SOUTHERN CALIFORNIA GAS COMPANY

SAN DIEGO GAS & ELECTRIC COMPANY

PACIFIC GAS AND ELECTRIC COMPANY

REBUTTAL TESTIMONY

JULY 3, 2008

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A. Introduction

In this testimony, Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), and Pacific Gas and Electric Company (PG&E) (jointly, the Utilities) respond to testimony submitted by intervening parties. Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN), and Disability Rights Advocates (DiRA) served testimony opposing the Utilities' proposal. California Manufacturers and Technology Association (CMTA), Indicated Producers (IP), California League of Food Processors (CLFP), and Agricultural Energy Consumers Association (AECA) served testimony supporting the proposal. Consumer Federation of California (CFC) did not serve testimony but instead submitted a "notice of evidence" that several of the Utilities' data request responses will be entered into the record. Our rebuttal testimony addresses the major factual contentions and arguments raised by the parties opposing this Joint Application, and the material errors contained in their respective testimonies. The Utilities therefore have not contested each and every point raised or error found in the parties' collective testimonies. However, this should not be interpreted as constituting a waiver or concession on any point. Notwithstanding, the Utilities provide a table in Attachment A listing several material errors, inconsistencies, and contradictions that appear in the testimony of DRA witness, Pearlie Sabino.

B. Discussion

The main arguments made by those opposing the Joint Application are as follows:

- The Utilities' proposal of EPBR results in large businesses not paying their fair share of social programs costs;
- The costs to business customers under the current allocation methods are not disproportionately large and onerous;

- The cost impact to residential customers under the Utilities' proposal would create unbearable hardship;
- The Utilities' proposal threatens the funding level and outright continued existence of CARE and other low-income assistance programs;
- The business climate in California is not as bad as the Utilities claim, and the costs of social programs are not driving businesses out of California; and
- The Utilities' tax incidence argument is flawed.

Each of these arguments is addressed below.

In addition, TURN witness, Michel Florio, makes two alternative proposals in his testimony: (1) that the cost of all of the programs should be allocated using equal-cents-per-therm (ECPT), and (2) in the alternative, Self-Generation Incentive Program (SGIP) costs should be allocated using a version of Direct Benefits, in which none of the costs would be allocated to residential customers. The Utilities oppose both proposals as counterproductive, contradictory, and completely unsupported. Finally, the Utilities disagree with TURN and DRA that California Institute for Climate Solutions (CICS) and Solar Water Heating (SWH) cannot be allocated under the Utilities' proposed equal-percent-of-base-revenue (EPBR) method, and recommend that the Commission should in fact allocate these programs under EPBR.

1. Contentions That Large Businesses Would Not Pay Their Fair Share of Social Programs Costs Under the Utilities' Proposal Are Flawed and Misrepresent the Intent of the Proposal [witnesses: G. Wright and R. Blatter]

Opposing intervenors have attempted to characterize the Utilities' proposal as one of giving larger businesses a break at the expense of residential customers, especially in a time of difficult economic conditions.[1] California businesses, and their employees, also face difficult economic conditions and a weakened economy. As described further below, the proposal is not an effort by the Utilities to simply have "large business

[1] See TURN Prepared Direct Testimony of Michel Peter Florio, p. 6 (June 13, 2008); DRA Prepared Direct Testimony of Pearlie Sabino, p. 5 (June 13, 2006).

customers to pay less and their residential customers to pay more."[2] Rather, the Utilities propose a more equitable solution to a growing problem: social program costs becoming disproportionately large relative to the cost of basic gas service for non-residential gas consumers. Where the Utilities have presented evidence showing the rising costs of social programs costs, how those costs under the current allocation methods are becoming a disproportionately large item relative to basic gas service to a diverse population of commercial, industrial, and agricultural customers, and real-world examples of how some customers are responding to this situation (e.g., Vernon and interstate pipeline customers,[3]) the opposing intervenors have chosen to frame this as the Utilities favoring "big oil" over the poor.[4]

DRA also provides a blanket burden of proof argument[5] that is undermined by its inability (or unwillingness) to properly construe the arguments raised by the Utilities.[6] Further, in order to find that the current allocation is reasonable and fair, the intervenors attempt to confuse the issue by adding in costs that have never been considered and are not relevant, namely gas commodity.[7] Moreover, DRA in particular cites to Commission precedent to support its position, but fail to acknowledge Commission precedent supporting the Utilities' position. On the question of allocation, the Commission has consistently been clear that their decision is based on the facts and circumstances of the time, and does not preclude a different result at a later time. In this instance, it is up to the Commission to

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[2] Florio Direct, p. 3.

[3] See Joint Utilities' Prepared Direct Testimony, Ch. 1, p. 1-11 (December 11, 2007).

[4] See Florio Direct, p. 6.

[5] Both DRA and TURN raised the same type of argument in support of TURN's motion to dismiss, which was denied.

[6] See Sabino Direct, p. 5. For example, DRA's third point suggesting that the Utilities have alleged that "existing methodologies result in such a great cost that businesses have left and will continue to leave the state unless the EPBR method is adopted" blatantly mischaracterizes the Utilities' testimony, which reads, "Although it is difficult to demonstrate that these costs specifically are causing business closures, reductions, and migrations . . . ." Utilities' Prepared Direct Testimony, Ch. 1, p. 1-13.

[7] See Florio Direct, p. 3.

decide the best approach. The principal issue then is what is a business customer's "fair share" of social programs costs?

(a) Why TURN and DRA Claim ECPT Is Fair and EPBR Is Unfair

In this proceeding, the Commission must decide whether the EPBR method is equitable and reasonable, and in particular, more equitable than the current mix of allocation methods in place for social programs costs. The primary reason why TURN and DRA argue that EPBR is inequitable is because it results in a shifting of costs to residential customers.[8] The notion that EPBR is *per se* inequitable simply on the basis that it is different than the current allocation should be disregarded. Any change in allocation will result in higher costs for some classes and lower costs for others. The representatives for the class(es) receiving a higher allocation of costs generally argue against the change, for obvious reasons. It is reasonable in the case of a change in allocation to also look at the immediate rate impact of the change, and to avoid rate shock. While the Utilities believe that the proposed change is reasonable, we have proposed a three-year phase-in to address the issue of the impact of the change itself. None of the intervenors addressed the phase-in proposal, or proposed any alternative.

Second, they argue that since EPBR, which is based on the cost of providing gas transportation service, bears no relationship to social programs, EPBR is not equitable.[9] The same could be said for ECPT, which is based on gas usage. Further, this argument doesn't work for programs such as Energy Efficiency, Low Income Energy Efficiency (LIEE), and public purpose RD&D costs, because these programs can actually help avoid infrastructure investment. Therefore, allocating their costs similarly to infrastructure costs does make sense. One straightforward example is the constrained areas of the SoCalGas and SDG&E systems. The approaching capacity constraint in the San Joaquin Valley is driven by overall growth in peak winter load.

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[8] See Sabino Direct, p. 4 and Florio Direct, p. 3.

[9] See Florio Direct, p. 7-8, Sabino Direct, p. 37, and DRA Prepared Direct Testimony of Dana Appling, p. 6 (June 13, 2008).

Energy efficiency deployed in the San Joaquin Valley could defer or avoid costly capacity additions. The same is true for the SDG&E system.

However, even if it were not true that at least some of the social program costs have a relationship to the cost of providing utility service, there is precedent at the Commission for using an equal-percent-of-marginal-cost (EPMC) method, which is similar to EPBR, for general costs that cannot be attributed to one class of customers and are not related to utility service.[10] RD&D, LIEE and SGIP are all allocated EPMC for at least one utility currently. In addition, electric-related hazardous waste cleanup costs are allocated EPMC for all three major electric utilities (PG&E, Southern California Edison (Edison), and SDG&E). These costs are allocated ECPT for gas-related costs. Regarding Edison's hazardous waste cleanup costs the Commission notes "In most cases the two utilities [SoCalGas and Edison] are incurring joint costs for cleaning up the same sites."[11] In other words, the Commission elected to allocate *the same costs*, to largely the same customers, both ECPT and EPMC.

The intervenors state that ECPT is fair by definition because all non-exempt customers pay the same rate.[12] This is overly simplistic. Paying the same rate is not equitable under every circumstance.[13] This is becoming increasingly so as costs for social programs have risen far beyond what they were when first implemented. Regarding the Commission's past decisions upholding ECPT, contrary to DRA, ECPT was not a product of meticulous design.[14] As described in the

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[10] Note that EPBR is a better choice than EPMC because under the Utilities' proposal, EPBR would be consistent across the three Utilities.

[11] D.96-04-050, pp. 81.

[12] <u>See</u> Sabino Direct, p.40; Appling p. 5.

[13] This circularity is particularly evident in Ms. Sabino's testimony at page 41, where she states "DRA's examination shows that for each of the 3 utilities, the unit costs per therm are on an equal cents per therm basis for programs that are based on ECPT," and on page 40, "DRA's review indicates that the current ECPT method is an equitable policy since the CARE rate component is properly collected on equal cents per therm basis for the different customer classes of the utilities."

[14] <u>See</u> Sabino Direct, p. 5.

Utilities' Prepared Direct Testimony, absent a basis for a different allocation the Commission has frequently (though not exclusively) chosen ECPT. However, the context has always been addressing allocation for a subset of costs allocated to any customer class. It is only recently that these "default" allocated costs have grown to the point of being the majority of costs for some customers and a large and fast growing component for many others.

DRA in particular cites several past decisions by the Commission upholding ECPT (or equal-cents-per-kWh), which it claims demonstrates a long history of the Commission upholding ECPT as a method that the Commission has repeatedly found to be the "most equitable" for CARE. Closer scrutiny of the facts and circumstances underlying these decisions reveals that while the Commission has upheld ECPT, these decisions were made during a period when costs were substantially lower and represented only a small fraction of a customers' total bill for service from the Utilities. In the last 10 years, CARE costs for the three Utilities have increased over 400 percent, from approximately $54 million to almost $250 million.[15] Also, in most instances the language of the decisions is more tentative than DRA implies. A few examples suffice to make this clear. In several cases, the allocation was either not being challenged or the challenge had been dropped (D.89-09-044, D.95-12-053). Several decisions occurred just prior to the electric restructuring proceedings, and the Commission noted that social program cost allocation would be considered in that proceeding. For example, D.96-04-050 states "we may wish to revisit this issue of the DSM, CS&I, and CARE cost allocation in our electric industry restructuring proceeding, where the treatment of public purpose programs will also be addressed more fully during implementation."[16] In SoCalGas' 1996 BCAP decision, the Commission similarly stated:

> Finally, the surcharge mechanism will be more thoroughly examined and modified in the Electric Restructuring proceeding to address

[15] The 2007 figure is from Figure 1-1 of Utilities' Prepared Direct Testimony Chapter 1. The 1997 figure is from Utilities' response to data request DRA PZS3 – 002.

[16] D.96-04-050 p. 83.

> competitive markets before this BCAP cycle closes. Therefore, the 31-month amortization will handle the high costs through this BCAP cycle and other forces will affect the size **and allocation of the surcharge** after that period. (emphasis added)[17]

In this decision the Commission indicated an intention to address cost allocation in a future proceeding at a time when the Commission believed that SoCalGas' new verification pilot program would *reduce* CARE costs.[18] Allocation of CARE costs was not addressed in the electric restructuring proceedings, while CARE costs have increased substantially.

