Company: Southern California Gas Company (U 904 G)
Proceeding: 2016 General Rate Case
Application: A.14-11-004
Exhibit: SCG-35-R

REVISED

SOCALGAS

DIRECT TESTIMONY OF RONALD M. VAN DER LEEDEN

POST-TEST YEAR RATEMAKING

March 2015

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Doc #295517

TABLE OF CONTENTS

LIST OF APPENDICES

CROSS-REFERENCES

SUMMARY

Applicable Term

Southern California Gas Company ("SoCalGas") proposes a three-year General Rate Case ("GRC") term of 2016-2018, with its next GRC test year in 2019. SoCalGas' test year (TY)2016 GRC proposal is consistent with the Commission's Rate Case Plan and avoids any conflict with the expected next GRCs of either Pacific Gas & Electric Company ("PG&E") or Southern California Edison ("SCE").

O&M and Capital-Related Margin Escalation

SoCalGas proposes a Post Test Year ("PTY") ratemaking mechanism to adjust its authorized revenue requirement in the post-test years by applying separate attrition adjustments for operating and maintenance ("O&M") expenses (including a separate attrition adjustment for medical expenses) and capital-related costs. Adoption of this mechanism will provide SoCalGas with sufficient revenues during the PTY period to continue providing safe and reliable service to its customers, while providing shareholders a reasonable opportunity to earn the rate of return ("ROR") authorized by this Commission.

SoCalGas proposes: (1) using IHS Global Insight's ("GI") utility cost escalation factors to determine PTY O&M escalation (excluding medical expenses); (2) adopting Towers Watson's actuarial forecasts to determine PTY medical expenses; and (3) calculating PTY capital-related revenue requirements using escalated historical and forecasted 7-year average capital additions. Finally, SoCalGas proposes to continue to absorb customer growth as a productivity factor and to retain the existing Z-Factor revenue requirement adjustment mechanism.

Using the current GI 2017 and 2018 forecasted utility cost escalation factors, SoCalGas' proposal would result in attrition year revenue requirement increases of $125 million (5.3%) in 2017 and $94 million (3.8%) in 2018.

REVISED SOCALGAS DIRECT TESTIMONY

OF RONALD M. VAN DER LEEDEN

POST-TEST YEAR RATEMAKING

I. INTRODUCTION

A. Summary of Proposals

My testimony requests that the California Public Utilities Commission ("Commission") approve SoCalGas' PTY ratemaking mechanism proposal to provide an appropriate level of authorized revenues in 2017 and 2018. The mechanism would provide sufficient revenues to implement the principles and policies described in the prepared direct testimony of SoCalGas witness Mr. Bret Lane (Exhibit SCG-01-R).

SoCalGas proposes a PTY ratemaking mechanism to adjust its authorized revenue requirement in the post-test years by applying separate attrition adjustments for O&M expenses (including a separate attrition adjustment for medical expenses[1]), capital-related costs and exogenous cost changes (see Section III). Adoption of this mechanism will provide SoCalGas with sufficient revenues during the PTY period to continue providing safe and reliable service to its customers, while providing shareholders a reasonable opportunity to earn the ROR authorized by this Commission.

SoCalGas proposes: (1) using IHS GI utility cost escalation factors to determine PTY O&M escalation (excluding medical expenses[2]); (2) adopting Towers Watson's actuarial forecasts to determine PTY medical expenses; and (3) calculating PTY capital-related revenue requirements using escalated historical and forecasted 7-year average capital additions. Finally, SoCalGas proposes to continue to absorb customer growth as a productivity factor and to retain the existing Z-Factor revenue requirement adjustment mechanism.

Using the current GI 2017 and 2018 forecasted utility cost escalation factors, SoCalGas' proposal would result in attrition year revenue requirement increases of $125 million (5.3%) in 2017 and $94 million (3.8%) in 2018.[3]

[1] Escalation is proposed to be applied to net medical expenses (i.e., after reassignments to capital).
[2] Franchise fees and uncollectible expense are also excluded from O&M escalation.
[3] SoCalGas proposes to update the GI O&M and gas plant escalation factors used to calculate the attrition year revenue requirement changes (see Section III.B.2).

