425	(\$45,063)	0%
BTS w/BTBA \$/dth/d	\$0.110	\$0.154	40%		\$0.154	\$0.044	40%
SAR w/ BTS \$/th	\$0.201	\$0.201	0%	\$0	\$0.202	\$0.001	0%
<u>SDGE:</u>							
Res \$/th	\$0.664	\$0.743	12%	(\$10,000)	\$0.708	\$0.044	7%
CCI CA \$/th	\$0.240	\$0.156	-35%	\$10,000	\$0.215	(\$0.024)	-10%
NGV Uncompressed post-SW \$/th	\$0.070	\$0.082	18%	\$0	\$0.077	\$0.007	10%
Core Class Average \$/th	\$0.512	\$0.515	1%	\$0	\$0.514	\$0.003	1%
NCCI-D \$/th	\$0.145	\$0.230	59%	(\$550)	\$0.160	\$0.015	10%
EG-D Tier 1 post-SW \$/th	\$0.056	\$0.123	118%	(\$300)	\$0.062	\$0.006	10%
EG-D Tier 2 post-SW \$/th	\$0.024	\$0.040	67%	(\$800)	\$0.026	\$0.002	10%
TLS CA Rate csitma/efba exempt	\$0.016	\$0.011	-29%	\$1,650	\$0.014	(\$0.002)	-13%
TLS CA Rate csitma/efba non-exempt	\$0.018	\$0.017	-4%		\$0.019	\$0.002	10%
SAR \$/th	\$0.226	\$0.228	1%	\$0	\$0.226	\$0.000	0%

1 **III. RENTAL VS. NCO**

2 In their protest, the Division of Ratepayer Advocates (DRA) states that it “intends to
3 review and make recommendations on the Applicants’ use of the “rental method,” as opposed to
4 the New Customer Only (NCO) method that the Commission has endorsed.”⁸

5 SoCalGas and SDG&E proposed the use of the Rental method in their Long Run Marginal
6 Cost (LRMC) studies for their respective customer cost functions. The Rental method calculates
7 the capital component of the unit marginal cost by annualizing the cost of hooking up a new
8 customer, or marginal investment, using the Real Economic Carrying Charge (RECC).

9 Another method that has been used for determining unit marginal costs in LRMC studies is
10 the NCO method. The NCO method derives the unit marginal cost by first determining the
11 present value of future revenue requirements for the new customers only. This is done by
12 multiplying the marginal investment/customer by a Present Value of Revenue Requirements
13 (PVRR) factor, and then applied to just the number of new customers. The present value of all
14 new customers is then divided by the total number of existing customers to determine the unit
15 marginal cost. The table below illustrates the formulas for deriving unit marginal costs under the
16 two methods, using SoCalGas’ Residential Class as an example.

⁸ DRA Protest at 4.

Rental Method		NCO Method	
Marginal Investment/ customer	\$1,309.02	Marginal Investment/ customer	\$1,309.02
* RECC	9.1%	* PVRR	1.242
		= Present Value/ customer	\$1,625.61
		* Number of New Customers	24,152
		= Amount incurred by new customers \$000	\$39,262
		/ Total Number of Customers	5,327,003
= Capital related Portion of Marginal Unit Cost \$/customer	\$119.47	= Capital related Portion of Marginal Unit Cost \$/customer	\$7.37
+ O&M Loaders	\$96.74	+ O&M Loaders	\$96.74
= Marginal Unit Cost/ customer	\$216.21	= Marginal Unit Cost/ customer	\$104.11
* Forecasted # Customers	5,548,845	* Forecasted # Customers	5,548,845
= Allocated Customer- Related Costs \$000	\$1,200,000	= Allocated Customer- Related Costs \$000	\$578,000

1 SoCalGas and SDG&E believe that the Rental method is more appropriate for determining
2 marginal customer costs in this proceeding than the NCO method because it does not have the
3 deficiencies that NCO does. These deficiencies are:

- 4 A. Rental method determines customer-related costs for the entire rate class; the
5 NCO method does not.
- 6 B. The Rental method is consistent with Commission approved ratemaking
7 procedures.
- 8 C. NCO method is skewed by variations in growth rate.
- 9 D. NCO does not fully account for replacement costs.