As recently as 2005, when the Commission declined to change the allocation methodology, Commissioner Kennedy, who voted in the affirmative on the overall PG&E BCAP proceeding, voiced her disappointment that the Commission did not support a change in the allocation methodology away from ECPT and said it was a "serious mistake not to address the allocation methodology" in that proceeding, lamenting that this was a "missed opportunity."[19]

The history of Commission decisions on the allocation of CARE does reveal that the Commission has been reluctant to raise the allocation to residential and (where applicable) small commercial and industrial customers. However, the Commission has also recognized the importance that prices for utility service have on business customers, finding in D.06-04-002 that for a large customer, Guardian Glass, "that the difference in the cost of natural gas is a material factor in its decision whether to remain in California."[20]

In approving Economic Development Rates (EDR) for electric utilities, the Commission found that these rates were a "stopgap measure" and that "the need for this EDR serves as a flashing warning light that we must continue to take all steps necessary to address the level of rates in California."[21] Approval of the Utilities' proposal to

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[17] D.97-04-082, PUC Lexis 241 * 72 CPUCd 151, p. 50.

[18] See D.97-04-082, p. 170.

[19] See discussion of D.05-06-029 at the CPUC meeting of June 16, 2005.

[20] See D.06-04-002, Finding of Fact 2.

[21] See D.05-09-018, p. 12.

move to an EPBR allocation is just such a step to address the impacts of natural gas rates.

However, gas CARE costs have now risen to almost $250 million for the three Utilities combined, and will likely rise further with higher commodity prices and increased outreach efforts. If the Commission were to establish the CARE program for the first time today, at its current cost levels, it is hard to imagine it would adopt an allocation method where from the start, the allocation of CARE costs would approach the allocation of all other utility costs. The inherent inequity in the ECPT method with respect to how CARE program costs are allocated will only grow as CARE costs grow. Therefore, what may have been less concerning to the Commission in the past can no longer be resolved using a status quo approach.

In the PG&E 2005 BCAP decision, the Commission stated that PG&E and its supporters had not demonstrated that businesses had left the state or gone out of business as a result of CARE costs. Fundamentally, the Utilities do not believe this is a reasonable or considered standard for cost allocation and are asking the Commission to reconsider whether that is in fact the standard it wants to apply for social program costs allocated to business customers. The logical endpoint of this standard would be to allocate costs just up to the point where they would clearly cause large numbers of businesses to fail or leave the state. Because this point is impossible to know precisely, more than likely the tipping point would be passed.

(b) <u>The Burden to Commercial, Industrial, and Agricultural Customers Is Onerous</u>

This application is the result of growing pressure on the Utilities and the Commission from non-residential business customers regarding Public Purpose Program Surcharge (PPPS) rates in particular, and rates in general. As noted by both DRA and TURN, the Utilities' transportation rates have remained virtually flat for both residential and non-residential customers since the early 1990s. However, social program costs as a bill component have become significant for non-residential customers, and continue to skyrocket.

In terms of absolute costs, proportion to transportation rates, and proportion of total delivered energy costs, social program costs for non-residential customers have risen more and faster than for residential customers, as discussed further below. EPBR would ensure that proportions and rates of increase would be more consistent across classes and more stable over time.

(c) Many Businesses and Industries Would Be Affected by the Proposal

The intervenors have highlighted oil refineries as the beneficiaries of this proposal. SDG&E does not serve any refineries, so this is clearly not true at all for SDG&E. It is also misleading for SoCalGas and PG&E. SoCalGas and PG&E each have just over 20 refinery customers, out of a total non-residential customer population of over 200,000 each, and noncore commercial and industrial (C&I) customer populations of just over 720 for SoCalGas, just over 780 for PG&E.[22] The majority of the customers of all three Utilities who would benefit from this proposal is not comprised of refineries, and the majority of throughput affected is not from refineries. Most are manufacturers in other industries, such as those represented by CMTA, CLFP, and AECA, as well as many others not represented. Respected economist Jack Kyser, Chief Economist for the Los Angeles Economic Development Corporation, has this to say about the importance of manufacturing in California:

There are several reasons to pay attention to manufacturing, including:

- Given the challenge of K-12 education in the region, manufacturing can offer a career path that could lead to middle class economic status. Smaller manufacturers are willing to do on the job training and work with community colleges on it. The average salary in the sector was above the average for all industries in many local areas. Some manufacturing firms also have employee health benefits.

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[22] Excludes cogeneration customers. Sources: SoCalGas and PG&E Workpapers to 2008 California Gas Report.

- Manufacturing tends to have a higher job “multiplier” meaning that more indirect jobs in related industries are supported by every direct position in manufacturing.[23]

Commercial customers such as restaurants and hotels, and public sector customers such as hospitals, universities, and schools will also benefit. For SoCalGas and SDG&E, even the smallest C&I customers would see a decrease in social program costs. Many of the Utilities’ non-residential customers are struggling to stay afloat in California amid a number of cost pressures. These customers are the engines of our economy, provide millions of jobs to Californians, and represent a significant source of tax revenue to the State’s General Fund.

Even for the maligned refineries there is an issue of concern, which is their ability and incentive to avoid paying social program costs. PPPS costs are in theory non-bypassable, but other social program costs can be avoided by taking service from an alternative service provider such as an interstate pipeline. There is a potential opportunity for some refineries to avoid PPPS costs as well, by using proprietary pipelines to transport their natural gas.[24] If more refineries begin to choose this avenue, it would increase the burden of both social program costs and utility transportation costs for all other customers. Although the Utilities are not aware of any refineries currently planning to make this switch, we are aware that refineries and their parent companies own and have access to large networks of existing pipelines originally used for crude oil or liquid petroleum products, which can easily be converted to natural gas use. The Utilities do not know the extent of the risk, but past experience demonstrates that by the time the risk becomes clear the commitments may already have been made.

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[23] Jack Kyser, “Manufacturing in Southern California.” Los Angeles Economic Development Corporation, March 2007.

[24] Public Utilities Code Section 896 states “Consumption does not include … natural gas that is produced in California and transported on a proprietary pipeline.”

2. DRA and TURN Fail to Refute That Business Customers Under the ECPT Allocation Method Are Paying a Disproportionately Large Share of Several Social Programs Costs [witnesses: G. Wright and R. Blatter]

The statement that the burden on business customers is not disproportionate because the rates are so low relative to residential rates or that the rates don't include the cost of commodity, is misleading. The transportation rates are set by the Commission according to the cost to serve that customer class. Cost of commodity is not a factor in the allocation of social program costs for any class, nor should it be, and was never mentioned in the few discussions of allocation prior to PG&E's 2005 BCAP. That decision was the first time the Commission mentioned gas commodity costs when considering the equity of social program cost allocation. One benefit of EPBR is that it creates a relationship between the transportation rates and the social program costs. So if the rates for commercial and industrial customers are too low, as perhaps TURN may believe, and they successfully persuade the Commission to change them, the social program obligation would also adjust under an EPBR allocation.

DRA witness Sabino states that data provided by the Utilities show that the PPP surcharges have historically only been a small portion of industrial customers' total natural gas costs and that gas transportation rates have declined. What DRA's tables[25] do not show (and what we have added below) is the percentage increase in PPP program costs for each customer group.

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[25] See Sabino Direct, p. 60.

TABLE 1
SOCIAL PROGRAM COSTS AS A PERCENTAGE
OF THE INDUSTRIAL CUSTOMER'S TOTAL GAS COST

Line No.	Period	PG&E	SoCalGas	SDG&E
1	1993 – 1995	0.9%	1.5%	2.2%
2	1996 – 1998	1.4%	3.1%	1.7%
3	1999 – 2001	1.1%	1.0%	1.5%
4	2002 – 2004	2.1%	3.3%	4.3%
5	2005 – 2007	4.3%	4.0%	2.3%
6	Increase 1993 – 2007	378%	167%	4%

TABLE 2
SOCIAL PROGRAM COSTS AS A PERCENTAGE
OF THE RESIDENTIAL CUSTOMER'S TOTAL GAS COST

Line No.	Period	PG&E	SoCalGas	SDG&E
1	1993 – 1995	2.79%	2.7%	3.1%
2	1996 – 1998	2.13%	2.7%	3.3%
3	1999 – 2001	1.78%	2.0%	3.4%
4	2002 – 2004	2.68%	3.4%	5.5%
5	2005 – 2007	4.49%	4.0%	4.0%
6	Increase 1993 – 2007	61%	48%	29%

As is clear from these tables, PG&E and SoCalGas industrial customers are now paying a substantially higher proportion of their delivered gas cost for social program costs.[26] Thus, even with the cost of commodity factored into the analysis, it is clear that social program costs are increasing even faster than the rapidly increasing commodity costs.[27] During the same time period, Ms. Sabino shows that gas transportation rates as a percentage of industrial customer total delivered gas cost declined.[28] However, she does not highlight that the declining percentage is due to a large increase in commodity rates, compared to relatively flat transportation

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[26] Ms. Sabino labels the data as PPP surcharges, but appears to also include SGIP after 2004.

[27] Note Ms. Sabino uses WACOG as a proxy for industrial commodity costs. For purposes of comparison the Utilities use the same assumption, and agree that WACOG will generally capture overall long term movement in the market. However, the Utilities note that in a given time period industrial commodity costs may differ significantly from utility WACOG.

[28] See Sabino Direct, p. 60 – 61.

rates. Nor does she describe that the relatively smaller decline in residential rates as a percentage of total delivered gas cost is due to the lower proportion of commodity in delivered gas costs compared to transportation rate, which have also remained relatively flat for the last 10 to 15 years, particularly for SoCalGas and PG&E.

As shown in Figures A, B and C below, industrial customers now pay about the same for gas transportation, a lot more for social programs, and a whole lot more for commodity.