B. Organization of Testimony

My prepared direct testimony will address the following topics: the appropriate term for the TY2016 GRC; why the proposed post-test year revenue requirement adjustment mechanism is reasonable; why the existing Z-Factor revenue requirement adjustment mechanism should be retained; and proposed regulatory filings.

II. TERM

SoCalGas proposes a three-year GRC term of 2016-2018, with its next GRC test year in 2019. Currently, PG&E and SCE are proposing that their next GRC test years will be 2017 and 2018, respectively.[4] The TY2012 GRCs for SoCalGas, San Diego Gas & Electric ("SDG&E") and SCE were overlapping and resulted in significant procedural delays. While the Rate Case Plan calls for a final GRC decision in advance of the test year,[5] the SCE TY2012 GRC final decision was not received until November 2012 and the SoCalGas/SDG&E TY2012 GRC final decision was not received until May 2013.[6]

SoCalGas' 2016 GRC proposal for a three-year (2016-2018) term, followed by a subsequent TY2019 GRC, is reasonable because it is consistent with the Commission's Rate Case Plan and avoids any conflict with the expected next GRCs of either PG&E (TY2017) or SCE (TY2018).

III. POST-TEST YEAR RATEMAKING MECHANISM

A. Background

SoCalGas is proposing a 3-year GRC framework with attrition adjustments in the second and third years (2017 and 2018). Since SoCalGas proposes to continue balancing account treatment for variations in sales revenue, this means that no additional sales revenues will be available to offset cost increases in the PTY period. The proposed attrition increases in 2017 and 2018 account for expected increases in costs due to inflation and increased capital spending (capital additions). Without an explicit attrition adjustment, SoCalGas would not have a reasonable opportunity to earn its authorized ROR in 2017 and 2018.

There are three elements to the SoCalGas' proposed 2017 and 2018 attrition adjustment: (1) O&M margin and medical expense escalation (excluding franchise fees and uncollectible expense); (2) growth in capital-related margin; and (3) Z-factor revenue requirement adjustment

[4] A.12-11-009 (PG&E); A.13-11-003 (SCE).
[5] D.89-01-040.
[6] SCE Final Decision: D12-11-051; SoCalGas/SDG&E Final Decision: D.13-05-010.

(if applicable). As part of this framework, SoCalGas proposes to forego increases related to customer growth as a productivity factor by having no specific adjustment for customer growth or productivity in the PTY mechanism. Appendix 1 provides calculations of the 2017 and 2018 SoCalGas revenue requirements using the current forecasted 2017 and 2018 O&M and capital GI cost escalation factors.[3]

B. Proposed 2017 and 2018 O&M Margin Escalation

1. Escalatable O&M Margin

Total O&M and capital-related costs necessary to support SoCalGas' rate base is called a revenue requirement. The revenue requirement is collected in two components: miscellaneous revenues and base margin. The escalation mechanism of the base margin component is the topic of this section. SoCalGas will not seek escalation of any miscellaneous revenues.

The O&M portion of base margin includes the direct and indirect O&M expenses. The base to which our proposed O&M escalation factor will be applied is called "escalatable margin." SoCalGas proposes to escalate total O&M margin excluding medical expenses, franchise fees and uncollectible expense. SoCalGas also proposes to separately escalate medical expenses (see Section III.B.3) and provide attrition adjustments for growth in capital-related margin (see Section III.C). Escalation on miscellaneous revenues will not be requested, because miscellaneous revenues are proposed to be fixed amounts for the post-test year period and franchise fees and uncollectible expense items are not subject to escalation (as they are proposed to be applied as fixed rates for the post-test year period).

2. O&M Margin Escalation Factors

In its TY2012 GRC, SoCalGas opposed the use of CPI-Urban ("CPI-U") as a utility cost escalator on a standalone basis since it is based on a representative basket of goods and services purchased by a typical U.S. household, and accordingly has very little relationship to the SoCalGas cost structure.[7] The Commission recognized this lack of relationship in the TY2012 GRC final decision (D.13-05-010):

> Instead, we adopt a variation of DRA's proposal to use the CPI-Urban approach to determine the PTY revenue requirements of SDG&E and SoCalGas. DRA recommends an increase of 1.9% for 2013, 2.0% for 2014, and 2.0% for 2015. The Applicants have pointed out in their comments on the proposed decision that an attrition adjustment based on

[7] Revised Prepared Direct Testimony of Herbert S. Emmrich: A.10-12-006, Exhibit 400; Prepared Rebuttal Testimony of Herbert Emmrich: A.10-12-006, Exhibit 402.