1 **A. Rental Method Determines Customer-Related Costs for the Entire Rate Class;**
2 **the NCO Method Does Not**

3 The intent of this part of the cost allocation process is to determine the customer-related
4 costs incurred by each rate class. The LRMC method does this by determining the incremental
5 cost required to serve one additional customer and then applying that to the total number of
6 customers in that class. The key point here is that the end result is the allocation of costs to the
7 entire rate class.

8 The Rental method does indeed determine the costs for the entire class because the
9 marginal unit cost of a residential customer is applied to the entire residential customer class. This
10 is justified because existing customers, of which there are over 5 million, continue to incur capital
11 related costs and not just the new customers. The NCO method does not determine the costs for
12 the entire class because it bases the capital-related portions of the marginal unit cost only on the
13 total amount spent on new customers. This is the same as saying that a certain customer class
14 must be incurring a lesser amount of customer-related costs because they had a smaller operating
15 budget for new customers. Such an approach ignores the customer-related costs that are still being
16 incurred by the existing customers. These customer-related costs that are still being incurred by
17 existing customers are the annualized revenue requirement related to invested capital, which
18 continues over a 30+ year service life. Therefore, it is not correct to base the allocation only on
19 the number of new customers while ignoring the authorized costs to be recovered from existing
20 customers. This is illustrated by the differences in the capital-related portion of marginal unit
21 customer costs. Using the Rental method this amount is \$119.47/customer. Using the NCO
22 method this amount decreases substantially to only \$7.37/customer.⁹

⁹ These amounts are shown in the workpapers of Mr. Lenart at Section 1 Tab “Cust MC”; and, also in the SoCalGas and SDG&E response to the second set of data requests from SCGC requesting rates using the NCO method.

1 **B. The Rental Method is Consistent with Commission Approved Ratemaking**
2 **Procedures**

3 The Rental method uses the RECC factor which annualizes the capital related costs¹⁰ to
4 provide what the totality of these costs represents to the utilities in a given year. This process
5 mimics how authorized revenue requirement is determined in a General Rate Case proceeding. In
6 contrast, the NCO method uses the present value of all these costs. This present value does not
7 reflect the marginal cost for a customer in a given year, but instead for the life of the asset. This
8 deviates from the traditional (annualized) revenue requirement ratemaking procedures.

9 **C. NCO Method is skewed by Variations in Growth Rate**

10 Additionally, the NCO method is based only on the number of new customers of the
11 utility. This can unnecessarily skew the results because the allocation is influenced by the number
12 of new customers. If a customer class observes low customer growth, the amount of cost allocated
13 to that class will be low, whereas a customer class observing high customer growth will be
14 allocated greater costs.

15 **D. NCO does not Fully Account for Replacement Costs**

16 The NCO Method ignores the fact that a segment of utility operations is replacement work.
17 Again, this is because the present value is only applied to the number of new customer rather than
18 all customers. The NCO method that incorporates replacement cost adders attempts to correct this
19 omission, and would be a better alternative than the NCO method in isolation. However, it is still
20 lacking in the ties to true marginal economic cost available in the Rental method. Further, because
21 the annualized cost is applied to all customers in the Rental method, there is no doubt as to the
22 inclusiveness of replacement costs when allocating costs.

¹⁰ Capital Related costs include return on capital, depreciation, and taxes.

1 **IV. WORKPAPERS FOR NCO METHOD**

2 Workpapers supporting the NCO method have previously been provided by SoCalGas and
3 SDG&E, and remain available at the SoCalGas and SDG&E websites at:

4 <http://socalgas.com/regulatory/A1111002.shtml> and <http://sdge.com/node/2192> (see the second
5 data request response for SCGC, SCGC-02). As requested in the Scoping Memo,¹¹ the NCO
6 method used does not include replacement adders, which is consistent with D.00-04-060.

7 SoCalGas and SDG&E did not make any changes to their proposed Transition
8 Adjustments as part of this supplemental testimony in order to provide a better comparison
9 between the two cost allocation methodologies. However, the NCO allocation method may
10 change the 7% and 10% benchmarks that were used. Therefore, if the NCO method was adopted
11 it may require a change to the proposed transition adjustment to account for any change in the
12 benchmark.

13 This concludes my supplemental direct testimony.

¹¹ Page 10, Issue #6.