FIGURE A
PG&E GROWTH IN INDUSTRIAL DISTRIBUTION NATURAL GAS TRANSPORTATION, SOCIAL PROGRAM AND GAS COMMODITY RATES
1993-2007

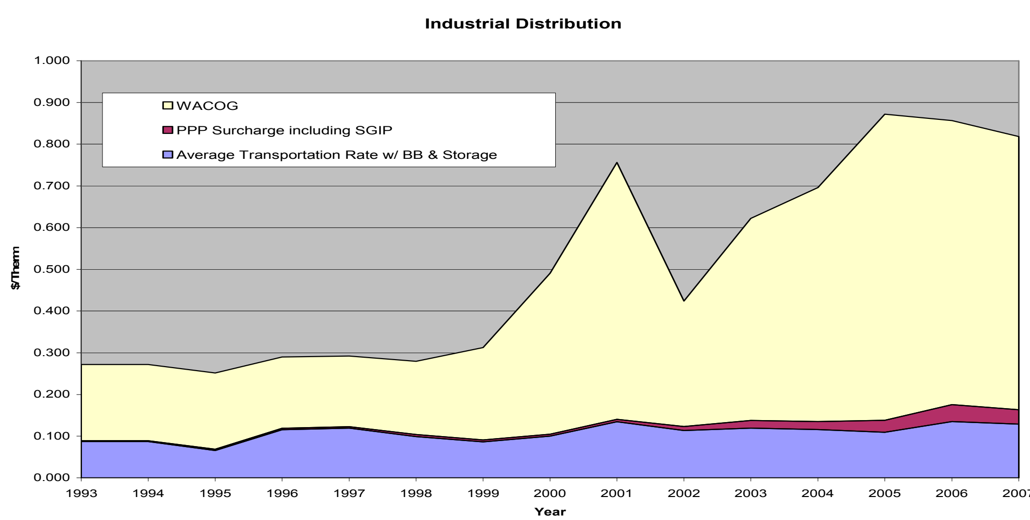


FIGURE B
SOCALGAS GROWTH IN COMMERCIAL AND INDUSTRIAL NATURAL GAS TRANSPORTATION, SOCIAL PROGRAM AND GAS COMMODITY RATES
1993-2007

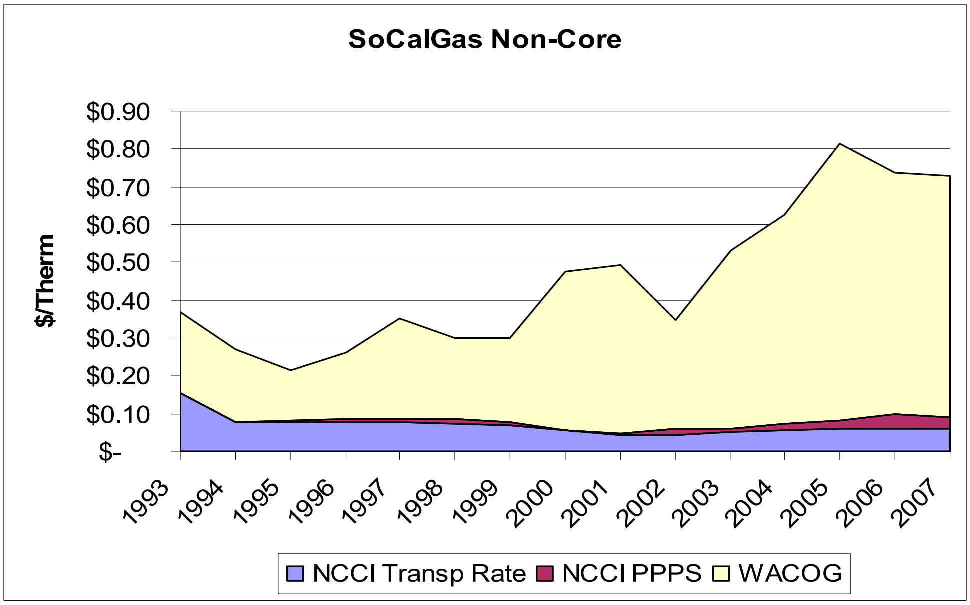
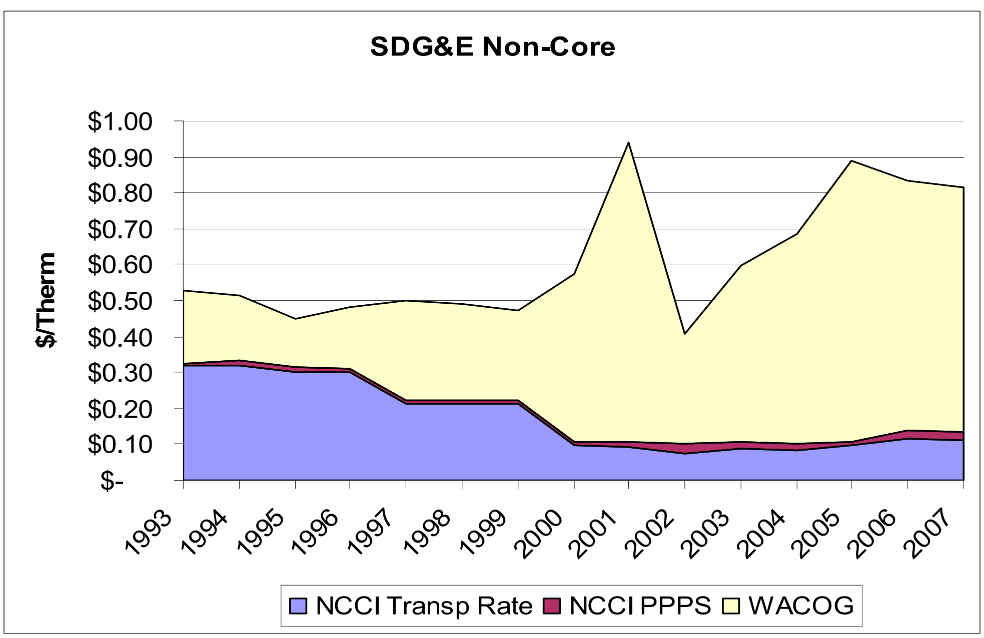


FIGURE C
SDG&E GROWTH IN COMMERCIAL AND INDUSTRIAL NATURAL GAS TRANSPORTATION, SOCIAL PROGRAM AND GAS COMMODITY RATES
1993-2007



It is difficult to discern in these charts the relative increases in each of the components because the contribution of the gas commodity is so large.

Therefore, Tables 3 and 4 below show the widely different percentage increases for each component between 1993 and 2007 for C&I and residential customers.

TABLE 3
PERCENTAGE CHANGE IN DELIVERED GAS COST COMPONENTS
FOR NONCORE INDUSTRIAL CUSTOMERS 1993-2007

Line No.		Transportation Rate	WACOG	PPPS and SGIP
1	PG&E	49%	259%	1,518%
2	SoCalGas	(60%)(a)	200%	1,322%
3	SDG&E	(65%)(a)	276%	108%

(a) Reflects change to LRMC in 1994.

TABLE 4
PERCENTAGE CHANGE IN DELIVERED GAS COST COMPONENTS
FOR RESIDENTIAL CUSTOMERS 1993-2007

Line No.		Transportation Rate	WACOG	PPPS
1	PG&E	19%	259%	145%
2	SoCalGas	6%	200%	186%
3	SDG&E	1%	276%	184%

DRA and TURN probably do not find the Utilities' proposal appealing because anything that has a relationship to utility costs will not have the degree of cross subsidy that appears in CARE subsidy costs in particular. Their reference to rates 15 years ago demonstrates nostalgia for a time when utility transportation rates for business customers also contained very significant cross subsidies for residential customers. Almost exactly 15 years ago, the Commission purposely moved away from these distorted and subsidized rates to a cost based rate structure, to protect the viability of business in California.

3. DRA, TURN, and DiRA Fail to Demonstrate That the Cost Impact to Residential Customers Would Cause Undue Hardship Under the Proposed Three-Year Phase-In Period [witnesses: G. Wright and R. Blatter]

DRA witness Sabino and DiRA witness Dorene Giacopini raise issues representing the interests of fixed income and low-income customers with incomes just above the income threshold that qualifies for CARE and LIEE assistance. The utilities are mindful of the fact of rising costs to all of its customers. There are a great many costs that have skyrocketed—gasoline and food—to mention a couple. The percentage increases of those costs are much more likely to cut into a fixed income or lower-income just barely in excess of 200 percent of the National Poverty Guideline than the modest increase caused by allocating under EPBR. There is little likelihood that the minimal bill impacts resulting from the Utilities' proposal will really result in families choosing between food and gas service, as some intervenors have suggested. Notwithstanding, the Utilities have proposed to phase in the modest increase over three years to help make them more easily absorbed by lower-income residential customers. Further, the Utilities' proposal to have EPBR as a standard allocation methodology across all social programs costs will shift LIEE program costs from residential to business customers. This cost shift will increasingly benefit residential customers as levels of LIEE budgets increase in the future.

Moreover, the Utilities and the Commission remain committed to providing low income assistance and increasing participation through outreach. The concerns raised by these parties appear to apply equally to overall program cost increases, yet the parties to this proceeding have not raised concerns regarding that pressure.

(a) <u>DRA's Calculations Showing the Impact of Funding Level Increases Contain Material Errors</u>

Ms. Sabino provided an analysis of the impact future social program funding level increases will have on residential rates. The analysis was fundamentally flawed. Ms. Sabino used information provided by the Utilities showing the average rate by customer class for $10 million ($1 million for SDG&E) allocated using the Utilities' proposed EPBR method. She represented that these figures were the incremental effect of using EPBR instead of the current allocation methods. However, she failed to account for the rate increases that would occur under the current allocation methods. For example, in PG&E's case, Sabino states that a $10 million dollar incremental increase will have a 0.3 cent impact on residential PPP rates. Given an average residential use of 45 therm per month, the bill impact, according to Ms. Sabino, would be $0.135 ($0.003 x 45 therms = $0.135). This amount is the typical bill effect of $10 million allocated using the EPBR method, and would be an accurate representation in a proceeding in which funding levels are approved by the Commission (provided that EPBR was the adopted allocation method). However, cost allocation, not funding, is the subject of this proceeding. As such, the impacts of cost allocations should be shown.

Ms. Sabino does not show what the incremental increase would have been under the status quo method, such as ECPT. Under ECPT, a $10 million incremental funding level increase would increase PG&E's residential rates by $0.00243 per therm. To show the impact of the Utilities cost allocation proposal, one must subtract one rate impact from the other as follows:

PG&E Residential Rate Impact under EPBR method	$0.00330
PG&E Residential Rate Impact under ECPT method	$0.00243
Difference per $10 million increase	$0.00087
PG&E Residential Bill Impact (45 Therms x $0.00087)	$0.039/Mth
DRA's Erroneous Calculation (as stated above)	$0.135/Mth

Ms. Sabino makes the same error in her characterization of the impact incremental future funding level increases will have on the bills paid by SoCalGas and SDG&E residential customers. She overstates the per therm impact of incremental funding increases by 2 times (in the case of ECPT) because she does not show the difference in the rate impacts using currently adopted cost allocation methods versus the proposed EPBR method. Sabino also errs in her analysis of the residential rate impact of proposed incremental increases to SDG&E CARE funding levels by grossly overstating SDG&E's gas CARE funding request for the 2009 – 2011 period. She also indicates that SDG&E has requested a gas CARE funding increase of $36.9 million over 2007, which actually represents the total increase for gas and electric. SDG&E requested only a $2.3 million increase for gas CARE funding.

Clearly, the cost allocation changes proposed by the Utilities will have very little incremental impact on residential bills due to increased program funding levels. In addition, the Utilities have all requested incremental LIEE funding level increases for the 2009 – 2011 time period. Yet, Ms. Sabino did not address the Utilities' LIEE funding requests or acknowledge that the Utilities' EPBR cost allocation proposal will allocate fewer costs to residential customers resulting in a negative impact on residential bills.

Given these material defects in Ms. Sabino's analyses, her conclusions drawn from them should be given no weight.

4. DRA,TURN, and DiRA Clearly and Improperly Mischaracterize the Utilities' Proposal as One That Would Lead to the Demise of Social Programs Such as CARE [witnesses: G. Wright and R. Blatter]

Perhaps one of the most egregious claims made by DRA, TURN, and DiRA are that the social programs themselves, and primarily the CARE program, are at risk and will face possible extinction if the Commission adopts the EPBR method. DRA witnesses Sabino and Appling, and DiRA witness Giacopini, all argue that changing the allocation of social program costs such that residential customers must pay more will threaten the funding of the programs, in particular the CARE program.[29] This is simply untrue and an irresponsible scare tactic. The Joint Application proposes *no changes* to the program funding or services; in fact it does not address the structure of the programs at all.