> the CPI-Urban will not reflect the labor rate increases and medical cost increases the Applicants will face in the attrition years, and is inconsistent with what the Commission has adopted in other GRC decisions. Taking those factors into accounts, as well as the other considerations mentioned above, it is reasonable to add 75 basis points (0.75%) to DRA's recommended percentages, as the attrition adjustments that should be adopted for the PTY period.[8]

The Commission reiterated this finding more recently when discussing attrition-year methodology in the PG&E TY2014 GRC final decision (D.14-08-032):

> We adopt a two-part mechanism to capture distinctions driving attrition increases (a) for expenses versus (b) for capital expenditures. We decline to adopt DRA's primary proposal to set post-test-year revenue increases simply based on a single index, with no distinction between expenses versus capital additions. While applying a single index, as proposed by DRA, offers simplicity, we conclude that such an approach fails to adequately capture the distinctions between expense and capital expenditure attrition. We also decline to apply the CPI as an escalation factor. The CPI reflects consumer retail price changes, not the escalation in wholesale purchases of utility goods and services. Accordingly, we generally adopt industry-specific escalation factors, rather than use of the CPI.[9]

SoCalGas continues to disagree with the use of CPI-U as a utility cost escalator on a standalone basis for its TY2016 GRC, for the same reasons as discussed above and as recognized by the Commission in D.13-05-010 and D.14-08-032. However, rather than making a basis point adjustment to CPI-U in an attempt to better align it with the actual drivers of SoCalGas' costs, SoCalGas believes that a better approach for O&M escalation is to rely on utility price indices, which are already representative of the changes in costs faced by the utility sector, as discussed by Mr. Scott Wilder (Exhibit SCG-31). SoCalGas proposes that PTY O&M escalation be based on the GI Utility Cost Information System Power Planner Forecast.

Mr. Wilder's testimony describes how he uses the GI Power Planner Forecast to develop separate weighted average labor and nonlabor O&M escalation factors, and then creates a single weighted average labor and nonlabor O&M escalation factor based on 2013 recorded expenses. For PTY attrition calculation purposes (see Appendix 1), SoCalGas has used the GI 4th Quarter 2013 forecast (released in February 2014), which resulted in single weighted average O&M escalation factors of 2.52% for 2017 and 2.42% for 2018.

---

[8] D.13-05-010, p. 1010.
[9] D.14-08-032, p. 653.

To account for prospective changes in escalation rates, SoCalGas proposes that the GI forecast available in September 2016 be used to determine the TY2016 O&M escalation index. The dollar escalation increase for attrition year 2017 would be effective January 1, 2017, and the GI forecast available in September 2017 would be used to determine the 2017 O&M escalation index. The dollar escalation increase for attrition year 2018 would be effective January 1, 2018. SoCalGas proposes to omit explicit productivity and customer growth factors from O&M attrition, because they would offset each other. This proposal would require that SoCalGas achieve a level of productivity sufficient to offset the costs associated with customer growth in each of the two post-test years. Ms. Rose-Marie Payan's customer growth forecast is 0.82% for 2017 and 0.85% for 2018 (Exhibit SCG-30, workpapers). These implicit productivity factors are four times higher than the productivity factor most recently adopted for Southwest Gas of 0.2%.[10]

3. Medical Cost Escalation

SoCalGas' medical expenses have historically risen faster than most other operating expenses. SoCalGas expects to continue to experience higher medical expense increases in the post-test years, and for this reason is proposing a separate medical expense escalation factor based on Towers Watson's actuarial forecasts.

As described in the testimony of Ms. Debbie Robinson (Exhibit SCG-21), medical expense escalation is forecast to be 7.8% in each of 2017 and 2018. SoCalGas notes that this forecasted rate is similar to the post-test year medical expense escalation rate (7.5%) the Commission adopted in the SCE TY2012 GRC final decision.[11]

C. Post-Test Year Capital Additions

The use of CPI-U as a standalone escalator of capital-related margin is particularly problematic, since it will not reflect the revenue requirement increase from plant additions in excess of depreciation (rate base growth) and cost escalation that SoCalGas will face in the attrition years. Growth in capital-related costs (depreciation, taxes and authorized return) are primarily determined by the relationship between capital additions and depreciation. Capital additions in excess of depreciation will drive rate base growth and therefore the growth in

---

[10] D.14-06-028.
[11] D.12-11-051, p. 608.

capital-related costs. Such growth is unrelated to the growth in costs of a representative basket of goods as measured by CPI-U.

In SoCalGas' TY2012 GRC decision, a CPI-U plus 75-basis-point escalator was applied by the Commission to total base margin, meaning that both O&M and capital-related margin were escalated at the same rate. While this method provided additional revenues to cover inflationary pressure related to the test year level of capital-related margin, it did not address the growth in capital-related costs in the post-test years (2013-2015). Because SoCalGas expects to continue to make significant annual capital investments during the TY2016 GRC term, SoCalGas proposes that the TY2016 GRC PTY capital-related margin adjustment mechanism should also reflect the anticipated growth in capital additions in excess of depreciation in the PTY period.

SoCalGas proposes to use the escalated seven-year average level of capital additions (2010-2013 recorded and 2014-2016 forecast) as a proxy for the annual PTY 2017 and 2018 actual level of capital additions. Using this seven-year period is reasonable because it represents the most recent historical and forecast data available, and intervenors and the Commission will have closely examined both the historical and forecast capital data in the course of this proceeding. SoCalGas is not proposing to adjust the rate base elements of materials and supplies, customer advances or working cash.

Following is a brief summary of the calculation methodology. My workpapers contain a detailed narrative description of each step in the calculation process. SoCalGas developed its PTY calculation of the capital-related revenue requirements using a consistent methodology (rate base, depreciation and taxes[12]) and consistent escalation factors, used throughout this GRC request. The 2010-2016 recorded and forecast capital additions by major plant category are escalated to the appropriate PTY dollars and then averaged. Capital escalation is based on GI gas plant indices as described in the testimony of Mr. Scott Wilder (Exhibit SCG-31). For example, the recorded 2010-2013 and forecast 2014-2016 additions would be escalated into 2016 dollars and then averaged. To determine the capital additions for 2017 and 2018, the seven-year average capital addition amount is escalated to the appropriate PTY dollars using the above-mentioned GI indices. A weighting factor is applied to the plant additions to determine the

[12] The estimates contained in this section were calculated using current federal and state tax laws enacted through the filing date of this testimony.

weighted average plant additions to be included in rate base for the PTY period. Incremental net depreciation, amortization and deferred taxes are also calculated using the TY ratios, in order to determine the weighted average rate base for each PTY.

The methodology proposed by SoCalGas is – other than the relevant time period[13] – the same methodology adopted by the Commission in the PG&E TY2014 GRC final decision (D.14-08-032):

> We adopt an ARA base year amount for capital additions using a seven-year average as proposed by TURN. We apply an average covering the 2008-2014 period, however, rather than a 2005-2011 period. We also apply escalation factors based on the industry-specific indices proposed by PG&E, however, rather than the based on CPI as proposed by TURN.[14]

The Commission described the rationale for the use of a more recent period for a seven-year average and the use of utility-specific escalation indices as follows:

> Use of a more recent seven-year period offers a more robust, forecast relative to TURN's proposal based on the 2005-2011 period. Also, we decline to adopt TURN's use of the CPI to escalate the seven year average from 2012 to 2015-2016 dollar values. Although the CPI may reasonably measure price inflation faced by consumers, it does not measure price escalation for goods and services procured by an energy utility.[15]

Based on the calculations described above, the SoCalGas proposed 2017 and 2018 incremental capital-related revenue requirements are as follows:

2017 Incremental Capital-Related Revenue Requirement: $89 million

2018 Incremental Capital-Related Revenue Requirement: $59 million

D. Z-Factor Mechanism

SoCalGas proposes to continue the existing Z-factor mechanism, unchanged for this

[13] SoCalGas' historical time period of 2010-2013 is analogous to PG&E's historical time period of 2008-2011 and SoCalGas' forecast time period of 2014-2016 is analogous to PG&E's forecast time period of 2012-2014.
[14] D.14-08-032, p. 656.
[15] D.14-08-032, pp. 659-660.