DRA's "death spiral" scenario[30] has no basis in fact. Specifically, both Ms. Appling and Ms. Sabino suggest that changing to an EPBR allocation would result in a death spiral of "fewer and fewer customers paying higher

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[29] See Sabino Direct, p. 10 and 36; Appling Direct, p. 3; and DiRA Testimony of Dorene Giacopini p. 5-6 (June 13, 2008).

[30] See Sabino Direct, p. 36 and Appling Direct, p. 3.

and higher portions of the costs."[31] Further, Ms. Giacopini erroneously states that "[t]he Application proposes to grant an exemption for medium and large business customers."[32] Both parties are flat out wrong. There is no basis for the assertion that EPBR would reduce the number of customers contributing to social program costs, or that a higher allocation to residential customers would cause a change in the number of residential customers. Under the Utilities' proposal, all customers currently contributing to social program costs would continue to contribute, and would continue to pay their share of program cost increases. The Utilities have more confidence than DRA and DiRA that stabilizing the rate of growth in non-residential customer contributions and spreading more of the cost increases over the vastly larger residential customer class would actually help to sustain the necessary increases in program costs.

In fact, EPBR allocation would provide a more stable funding base for these very programs by reducing the dependence of the program funding on a few large customers, and decreasing the possibility of uneconomic bypass that would reduce the overall funding base. Economic growth, supported by a favorable business climate is the best protection of the funding base needed to support these programs.

The three Utilities have almost 10 million residential gas customers in their combined service territories, while their combined non-residential customer counts are less than 500,000. Based on the 2008 California Gas Report just released, all three Utilities forecast the residential customer class will grow at rates similar to the past several years, while the commercial customer count is forecasted to be flat to slightly growing (less than 1% annual growth) for all three Utilities. The Industrial customer count is forecast to continue a gradual decline for SoCalGas and PG&E, and to be flat for SDG&E, stabilizing steep declines experienced since 2000/2001.

The Utilities have not argued that social program dollars need to be reduced. The programs themselves and their funding levels are not within the scope of this proceeding. The Utilities have stated that "the dramatic

[31] Appling Direct, p. 3.

[32] Giacopini Direct, p. 4.

and continuing increase in state-mandated social program costs makes a change in allocation important."[33] All three Utilities filed proposed program budgets for CARE, LIEE, and the Direct Assistance Program (DAP) in May, 2008, a fact DRA itself noted with respect to SoCalGas and SDG&E proposed increased funding for CARE and LIEE.[34] Similarly, the Utilities plan to propose overall budget increases for Energy Efficiency as well, to address higher savings goals from the Commission.[35]

The critical yet obvious point that these intervenors ignore is that Commission decides what program budgets will be, and only the Commission can determine that program funding be cut. The Commission's strong views on the critical importance of these programs, and its equally strong commitment to these programs, is unrealistic to conjecture that the Commission would cut any program funding.

5. DRA and TURN Misconstrue the Utilities' Testimony on the Impact of Rising Social Programs Costs on California Businesses, and Themselves Fail to Demonstrate That Such Costs Have No Impact on Decisions Made by California Businesses [witnesses: R. Helgens and G. Wright]

DRA and TURN have mischaracterized the Utilities' testimony regarding the effect of social program costs on the California business climate. The Utilities never claimed that gas PPPS costs, or even gas social program costs in total, are forcing businesses out of California. However, rising social program costs and the way those costs are allocated to business customers, are matters of great concern for the non-residential class and do impact business decisions.

(a) <u>Social Program Costs Are Distinct From Operational Costs</u>

DRA and TURN may be correct that these costs are relatively low compared to some other costs faced by businesses. However, most of

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[33] Joint Applicants' Prepared Direct Testimony, Ch. 1, p. 1-1.

[34] Ms. Sabino incorrectly cites combined electric and gas figures for SDG&E. SDG&E does propose to increase gas only budgets, but not by the amount cited by Ms. Sabino.

[35] The Energy Efficiency filings for all major utilities in the State have been delayed until July 21.

the other costs identified are in some way directly related to the operation of the business: electricity, natural gas, gasoline, wages, other production inputs. The cost of social programs clearly provide general societal benefit but are distinct from operational costs in that social programs costs generally do not directly improve an individual business customer's ability to produce a competitively priced product or service. Businesses are willing to pay their fair share of social programs costs. However, the allocation of those costs should make sense and bear some relationship to the service that creates the obligation, i.e., gas transportation. However, intervenors representing commercial, industrial, and agricultural customers have sponsored testimony that social programs costs are not merely high and rising, but are out of whack. For example, CLFP stated that from 2001 to 2008, fruit and vegetable processors would experience a 571% increase in surcharges, far exceeding inflation or cost increases for any other significant production input during that period.[36] IP stated that program cost increases have resulted in public purpose charges dominating the rate paid by large industrial customers.[37] Cost increases to fruit and vegetable processors can have two outcomes. They can result in increases in the price of processed fruit and vegetables, or a reduction in the competitiveness of California processors and the farmers that supply them.

(b) <u>The Utilities Have Made a Showing That Social Program Costs Have Had Economic Impacts on California Businesses</u>

Other concrete examples of the growing pressure of social program costs specifically were described in the Utilities Prepared Direct Testimony, which were not addressed by any of the intervenors. For instance, the Utilities cited to the Guardian Glass case, in which state-mandated social program costs played a role in a glass manufacturer's decision to stay or leave California, and where the Commission recognized the benefit of keeping a large customer from leaving the

[36] <u>See</u> CLFP Direct Testimony of E.D. Yates, p. 9 (June 13, 2008).

[37] <u>See</u> IP Direct Testimony of Donald W. Schoenbeck, p. 4-5 (June 13, 2008).

State.[38] The Utilities also noted that several customers of SoCalGas have chosen to take service from the City of Vernon, where the only difference in service costs was equal to the PPPS and municipal surcharge (MSUR).[39]

In addition, the Utilities have noted that they have not received any PPPS revenue from the Board of Equalization (BOE) for customers served by interstate pipelines since 2005, although it appears the customers are still operating and receiving gas.[40] SoCalGas and PG&E have received forecasts of interstate volumes from the Energy Division each year. These interstate volumes are added to the customer class volumes that are used to calculate annual PPP surcharge rates. This is problematic in that the higher volumes result in lower PPP surcharge rates, creating an automatic undercollection that has not been offset through the receipt of revenues from the customers of interstate pipeline customers. This does not indicate a consistent pattern of payment or an expectation of a consistent future pattern.

These examples serve as an indicator that businesses are influenced by the rising cost of state-mandated social program costs, and the manner in which they are allocated, in their decisionmaking process.

(c) <u>TURN's testimony on the California business climate errs in concluding that the business climate generally and energy's impact on it specifically are not significant concerns [witness: R. Helgens]</u>

TURN witness James Weil asserts that "Whether or not California has a poor business climate, energy costs are not crucial to most location decisions by California businesses."[41] In support of this contention, TURN offers a study by the Public Policy Institute of California (PPIC), TURN's own conclusions drawn from the Utilities' informal survey of 20 large manufacturing customers, a Bain &

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[38] <u>See</u> Utilities' Direct, Ch. 1, p. 1-10.

[39] <u>See</u> Id. at p. 1-11.

[40] <u>See</u> Id. SDG&E does not have gas customers served by interstate pipelines within its service territory.

[41] <u>See</u> TURN Direct Testimony of Dr. James Weil, p. 6 (June 13, 2008).

Company study, and Mr. Weil's own recollections of a workshop he attended.

As a preface to the rebuttal of these issues, the Utilities would like to make the obvious economic point that businesses make their profits at the margin. Accordingly, even if a particular cost component is a small proportion of total costs, it can still have major implications for a business' location/operation decision. Many industries present in California have profit margins in the range of 1 to 5%.[42] It is easy to see that if 3% is an average margin for these industries, energy costs only comprise 10% of total costs that an increase (decrease) in energy costs of 30% would eliminate (double) profits. CLFP states that for California food processors, "Energy typically accounts for 5 to 10 percent of total production costs, and in some cases such as fruit drying can account for as much as 40 percent of total production costs."[43] AECA represents that energy costs are a significant operating cost for other agricultural industries, such as cotton ginning and wine production.[44] Even though certain costs such as employee costs or state regulatory costs, cited by TURN in the Bain & Company study, might comprise a larger proportion of total costs, this does not imply that energy costs are not crucial.

In the Bain & Company study that TURN cites, TURN has presented one small element of that study's conclusions to argue that energy (i.e., electric) costs are only a small percentage of the higher costs of doing business in California. TURN's testimony has conveniently left out certain key findings as:

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[42] For example, some industries with businesses in California: Semiconductors and Other Electronic Components (0.6%), Food Production (1.0%), Motor Vehicles and Parts (1.1%), Wholesalers Health Care (1.1%), Health Care: Pharmacy and Other Services (2.6%), Engineering, Construction (2.8%), Pipelines (3.1%), Health Care: Medical Facilities (3.3%), General Merchandisers (3.5%), Airlines (3.6%), Energy (3.7%), Home Equipment, Furnishings (5.3%), Metals (5.5%) and Computers Office Equipment (6.0%).

Source:http://money.cnn.com/magazines/fortune/fortune500/2008/performers/industries/profits/assets.html

[43] See Yates Direct, p. 5.

[44] See AECA Original Testimony of Dan Geis, p. 3-4.

- Since 1990, California's job growth has underperformed the national average in many of the higher-value sectors. On the other hand, California's job growth "out performance" has been concentrated in the low-value state and local government sectors.[45]

- Bain's extensive interviews with company decision-makers confirmed the clear-and-present-danger facing the California economy. Of the mobile sector companies (emphasis added) interviewed, 55 percent have plans to move jobs out of California.[46]

- The comprehensive analysis found that a startling 100 percent of senior executives interviewed view the business climate in California less favorably than other states.[47]

- The higher cost of doing business in California hits smaller low-margin companies particularly hard.[48]

- The study found, by a large margin, that California's regulatory environment is the most costly, complex and uncertain in the nation.[49]

Conveniently ignoring these findings, TURN offers a study by PPIC (although TURN indicates in a data response that it has not verified the results of the study) that purports to document that there has been "no substantial business exodus from California, and public policy focus on business relocation would be badly misdirected."[50] It should be noted that the PPIC study nowhere says that employment loss from relocation is unimportant. What is argued is that "...in the context of its overall

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[45] Supporting Documents for Direct Testimony of Dr. James Weil, p. 3, "California Competitiveness Project," Bain & Company (February 2004).

[46] Id.

[47] Id. at p. 4.

[48] Id. at p. 6.

[49] Id.

[50] Weil Direct, p. 2.

economy, California's net loss from relocation is negligible."[51] Specifically, the conclusion of the PPIC study is that "Employment change is primarily driven by business expansion, contraction, births, and deaths."[52] This is simply saying that there are many reasons for employment change in a state and relocation is a small proportion of those changes not that they are unimportant.

Irrespective of the importance of relocation compared to other sources of employment change, TURN has conveniently neglected to point out the statement in the PPIC study that, "Measured by either the number of business establishments or the number of jobs, California experienced a net loss because of business relocation in every year. The fact that there was never a net gain in any of these 10 years **is indeed quite striking**"[53] (emphasis added). Indeed, if there were no underlying trend, and if California had all the business advantages put forward by TURN in its testimony, then why wasn't there at least one year of positive net gain in employment due to business relocation? The study is not saying that employment loss due to relocation is unimportant; it is saying it is not as large a source of employment changes as other sources. Basic economic theory argues that increasing costs harm business and that the increased costs can result in slower expansion, faster contraction, fewer births of business and more deaths (i.e., businesses going out of business) and not solely nor largely in relocation of business. Increased costs can harm business, especially those characterized by lower profit margins as shown above. The Utilities have documented the increasing costs to business resulting from public purpose programs, and these increasing costs do not necessarily have to manifest themselves by causing businesses to flee the state, although a few may. They can certainly manifest themselves through the expansion/contraction or birth/death decisions that businesses make. Indeed the PPIC study argued that, "To the extent

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[51] Weil Supporting Documents, p. 19, "Are Businesses Fleeing the State?" Neumark, Zhang and Wall, California Economic Policy, PPIC (October 2005).

[52] Id.

[53] Id.

that policy has a role to play in improving the business climate, the evidence suggests that efforts to foster the formation of new businesses and to help existing businesses survive and grow would be better placed than efforts to attract businesses from other states or to discourage businesses from leaving the state."[54] This is certainly one of the goals of the Utilities' proposals.

One additional issue that the Utilities would take with the PPIC study is that it examines all industries in the aggregate. Its conclusion that "In any year from 1993 to 2002, the net job loss from business relocation was never higher than one-tenth of 1 percent of the total number of jobs"[55] is for businesses in the aggregate. It is certainly not appropriate to conclude, as TURN does, that "The Commission should disregard utility allegations of growing concerns about business migration and the cost of doing business in California."[56] As stated above, certain industries with lower profit margins and higher proportions of energy costs can be adversely affected even though the aggregate of all industries might show small employment responses. The trend for employment changes due to relocation for these industries could be of the type of significance highlighted in the Bain & Company survey results quoted above.

A more recent brief report on California employment in 2007 by PPIC finds that California's growth was slower than the national average in 2007, its unemployment rate higher, and that in addition to continuing losses in manufacturing there were significant job losses in the "other" high paying sector, finance and insurance. With regard to California's experience, the authors conclude "when California growth diverges from national growth, it is due to California-specific factors rather than to factors affecting heavily-weighted California industries, such as the information sector." (See Attachment B)

[54] Id. at p. 25.

[55] Id. at p. 14.

[56] Weil Direct, p. 4.

> A fundamental problem with social program costs for businesses is the high and quickly growing proportion of the obligation (which has grown faster than either rates or commodity costs, and faster for businesses than residential customers), and the signal it sends to businesses about the state's concern for their operating costs. Many of the categories of costs that are high in California relative to other states or countries are very difficult to address. Social program costs in gas rates represent one category of costs businesses (and other entities) face that can be addressed relatively easily and could to some degree relieve the pressure of the more intractable costs such as wages, gasoline or natural gas commodity. Declining to address this relatively easy cost category would send a signal that the Commission and the state are not interested in the challenges businesses face. A business considering a long term investment such as a plant expansion or major upgrade has to consider what the cost environment is going to be 5 or 10 years in the future. With social program costs already higher than transportation rates for some customers and growing as fast or faster than commodity costs, there is currently no reason a customer should assume there is any limit to the cost burden the Commission will assign them.

6. TURN Fails to Argue Convincingly That the Utilities' Tax Incidence Argument Is Flawed [witness: R. Helgens]

TURN asserts that (1) the Utilities' Tax Incidence argument is not an appropriate basis for providing a reasonableness foundation in support of the Utilities' proposal, and, (2) even if it was appropriate, the Utilities' analysis is flawed. TURN's criticism is based on a misunderstanding of the type of Tax Incidence that is being used to provide the reasonableness basis and, accordingly, results in serious flaws in TURN's own analysis.

Economists typically recognize at least two types of Tax Incidence. The first and simplest is what is sometimes called the "Statutory Incidence of Taxation." Simply explained, it implies a measure of who actually pays the dollars of taxes to the government. It makes no effort to determine how the flow of those dollars could actually affect economic activity and influence the burden of taxation on various groups as economic events unfold. The second type is sometimes called the “Economic Incidence of Taxation,” This is a measure that attempts to determine how the paying of taxes could generate economic outcomes that could shift the burden of taxes to other individuals or businesses. The distinction between these two types of Tax Incidence could be demonstrated by a simplistic example of a tax placed on a business where the business, though paying the tax, is able to pass the increased costs on to the customer. The Statutory Incidence would record the taxes the business pays and assign the tax burden to the business while the Economic Incidence would assign the cost to the customer since this is the outcome of the economic activity.

TURN criticizes the Utilities’ argument about using the Tax Incidence analysis to judge the reasonableness of the cost allocation of public purpose programs on the grounds that the Utilities have not provided sufficient evidence analyzing the complexities associated with the Economic Incidence of Taxation. For example, TURN states that “Tax incidence would examine whether taxes can be shifted on to other groups, or, in the case of state and local taxation, to other localities.”[57] TURN also makes statements such as, “Personal income and corporate taxes are deductible from federal taxes; thus, part of the burden of the state’s tax system is borne by the federal government,”[58] and “Is the sales tax passed through entirely to the consumer, or does the existence of the sales tax lower demand and therefore price, ….”[59]

Based on such observations, TURN concludes that “To model public purpose programs after tax incidence would require substantial analytical work not in evidence.”[60] The Utilities would agree that the analytical work required to document the Economic Incidence of Taxation is not in evidence; however, the Utilities are not proposing that the Economic Incidence of Taxation should be used as a criteria to judge the reasonableness of public purpose program cost allocation. The Utilities’ argument is more straight-

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[57] TURN Prepared Direct Testimony of Lenny Goldberg, p. 2 (June 13, 2008).

[58] Id.

[59] Id.

[60] Id. at p. 3.

forward relying more heavily on the concept of the Statutory Incidence of Taxation. TURN does not seem to understand that the Utilities have testified that these public purpose programs are of the kind that provide public benefits of the type that the state could have provided through expenditures made from its General Fund and, accordingly, if we look to see who actually pays the dollars to the State of California's General Fund, we may be able to derive a standard of fairness to judge the reasonableness of the cost allocations for public purpose programs.

The Utilities have accordingly examined the tax categories of the State's General Fund to provide a rough estimate of who pays the dollars into the State's General Fund since the expenditures that would have been made from the General Fund would have been based on those dollars collected from tax payers based on whatever tax base (e.g., personal income for personal income tax, corporate profits for corporate profits tax, etc.) is used to calculate the taxes and not on any recalculations based on the various economic impacts that would lead to a determination of the Economic Incidence of Taxation.

Why do the Utilities believe that dollars raised in this manner would constitute a fairness standard to judge the cost allocation of public purpose programs? The answer is not only because this is the basis that the State has established for funding these types of programs, but also because the various tax codes that provide the basis for raising these dollars state that the allocation of tax liabilities is fair. A good example is California Revenue and Taxation Code Section 24343.2, which states, "Whereas, the people of the State of California desire to promote and achieve tax equity and fairness among all the state's citizens…."

The Commission and other parties have been engaged in many proceedings attempting to set a standard of fairness for the allocation of these costs. The arguments for equity have been put forward to support principles of Equal Cents, Equal Percent of Revenues and, in at least one proceeding, Equal Dollars per Customer. It would appear that the California Tax and Revenue Code already has provided a standard of fairness.

TURN also criticizes the Utilities' use of a residential/non-residential split for estimating who pays the taxes to the State's General Fund on the grounds that the split with regard to the tax system "…is an arbitrary construct, not found in economic literature."[61] While technically correct, the assertion is misleading. The National Income and Product Accounts, that form the basis for the data collection methods that the state governments employ, do make the distinction between residential households and businesses (with the caveat that since the economic data originates from tax data, the business sector is measured on the basis of the business organizations that file as legal individuals, that is to say, corporations). This distinction does provide a basis for providing a reasonably accurate, although not exact, estimate of the split between residential and non-residential sectors. The Utilities do want to restate that they are proposing that the Tax Incidence analysis can provide a basis for estimating the reasonableness of a cost allocation split but are not proposing that the estimates should be used to do the split.

The second major criticism raised by TURN witness Goldberg is that even if one accepts the argument that the Tax Incidence analysis can be used to measure the reasonableness of the Utilities' proposed cost allocation, the Utilities' analysis of the Tax Incidence contains "serious errors."[62] It would appear that, in quite a few instances, TURN's concerns about alleged errors in the Utilities' analysis stem from its basic misunderstanding of the distinctions between Economic Incidence and the Statutory Incidence that is proposed by the Utilities. Accordingly, the Utilities will respond, in turn, to each of TURN's alleged errors.

TURN argues that the Utilities have excluded property taxes from their analysis which in 2005 accounted for approximately $38.3 billion in tax revenues. Local property taxes are administered by the counties and not by the State. These are not revenues that are included in the State's General Fund and should not be assigned for purposes of doing the allocation of taxes for the State's General Fund. TURN seems to miss the point again as can be best illustrated by CARE. CARE is an income redistribution social program enacted by the State instructing the CPUC to implement. As such,

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[61] Id. at p. 1.

[62] Id. at p. 4.

if the State had taken on the income redistribution of the CARE program, instead of delegating it, the program would have been funded from the General Fund and not from the local property taxes.

TURN states that “The utilities also seem to claim that ‘social’ programs are always a function of tax revenues, spread among all taxpayers. However, there are many examples of such programs that are financed from fees or special funds that do not reflect the general tax distribution.”[63] The Utilities do not dispute that some programs are financed from fees or special funds. That is exactly why the Utilities’ analysis focuses on the State’s General Fund and not on its Special Fund. The Special Fund represents those fees and revenues that are targeted to specific uses where selected groups, obviously, benefit and are taxed using a tax base to target the likely benefits (e.g., taxes on gasoline use to finance transportation programs, developer fees to finance school construction and other infrastructure costs, etc.). These are examples of programs where the benefits can be attributed to certain groups. The public purpose programs whose costs the Utilities are analyzing represent those programs where the Commission or the Legislature has made a finding that everyone benefits and no one group should bear the entire costs. That is one reason why the Utilities’ Tax Incidence analysis focuses on the State’s General Fund.

TURN argues that “…the vast flaw in the utility analysis is the substantial under-allocation of the personal income tax to business taxpayers,”[64] arguing that the Utilities have not included income from partnerships and subchapter S corporations, rents and royalties, estates and trust, farm income (although TURN claims to ignore this amount), capital asset sales, interest, and dividends.

One of TURN’s errors in its assessment is that TURN is still trying to apply the Economic Incidence analysis to what is essentially a Statutory Incidence analysis. TURN asserts (with no documentation) that rents and royalties are the product of business investment, and that estates and trusts are obvious business payments, although TURN does not say why. TURN,

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[63] Id. at p. 3-4.

[64] Id. at p. 5.

by arguing that these are ultimately attributable to business, includes these components in the non-residential sector's allocation. Whatever the ultimate source of generation of incomes, they are paid by individuals as a personal income tax and are not paid by business. They constitute the incomes that members of private households earn and use to make purchases of many different assets including energy using appliances.

TURN argues that the Utilities' analysis should have included income from partnerships or S-corporation income in the non-residential allocation of Personal Income taxes. Conceptually, this was an issue of concern to the Utilities, namely that some businesses because they are not incorporated, are not regarded as separate legal entities for purposes of paying taxes. Thus, the incomes from these entities are regarded as the personal income of their owners and reported as personal income tax. Since they represent income generated by a particular kind of business that is not a separate legal entity, the taxes on that income should be assigned to the non-residential sector. That is why the Utilities' analysis removed sole proprietorship income from the personal income component and assigned it to the non-residential sector.