2016-2018 GRC term.[16] The mechanism uses a series of eight criteria[17] outlined in D.94-06-011 to identify exogenous cost changes that qualify for rate adjustments prior to the next GRC test year. If all eight criteria are met, the Z-factor mechanism allows for rate adjustments for only the portion of the Z-factor costs not already contained in SoCalGas' annual revenue requirement and only for costs that exceed a $5 million deductible per event.

In the case of a potential Z-factor event, SoCalGas will notify the Commission's Executive Director of the event by letter, providing all relevant and available information about the event, and will activate the Z-factor Memorandum Account for potential entries. Following this notification, SoCalGas would have the option to file an application for a revenue requirement supplement if the Z-factor event exceeds the $5 million per event deductible.

IV. REGULATORY FILINGS

Currently SoCalGas updates PTY revenue requirements through an annual advice letter filing. SoCalGas proposes to continue this process and will file an annual advice letter on or before November 1 (beginning November 2016) to update the authorized revenue requirement, according to the adopted PTY ratemaking mechanism. The resulting customer rate adjustments to recover the updated revenue requirement would be effective the following January 1. The advice letter will contain all calculations necessary to update the revenue requirement for the subsequent year.

V. CONCLUSION

This concludes my revised prepared direct testimony.

---

[16] *See* SoCalGas' current Preliminary Statement (Part VI) for a description of the operation of the Z-factor mechanism, *available at* www.socalgas.com.

[17] In D.97-05-054, the SoCalGas PBR decision, the Commission established a Z-factor mechanism for SoCalGas based on the same nine criteria established for D.94-06-011. In D.05-03-023 (SDG&E/SoCalGas 2004 COS Phase II decision), mimeo., at 78 (Ordering Paragraph No. 2 authorizing SDG&E and SoCalGas to file for rate adjustments using the mechanism described in the Settlement Agreement) and P. 12 of Appendix C (Settlement Agreement). The eliminated criteria provided that the costs and events are not part of the rate update mechanism.

VI. WITNESS QUALIFICATIONS

My name is Ronald M. van der Leeden. My business address is 555 West Fifth Street, Los Angeles, California 90013. I am employed by SoCalGas as Director – Financial & Operational Planning in the Accounting & Finance Department. I have been in this position since September 2012. In addition, over the last 20 years I have held positions of increasing responsibility in the SoCalGas Regulatory Affairs Department including Rate Analyst, Regulatory Case Administrator, Regulatory Case Manager, Manager – Cost of Service and Director – Rates & Revenues and Director – Revenue Requirements. Outside of SoCalGas, I held the position of Managing Director at Micronomics from 1998-2000 specializing in energy economics.

My academic qualifications are as follows: I earned an undergraduate degree in Economics from University of California Santa Barbara in 1983 and a Master of Arts Degree in Economics from University of California Santa Barbara in 1994.

I have previously testified before this Commission.

APPENDIX A – POST TEST YEAR ESCALATION EXAMPLES

<u>Description</u>:

Calculations of the SoCalGas 2017 and 2018 revenue requirements assuming no Z-Factor adjustment using the GI 4th Quarter 2013 forecast of 2017 and 2018 O&M and capital escalation factors.