As for the subchapter S Corporation profits tax, PG&E in its data responses to TURN and CFC, had indicated that it had relied on advice it received in communications with the California Department of Finance to allocate some of the tax revenues to residential and non-residential. PG&E had asked about S Corporation profits tax and was informed that even though owners of S Corporations report their income as personal income, the taxes paid on that income are recorded as S Corporation taxes and included in the Corporate Profits Tax component of the General Fund. Table C-2A and C-2B documents a breakout of the income and tax information for C and S Corporations for year 2005 and highlights that the sum of the two tax components is roughly equal to the Corporate Tax component that the Utilities reported in their Table 2-1.[65] The Utilities, however, would agree that taxes paid by partnerships, to the extent they are not already included in proprietorship taxes or S Corporation taxes, and

[65] http://www.ftb.ca.gov/aboutftb/annrpt/2006/2006AR.pdf

included in Personal Income Taxes should be assigned to the non-residential sector. Using TURN's estimates, the partnership taxes would amount to only approximately $6 billion generating a minor shift in the allocation.

TURN goes on to argue that the "….income tax must be taken a step further."[66] TURN basically argues that the personal income of individuals earning over $1 million annually must necessarily be based on such things as the cashing out of stock options, sales of commercial real estate and sales of other investments, sale of capital assets, etc. which, according to TURN must ultimately derive from business activity and, thus, should be assigned to the non-residential component. TURN again appears to be attempting its exercise of an Economic Incidence analysis and even doing that rather badly. The fact of the matter is that sales of stock resulting from increases in the price of stock is paid by the owner of the stock, not by the business whose stock price increased.

As for the other tax components, TURN (1) accepts the Sales Tax distribution, (2) accepts the Corporation Tax allocation though indicating that part will be borne by out-of-state shareholders and the federal government, (3) accepts the Cigarette Tax allocation, (4) accepts the Insurance Gross Premium allocation and (5) although having some disagreement with the assignment of the Alcoholic Beverage Taxes, recognizes that the change would likely be small. TURN, recognizing that the Horse Racing License Fees is a small number, argues that it is paid by the industry and should not be assigned to the residential sector. The Fees are paid by the owners of the horses, which the Utilities would agree, that in some cases might be businesses and not necessarily always individuals. However, even assigning a portion of this category to the non-residential sector would cause an insignificant change in the overall allocation between residential and non-residential.

Finally, TURN argues that the Pooled Money Investment category should be fully assigned to the non-residential sector. The Pooled Money Investment category is not really a tax category but it is part of the State's

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[66] Goldberg Direct, p. 6.

General Fund. It generates income for the State when tax revenues are paid to the State but the State does not immediately expend those funds. Thus, there is an opportunity to earn income on the unspent funds. The Utilities have argued that the income comes ultimately from the tax revenues in the General Fund and, since it cannot be determined which tax category accounted for the income generated from unspent funds, it is appropriate to allocate these revenues on the basis of the overall allocation of tax revenues in the General Fund. TURN's argument is that the government generated these revenues and the government is non-res so allocate all this revenue to the non-residential component. It may be true that government financiers are investing the unspent funds to generate the revenues but those revenues ultimately flow from the taxes paid by both residential and non-residential customers, thus, it is appropriate to allocate according to the overall allocation of tax revenues or, at the very least, to argue that these are not taxes or fees and should not be included in any residential/non-residential allocation. Since the Utilities allocate by using the overall allocation percentage, eliminating this category would have no effect on the overall percentage allocation.

In any event, TURN states that the purpose of the comments on the allocations, "….is not to recalculate the amounts, but to highlight the arbitrary nature of the exercise."**[67]** The Utilities maintain that TURN's concerns are based on their fundamental misunderstanding about the type of Tax Incidence that the Utilities are proposing to use as a standard for judging the allocation of costs for the Public Purpose Programs. TURN's focus on the Economic Incidence of Taxation has caused them to engage in a series of analytical gyrations trying to reallocate many of these tax revenue categories to the non-residential sector and, in some cases, making unsupported claims to justify their reallocations. In this rebuttal, the Utilities have pointed out the many errors that TURN has committed in this effort. The Utilities would pose one question for thought and that is, if TURN believes that the Economic Incidence of Taxation is a better gauge of the allocation of tax burden, then why hasn't it accepted a very basic economic

[67] Id. at p. 8.

concept that, in the long-run, all business costs are passed on to the consumer, in which case there would be nothing assigned to the business sector.

7. TURN's Counter-Proposals Are Red Herrings and Should Be Rejected

TURN witness Florio proposes two red herring alternatives to the Utilities' proposal which should be rejected. He recommends that the Commission either allocate all social program costs using ECPT, or, if energy efficiency is not allocated ECPT, then SGIP should be allocated only to non-residential customers (in effect a Direct Benefits allocation), which would not surprisingly shift costs to non-residential customers and exacerbate the problem the Utilities are attempting to remedy.[68] Yet, Mr. Florio fails to offer any support for why his counter-proposals are necessary and should be adopted.

TURN has a great fondness for ECPT generally, and has proposed ECPT for energy efficiency programs in the past, without success. In this instance, TURN states that since energy efficiency is recognized as a "supply resource" energy efficiency program costs should be allocated ECPT, like other supply resources. This is the same flawed logic that has created the growing gap between social program costs and gas transportation service costs. An ECPT allocation would have no relationship to the savings goals identified by the Commission, or the costs to achieve those goals.[69] Not surprisingly, energy efficiency savings in the residential sector tend to cost more per therm than do savings in the commercial and industrial sectors. This is a reflection of the same basic factors that affect the cost to provide gas service, reflected in EPBR. In simple terms, it costs more to provide the same total energy savings to a lot of residential customers than to a smaller number of larger C&I customers.

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[68] See Florio Direct, p. 2.

[69] Supply resources for residential and non-residential customers likely have different costs as well. The load characteristics, size, and to some extent different reliability requirements and operating flexibility of some large non-residential customers in particular can result in lower overall commodity prices.

TURN is correct that "California is already in the process of adopting GHG regulations that will ultimately result in carbon emissions being 'priced'" and correctly asserts that "GHG emissions are directly related to the amount of energy consumption." But TURN errs when it concludes that the costs of programs to control greenhouse gas (GHG) "should be recovered based on the amount of energy used (ECPT)." This conclusion totally ignores the actual methods the Air Resources Board (ARB) will use to control GHG as described in its Draft Scoping Plan, issued on June 26, 2008.

In that document, ARB proposes to meet the State's 2020 GHG emissions goals with separate regulations for small natural gas users, and large natural gas users (producing more than 25,000 metric tons of CO_2 annually).[70] ARB has proposed use of the utility energy efficiency programs for compliance of small gas users in emission reduction measure 3 of its Draft Scoping Plan.[71] ARB has proposed a separate energy efficiency program for large industrial sources that would rely on ARB audits and mandated equipment changes paid for by the industrial source in emission reduction measure 17.[72]

The ARB is also proposing that California participate in a western region cap-and-trade program. The proposed cap-and-trade program development is still at an early stage, but the current proposal would regulate large natural gas sources directly and small natural gas customers through the utilities.[73] Under the proposed cap-and-trade framework, large sources will eventually be required to buy allowances associated with their natural gas use, while utilities would have to buy allowances on behalf of small customers.[74] Therefore, the majority of savings achieved by large natural gas users will go to meet their obligations under Assembly Bill (AB) 32. While the energy efficiency programs may incent these customers to exceed the requirements of AB32, it does not make sense to require them to pay for

[70] This level is equivalent to use of 2.5 million therms annually. An alternate level of 10,000 metric tons (1 million therms) is also under consideration.

[71] ARB, Draft Scoping Plan, p. 21-23.

[72] Id. at p. 36.

[73] Id. at p. 15-20.

[74] Id. at p. 18.

the majority of energy efficiency program costs. With ECPT, industrial sources will be paying twice – once directly and once through the social program allocation, with the second payment likely greater than the first for the reasons described above.

Low income energy efficiency plays an important role, but as a supply resource, it is generally not cost effective. However, it may help contribute to avoided infrastructure costs as these programs are targeted specifically at reducing peak consumption, which drives distribution investment in particular. The Utilities recommend that it be allocated EPBR, recognizing the general societal benefit of assisting low income customers to spend less on energy and to reduce their greenhouse gas emissions. Clearly this population should not be left out in the cold, but both the energy and emissions impact are smaller and more costly than other sectors. Moreover, there is no relationship whatsoever between savings achieved with low income energy efficiency and gas usage of all customers. Instead, funding LIEE is essentially a tax to provide assistance to low income customers. If the Commission does not adopt EPBR for LIEE/DAP then the allocation should remain Direct Benefits.

The Utilities reject TURN's second alternative: to allocate all SGIP costs to non-residential customers if energy efficiency is not allocated ECPT. TURN offers no reasonable basis to exclude residential customers from the allocation of SGIP costs. Residential customers are eligible to participate in SGIP, and have participated in the program. As described in the Utilities' Prepared Direct and Supplemental Testimonies, SGIP offers benefits to all customers in the form of reduced pollution, avoided electric costs (reduced peak generation), and bringing down the cost of technology. Residential customers share in these benefits in much the same way that all California benefits from the poverty reduction effects of the CARE program, as described by Mr. Florio.[75]

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[75] Incidentally the Utilities have not questioned the benefits of the CARE program or its value to California. It is not clear what Mr. Florio had in mind when he stated that the Utilities assert that the benefits of the CARE program impact primarily other residential customers. (See Florio Direct, p. 8.)

8. New Programs Can and Should Be Allocated Under EPBR

TURN witness Florio and DRA witness Sabino err in their argument that the CICS and SWH (if adopted) programs cannot be allocated EPBR.[76] Regarding CICS, the Commission decided the CICS proceeding before this proceeding was resolved. Since EPBR is being evaluated in this proceeding, it would have been difficult for the Commission to adopt it in the CICS. Once the Commission has reviewed and considered this application, there is nothing to stop the Commission from adopting EPBR for CICS at that time. CICS is very similar to RD&D in its focus and purpose, so there is clearly a reasonable basis for adopting a similar allocation. While greenhouse gas emissions are based on usage, there is no guarantee that the benefits of the CICS work will accrue to customers in proportion to usage. The Utilities believe it is more reasonable to treat CICS as a public interest investment, and since the Commission has decided contrary to TURN's recommendation to fund it through utility rates rather than tax revenues, then like the other social programs, CICS costs should be allocated in proportion to the service it is attached to, under the EPBR method.

In the case of SWH, the Utilities see more latitude for the Commission to interpret the Legislation with regard to allocation than does TURN.[77] This program's direct benefits would nearly exclusively go to residential customers, so an EPBR allocation also more closely approximates benefits.

C. Conclusion

Given the resistance we face, why would the Utilities even bother to raise this issue at all (which to the Utilities is revenue-neutral), much less in an unprecedented joint application outside the BCAP process? This is a significant effort for the Utilities to take on. The answer is that the Utilities are concerned about the struggles of all their customers, and see that the current imbalance in the allocation of social program costs is putting an unnecessary burden on already struggling business customers. There may be other challenges California businesses face, and addressing the allocation of social program

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[76] See Florio Direct, p.11 and Sabino Direct, p. 12-13.