SCG/POST-TEST YEAR/Exh No:SCG-35-R-WP/Witness: RvanderLeeden
Southern California Gas Company
Calculation of 2017 and 2018 Post Test Year Revenue Requirements
Exemplary Calculation of 2017 and 2018 Revenue Requirements
(Using GI 4th Quarter 2013 Forecast)

Line	Descriptaion	(in Millions) Rev Req	Escalation
1	**2016 Total Revenue Requirement**	**$ 2,342**	
2	Less: 2016 Misc. Revenues	$ 101	
3	Less: 2016 Capital Related Margin	$ 961	
4	Less: 2016 Medical Expense	$ 72	
5	Less: 2016 Franchise & Uncollectible	$ 39	
6	2016 Escalatable O&M	$ 1,169	
7	2017 O&M Escalation Rate	*2.52%*	
8	2017 O&M Escalation $ (L6 * L7)	$ 29	$ 29
9	2017 Medical Escalation Rate	*7.80%*	
10	2017 Medical Escalation $ (L4 * L10)	$ 6	$ 6
11	2017 Capital Related Costs (as Proposed)	$ 89	$ 89
12	2017 O&M (L6 + L8)	$ 1,199	
13	2017 Medical Expense (L4 + L10)	$ 77	
14	2017 Capital Related Costs (as Proposed) (L3 + L11)	$ 1,051	
15	2017 Misc. Revenue	$ 101	
16	2017 F&U	$ 40	$ 1
17	**2017 Revenue Requirement (Sum of Lines 12 through 16)**	**$ 2,467**	**$ 125**
18	Less: 2017 Misc. Revenues	$ 101	
19	Less: 2017 Capital Related Costs (as Proposed)	$ 1,051	
20	Less: 2017 Medical Expense	$ 77	
21	Less: 2017 Franchise & Uncollectible	$ 40	
22	2017 Escalable O&M	$ 1,199	
23	2018 Based Margin Escalation Rate	*2.42%*	
24	2018 O&M Escalation $ (L22 * L23)	$ 29	$ 29
25	2018 Medical Escalation Rate	*7.80%*	
26	2018 Medical Escalation $ (L20 * L26)	$ 6	$ 6
27	2018 Capital Related Costs (as Proposed)	$ 58	$ 58
28	2018 O&M (L22 + L24)	$ 1,228	
29	2018 Medical Expense (L20 + L26)	$ 83	
30	2018 Capital Related Costs (as Proposed) (L19 + L27)	$ 1,109	
31	2018 Misc. Revenue	$ 101	
32	2018 F&U	40	$ 1
33	**2018 Revenue Requirement (Sum of lines 28 through 32)**	**$ 2,561**	**$ 94**

APPENDIX B – GLOSSARY OF TERMS

CPI-U: Consumer Price Index-Urban

DRA: Division of Ratepayer Advocates

GI: Global Insight

GRC: general rate case

O&M: operations and maintenance

PG&E: Pacific Gas and Electric Company

PTY: post-test year

PTYR: post-test year ratemaking

ROR: rate of return

SAP: SoCalGas internal financial system

SCE: Southern California Edison Company

SDG&E: San Diego Gas & Electric Company

SoCalGas: Southern California Gas Company

TY: test year

SoCal Gas 2016 GRC Testimony Revision Log – March 2015

Exhibit	Witness	Page	Line	Revision Detail
SCG-35	Ronald M. Van Der Leeden	Cover	N/A	Changed “SCG-35” to “SCG-35-R”
SCG-35	Ronald M. Van Der Leeden	Cover	N/A	Added “Revised”
SCG-35	Ronald M. Van Der Leeden	Cover	N/A	Changed “November 2014” to “March 2015”
SCG-35	Ronald M. Van Der Leeden	RMV-i	N/A	Changed “SCG-01” to “SCG-01-R”
SCG-35	Ronald M. Van Der Leeden	RMV-ii	N/A	Changed “126” to “125”
SCG-35	Ronald M. Van Der Leeden	RMV-1	1	Added “Revised”
SCG-35	Ronald M. Van Der Leeden	RMV-1	10	Changed “SCG-01” to “SCG-01-R”
SCG-35	Ronald M. Van Der Leeden	RMV-1	25	Changed “126” to “125”
SCG-35	Ronald M. Van Der Leeden	RMV-7	5	Changed “methodogy” to “methodology”
SCG-35	Ronald M. Van Der Leeden	RMV-7	22	Changed “90” to “89”
SCG-35	Ronald M. Van Der Leeden	RMV-A-2	N/A	Replaced Exemplary Calculation table

Doc #295517