[77] See Florio Direct, p. 10.

costs will probably not, by itself, rescue businesses from their many challenges. However, a more equitable allocation of these costs would relieve the pressure on struggling businesses to some degree, helping them to absorb the high costs of wages, workers compensation, etc. This proposal is forward movement towards increasing the competitiveness of California businesses, potentially spurring growth in employment, and increasing the State's overall economic vitality.

More importantly, by getting the allocation back in proportion to the transportation bills, the additional growth in the social programs can be better and more fairly absorbed.

The opposing intervenors have made material misrepresentations and have completely disregarded the mounting concerns expressed by class of customers they have no interest in helping. The Commission is in a unique position to address, on a statewide basis, a growing concern of business customers across California, as a stand-alone issue in this proceeding. This is also an opportunity to adopt a standardized allocation method suitable for all public purpose programs, creating uniformity among all current and future public purpose programs funded through gas rates. The Utilities therefore urge the Commission to adopt the EPBR method as reasonable, equitable, and preferable to the current mix of allocators.

This concludes our rebuttal testimony.

SOUTHERN CALIFORNIA GAS COMPANY

SAN DIEGO GAS AND ELECTRIC COMPANY

PACIFIC GAS AND ELECTRIC COMPANY

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Southern California Gas Company
San Diego Gas and Electric Company
Pacific Gas and Electric Company
Rebuttal Testimony

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Errors, Inconsistencies, and Contradictions in Testimony of DRA witness Pearlie Sabino

Page	Line	DRA Testimony	Error/Inconsistency/Contradiction
3	8-11	Approximately nineteen years ago, the Commission adopted and has since consistently upheld the ECPT allocation for the PPP programs because the ECPT method abides by the statutory goal of minimizing the cost burdens on any one class of ratepayers.	Referenced decision only applied to LIRA (now CARE). DRA acknowledges and supports elsewhere in testimony other allocation methods for other PPPS programs.
3	12-14	Of the above-mentioned programs, CARE is the most controversial with respect to the instant application or any cost allocation proceeding *because it provides the most societal benefit,* and yet is the most costly of all the programs. (emphasis added)	Controversy has been over the magnitude of cost and nature of the program, not that it provides the most benefit.
3	24-25	Consistent with prior precedent, the Commission should not deviate from the ECPT allocation for the CARE program *or any other program.* (emphasis added)	ECPT is not the only allocator for social programs at issue in this proceeding. DRA acknowledges and supports elsewhere in testimony other allocation methods for other PPPS programs. And there are other programs outside the scope of this proceeding with different allocators.

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Page	Line	DRA Testimony	Error/Inconsistency/Contradiction
6-7	25, 1-2	For reasons of consistency, the Commission should consider aligning certain EPMC program allocators to the ECPT and Direct Benefits method in future BCAPs as discussed here.	This point is never discussed again. Elsewhere, DRA states all programs should be ECPT (p. 3), but later states that there should be no changes to current program allocations (p. 66).
7	10-19	For current PPP costs where no one class of customers is responsible for those costs and no direct benefits accrue to a particular customer class (except to the CARE eligible) but instead provide benefits to the whole society, the current ECPT allocation method in place is appropriate. ECPT enables equal sharing of cost among customer classes on a per therm basis, i.e., the utilities' core customers bear no greater costs within their rates than those borne by their non core customers.	Some programs are ECPT for one utility, and EPMC for another (e.g., RD&D, SGIP). For the CARE program, non-participating CARE eligible customers do not directly benefit from CARE.
19	7-11	The same decision ordered the use of gas volumes to calculate the gas surcharge when it states that "BCAP estimated throughput gas volumes, or recent test year estimates, are the most accurate gas volume projections for calculating the surcharge." D.04-08-	It is not clear why DRA cites this reference, but it correctly reflects that in setting the PPPS rate, which is volumetric and not a flat fee or reservation charge, the Commission directed which volumes the companies should use (BCAP adopted unless more than 3 years

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Page	Line	DRA Testimony	Error/Inconsistency/Contradiction
		010 provided the formulas for calculating the surcharge rates.	old). This same method would continue to apply if EPBR were adopted, as the Utilities do not propose to change the structure of the PPPS rate from a volumetric to a reservation or flat fee.
19	15-20	The Commission is simply complying with the statutory requirement with respect to customer exemptions to the PPP gas surcharge. The Commission further states that "although costs paid by exempt customers must be re-allocated to other customers, that re-allocation should occur in either a BCAP, or to other appropriate ratemaking proceeding."	It is not clear why DRA raises this point, but the Utilities have not proposed to change any of the exemptions or to address in this proceeding those classes that are allocated costs but are exempted from paying them.
22-	24-25,1-	Contrary to the current position of PG&E, SDG&E, and SoCalGas, they all supported the Commission's efforts in assisting low-income customers, even if it meant raising rates for other ratepayers.	The Utilities do not oppose the programs, or the Commission's efforts to assist low-income customers. In fact, our testimony says "the dramatic and continuing increase in state mandated social program costs makes a change in allocation important."

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24	23-24	The tables indicate that core residential customers have borne the majority of the increasing program costs in the 2001 – 2007 period.	Tables actually show a steady decline in residential customer share of costs from 2001 – 2007. For SoCalGas and SDG&E, the majority of the increase in program costs has been borne by C&I customers. For PG&E residential customers have borne the majority of the cost increase, but their share has declined similarly to the other utilities.
28	10-11	The actual current and proposed allocators are summarized in the charts shown in the Attachments A through C to this Prepared Testimony.	Attachments A through C show the percentage allocation of each program by class under the current and proposed allocation methods.
31	7-9	The programs that are the subject of this application are those currently being funded through the PPP surcharge in gas rates. In addition, cost associated with the CICS and SWH would also be allocated under the proposed EPBR in this application.	DRA incorrectly conveys the information contained in the Utilities' prepared direct and supplemental testimonies, as the programs that are the subject of the application are those currently funded through the PPPS surcharge *as well as* the SGIP, *and* potential new programs such as CICS and SWH.
31	15-16	In this application, the base revenue uses the currently adopted unscaled marginal revenue requirement for each gas transportation service.	This is not correct for PG&E, because part of PG&E's costs is allocated using embedded rather than marginal costs.

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Page	Line	DRA Testimony	Error/Inconsistency/Contradiction
36	2-3	And finally, the bill increases for larger usage residential customers would be much higher.	While the absolute amount of the social program cost allocation would be higher, under the inverted block rate structure rates are higher for res with higher usage. So as a percentage, the impact would be lower.
36	10-13	Either all of the programs' costs would get reallocated to a smaller and smaller volume of captive customers, whose rates would become intolerably high, or the programs would become underfunded and eventually collapse.	No change is being proposed to exemptions, therefore it is not clear where DRA sees a smaller volume of customers. There is no reason to expect the number of residential customers to shrink as a result of PPPS costs, unless DRA is suggesting that PPPS will drive residents out of the state.
36	13-16	In order to prevent this potential death spiral, the Legislature chose to spread the programs' costs over *every* class of customer for *all* natural gas consumed in California, including customers of bypassing interstate pipelines.	Putting aside that the Legislature did not spread the costs over every class of customer (as described by DRA on p. 19), or for all natural gas consumed in California (as noted by DRA at p. 19 – certain consumption is exempted, such as gas consumed by municipal utilities), the death spiral that concerned the Legislature was in the number of *non-residential* customers contributing to programs, and a general concern that these customers could take service from

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Page	Line	DRA Testimony	Error/Inconsistency/Contradiction
			competing providers to avoid these costs. Residential customer class has been growing, and is forecast to continue to grow as population grows. By contrast, the noncore industrial class has shrunk for all 3 Utilities.
37	22-23	There is no link between the PPP surcharge and the utilities' unscaled marginal (or embedded) distribution, transmission, and customer costs. It would be illogical and unfair to change the current cost allocation of the programs based on the customers' contribution to these utilities' unscaled marginal cost (or embedded) revenues.	SoCalGas and SDG&E each have programs that are currently allocated EPMC. PG&E does not currently, but the Commission left open the possibility that EPMC would be appropriate for RD&D in the PPPS decision, directing PG&E to take up the issue in the BCAP or other appropriate cost allocation proceeding.
38	29	CARE eligible customers do not pay for CARE program costs	Actually, only CARE participants avoid CARE program costs. Since, as DRA notes on p. 22, each of the three Utilities has less than 100% penetration of CARE participation in the CARE eligible population, a subset of CARE eligible customers do pay for CARE program costs. It is an unfortunate side effect of the Utilities' limited ability to reach the entire eligible population.

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39	22-24	Where no one class is responsible and all ratepayers benefit, there is no justification to allocate those costs based on cost causation related to other utility functions.	This is true of public interest RD&D costs, which are allocated EPMC for SoCalGas and SDG&E, which in at least one place in the testimony DRA appears to propose should not change (p. 66).
39-	24-26, 1-3	The elements necessary to allocate the costs based on cost causation are absent in the case of CARE and non-CARE PPP program costs. Therefore it would be inappropriate and inequitable for CARE and non-CARE PPP program costs to be allocated based on the EPBR. CARE/PPP programs should not be indexed to base revenues collected from each customer class as the proposed EPBR would do.	Since DRA limits discussion to PPP programs, is the position different for SGIP and the emerging programs not being added to PPP? And is DRA proposing that the allocator should change for RD&D for SoCalGas and SDG&E, although on p. 6 and 66 (to name a few), DRA states that current allocators should not change?
42	9-11	Applicants should not lose sight of the fact that by statute the PPP surcharge is imposed on natural gas consumption, and not on the basis of the natural gas user's share in the utilities' cost-based total base revenue.	Under PUC §890(f), "The commission shall allocate the surcharge for gas used by all customers, including those customers who were not subject to the surcharge prior to January 1, 2001." Consistent with the statute, the Commission has chosen multiple and different allocation methods for each of the programs, and for each of the Utilities. In other words, the statute clearly grants the

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			Commission full discretion to allocate the costs recovered through the surcharge.
44	2-4	This increase would be on top of the previously discussed initial increases associated with the change from ECPT to EPBR at current program funding levels in Section **III** of this chapter.	Increase calculated incorrectly, as the rule of thumb is the allocation breakdown for EPBR, not the difference in allocation between existing methods (EPMC, Direct Benefits of different vintages, and ECPT) and EPBR. Depending on the program costs at issue, the impact may be positive or negative.
46	11-13	PPP surcharges are not taxes and have never been designated as such in any of the statutes that established them or in any Commission decision that implemented them.	The PPPS has not been specifically designated as legally a "tax." However, as a bill with fiscal impact, the PPPS and any changes to it require a 2/3 vote of the Legislature – also the requirement for a tax. While DRA is misinformed on this point, even if it were not the case that the PPPS *is* a tax, the larger point is that it "walks like tax, talks like a tax" and so it is reasonable to view it, and other program costs that are not legally taxes, as a tax.

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Page	Line	DRA Testimony	Error/Inconsistency/Contradiction
47	10-12	DRA has been unable to identify any studies or evidence nor has any been presented by Applicants to show any adverse effects on oil refineries from the current historic high energy prices.	The proposal is not specific to oil refineries. The majority of customers affected are not refineries. However, if DRA is interested in the effect of high energy prices with regard to refining and petroleum products in general, a recent story on NPR (dated 6/18/08) may be of interest. This story quotes several experts explaining that high energy prices flow through to finished product prices.
49	27-28	No reason to believe the PPP could have driven industrial firms to Las Vegas where average industrial gas rates have been higher compared to California	EIA industrial gas price data does not include gas purchased from marketers or other non-utility entities for California or most states (a few eastern states' data do include gas purchased from marketers). Data for California represent only 8% of total industrial volumes. Nevada and Arizona are also less than 40% of total industrial volumes. So these price data are neither representative nor particularly comparable. See "EIA Natural Gas Prices, Appendix A – Summary of Data Collection and Report Methodology."

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58	6-8	With potentially higher gas prices going forward, the PPP surcharge may become even a smaller portion of the industrial customers' total natural gas cost.	Actually the data DRA reviewed show that PPP costs have increased as a percentage of total delivered gas cost, even as gas costs have increased. And they have increased faster for industrial customers than for residential.
60	9-11	It is noteworthy that the transmission cost as a percentage of the industrial and residential customers' total gas cost indicate (sic) that these costs have gone down substantially over the recent years.	It appears that DRA is referring to gas transportation cost as a percentage of the total delivered cost of gas, including gas commodity. And the percentages do not indicate that transportation costs have gone down substantially – they indicate that gas costs and PPPS costs have increased substantially while transportation costs have remained relatively flat.

SOUTHERN CALIFORNIA GAS COMPANY

SAN DIEGO GAS AND ELECTRIC COMPANY

PACIFIC GAS AND ELECTRIC COMPANY

ATTACHMENT B

JUST THE FACTS

THE CALIFORNIA ECONOMY: EMPLOYMENT IN 2007

JANUARY 2008

- **GROWTH IN 2007 WAS THE SLOWEST SINCE 2003 — AND SLOWER THAN THE NATIONAL AVERAGE.**
  California's total non-farm employment grew by 0.5 percent in 2007, well below California's 2006 growth of 1.7 percent. This was the slowest growth since 2003, when California's employment declined by 0.4 percent. National growth was 1.0 percent, making 2007 the first time since 2003 (and only the third time since 1995) that employment grew faster nationally than it did in California. Still, relative to California's economic performance since 1990, growth in 2007 was near the middle of the range: the fastest growth was in 1998, at 3.5 percent, and the slowest was in 1991, when employment fell by 2.0 percent. At the same time, California's unemployment rate rose to 6.1 percent in December 2007 from 4.8 percent in December 2006, a jump of 1.3 percentage points, whereas national unemployment rose to 5.0 percent from 4.4 percent, an increase of only 0.6 percentage points.

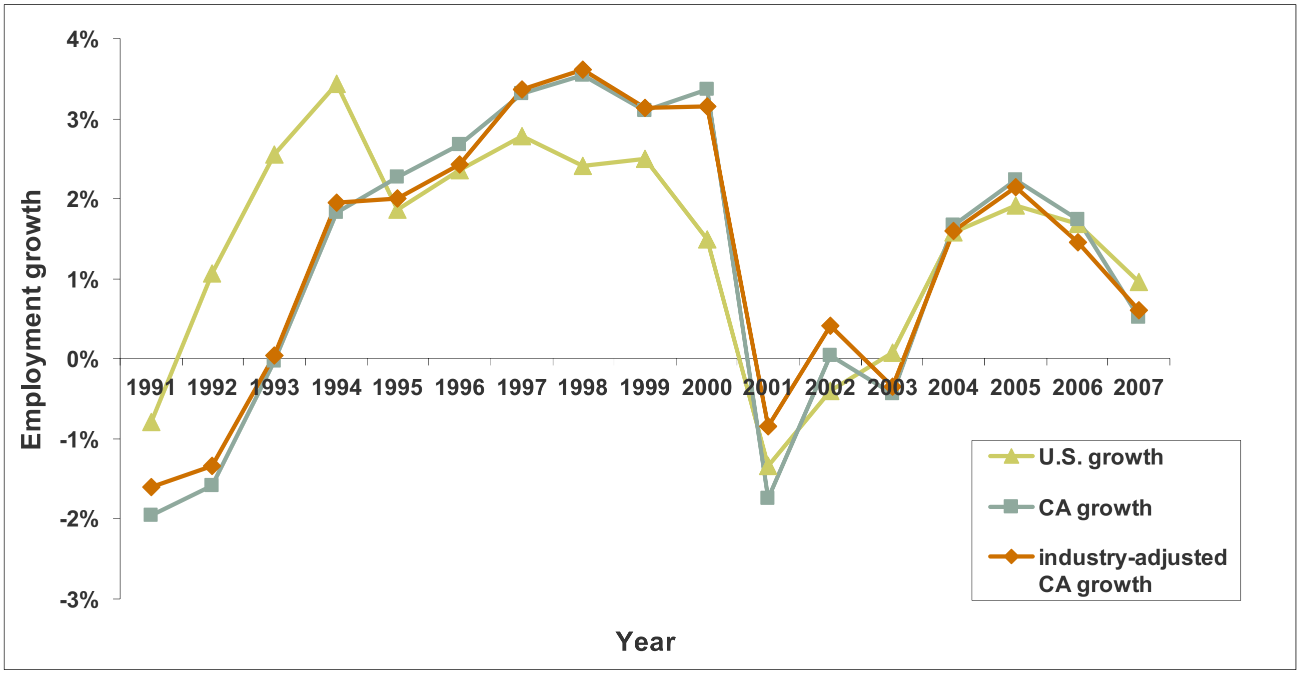
- **IN CALIFORNIA, THE HIGHS ARE HIGHER AND THE LOWS ARE LOWER.**
  Over the past 15 years, economic cycles have generally been more pronounced in California than in the rest of the country. For instance, when national employment growth was strong (1995-2000 and 2004-2006), California's growth exceeded it in most years. In 2007, a similar pattern occurred: U.S. growth slowed, and California growth slowed even more.

- **CALIFORNIA'S INDUSTRY MIX DOES NOT DETERMINE CALIFORNIA'S ECONOMIC PERFORMANCE.**
  California's growth rate differs little from its "industry-adjusted" growth rate, which estimates California's growth as if the state had the same industry mix as the rest of the country. Thus, when California growth diverges from national growth, it is due to California-specific factors rather than to factors affecting heavily-weighted California industries, such as the information sector. The notable exception was during the dot-com bust from 2001 to 2003, when the information sector lost more than 7.0 percent of its jobs annually, on average.

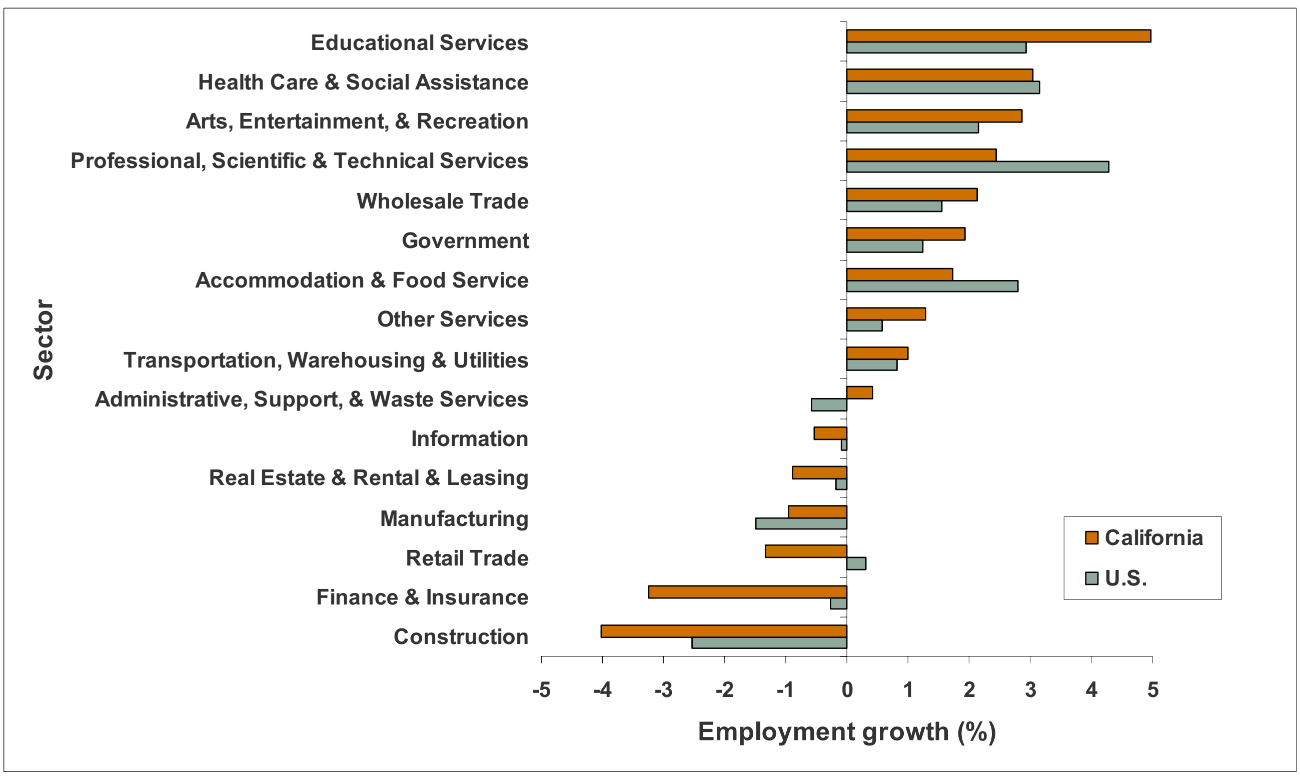
- **CONSTRUCTION HAD THE SHARPEST LOSSES, AS DID FINANCE AND INSURANCE.**
  Among broad sectors, construction employment fell the most in 2007, declining by 4.0 percent. Finance and insurance followed with a 3.3 percent drop. In both sectors, job growth in California was well behind the national average, and the decline in 2007 contrasts with earlier consistent growth even during the state's economic decline from 2001 to 2003. These sectors' fortunes are tied to the housing market, whose troubles have hurt California more than the nation overall.

- **SERVICE SECTOR EMPLOYMENT GREW FASTEST; MANUFACTURING'S DECLINE CONTINUED.**
  The fastest growing sectors in California were all services: employment in professional, scientific, and technical services, education, health care, and arts and recreation employment all grew well over 2.0 percent. California's manufacturing employment fell 0.9 percent, but this was hardly unique to California or to 2007. National manufacturing employment fell 1.5 percent in 2007, and in California manufacturing employment has contracted at an annualized rate of 1.5 percent from 1990 to 2007. Fewer than 10 percent of California's non-farm jobs are now in manufacturing.

California and U.S. Employment Growth, 1990-2007



Employment Growth by Sector, 2006-2007



Source: U.S. Bureau of Labor Statistics and California's Employment Development Department, based on the Current Employment Survey. National data were released on January 4, 2008, and state data were released on January 18, 2008. National and state data for December 2007 are preliminary and subject to revision.

Notes: All data shown in the charts and text are seasonally adjusted. The first figure shows total non-farm employment growth rates from Dec. of the previous year to Dec. of the labeled year. The second figure shows growth rates from Dec. 2006 to Dec. 2007. The industry-adjusted growth rate calculation, performed by PPIC, is based on data for 3-digit NAICS industries, which are not seasonally adjusted.

Jed Kolko and Davin Reed