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SOCALGAS

DIRECT TESTIMONY OF MICHAEL W. FOSTER

(WORKING CASH)

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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



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I. SUMMARY OF REQUEST

My Direct Testimony describes the methodology used by the Southern California Gas Company (“SCG”) to prepare its General Rate Case (“GRC”) request for working cash in compliance with California Public Utilities Commission (“CPUC”) Standard Practice (“SP”) U-16, based on 2013 as-recorded costs and Test Year (“TY”) 2016 forecasts. This effort results in a total 2016 working cash request for SCG of \$87.3 million (see Table SCG-MWF-1, below). Working cash is a means to compensate investors for providing funds that are committed to the business for paying operating expenses in advance of receipt of the offsetting revenues from customers. This testimony focuses on the major drivers and relies on the CPUC SP U-16 as a guide to construct and present SCG’s working cash requirements. Additionally, my testimony shows that lead/lag categories with expense lags less than revenue lag consume working cash.

TABLE SCG-MWF-1
Test Year 2016 Summary of SCG Working Case Requirement
(\$ in millions)

Operational Cash Requirement	\$83.3	
Lead Lag Working Cash Requirement	\$150.2	
Total Working Cash Requirement		\$233.5
Working cash provided by non-investors		(\$146.2)
Net Working Cash Requirement		\$87.3

II. METHODOLOGY

Generally, customers’ rates are calculated based on an authorized revenue requirement, and the resulting rate structures assume that revenues are collected as soon as services are rendered, and expenses are paid when incurred. However, customers pay their bills after they receive services, and on average SCG pays its suppliers after expenses are incurred. The net outcome of the timing of these transactions results in SCG’s average revenue lag (the lag between when utility services are rendered and when revenue is received for those services)

1 being greater than its average expense lag (the lag between when utility suppliers render services
2 to the utility and when the utilities pay for those services). Consequently, SCG's investors are
3 required to fund the operating cash needed during the net lag days (net of revenue and expense
4 lags).

5 The working cash forecast is based on a comprehensive analysis of recorded information,
6 and is prepared in compliance with SP U-16, as described in detail in this testimony and the
7 accompanying work papers (Ex. SCG-29-WP). As noted above, working cash is the capital
8 supplied by shareholders to meet day-to-day utility operational requirements, which provides the
9 bridge from the time that expenditures are made for services until the time revenues are collected
10 for those services. SCG's determination of working cash consists of a detailed analysis normally
11 referred to as the "weighted average" or "lead-lag days" method.¹

12 SCG's working cash allowance is comprised of items related to the income statement and
13 items related to the balance sheet. The requested working cash allowance for income statement
14 items quantifies the timing lag between when revenues and expenses are recognized in the
15 GRC's summary of earnings for ratemaking purposes, compared to when revenues are actually
16 collected and expenses are actually paid. Balance sheet items include accounts funded with cash
17 supplied by investors, such as other receivables (money owed to SCG) and prepaid expenses
18 (e.g., prepaid rent and insurance) as well as accounts that offset working cash requirements
19 because they are funded with cash supplied by others (e.g., employee withholdings and other
20 liabilities funded by ratepayers).

21 Table SCG-MWF-4, below, summarizes the total working cash capital required for
22 recorded year 2013 and forecasted TY 2016. Expenses charged to and forecasted for balancing
23 accounts authorized by the CPUC for energy commodities and customer service programs that
24 have no separate provision for working cash of their own are also included as part of the lead/lag
25 study. This is appropriate because interest is not applied to balancing accounts during the net
26 revenue lag period.

¹ See CPUC SP U-16-W, March, 2006, Chapter 3, section 1, which compares the detailed method to the simplified method (defined in Chapter 2, section 1). It states: "The detailed basis of determining working cash allowance is normally referred to as the 'weighted average or lead-lag days' method. Fundamentally, the same principles apply for the detailed basis as for the simplified basis. That is, first the operational requirement is determined and then amounts of monies available through tax accruals and other funds not supplied by the investor are deducted from the operational requirement."

1 **III. WORKING CASH DETERMINATION**

2 Determining SCG’s working cash requirement involved several steps. First, the
3 operational cash requirement is determined by examining certain asset accounts on the balance
4 sheet² and deductions are made for certain liabilities, such as tax accruals and other funds which
5 represent cash provided from sources other than investors. Second, SCG prepared the lead/lag
6 study which focuses on the income statement. The total of the operational (balance sheet)
7 requirement is added to the lead/lag study requirement to produce the total working cash
8 requirement. SCG’s investors who fund this total working cash requirement receive an
9 authorized rate of return on their investment to fund SCG’s cash requirements.³ My testimony
10 describes, in further detail below, the methodology and components for forecasting the working
11 cash requirement for the TY 2016 GRC.

12 The following narrative generally describes the steps used to prepare the working cash
13 study that determined SCG’s TY 2016 request. More details on each account category and
14 specifics relevant to each step in the process are provided later in this testimony, as well as in the
15 accompanying workpapers (Ex. SCG-29-WP).

16 **A. Working Cash Requirement for Balance Sheet Accounts**

17 SCG’s requested balance sheet-related working cash allowance is based on the sum of the
18 monthly balances from December 2012 through December 2013, less one-half of each December
19 balance, divided by 12 (i.e., a mid-month convention), and then escalated into 2016 dollar terms.
20 This practice of averaging month-end balances for determining the balance sheet-related working
21 cash allowance is outlined in Chapter 3 of SP U-16.

22 Working cash requirements for balance sheet accounts that require and provide working
23 cash were quantified using 2013 as-recorded account balances and a mid-month convention to
24 determine weighted-average annual account balances (see Table SCG-MWF-4, below). These
25 balances were escalated to 2016 dollars using the shared services escalation factor index, which

² A financial statement that summarizes a company's assets, liabilities and shareholders' equity at a specific point in time. These three balance sheet segments give investors an idea as to what the company owns and owes, as well as the amount invested by the shareholders.

³ Determination of Working Cash Allowance, CPUC SP U-16-W, March, 2006 (“Its purpose is to compensate investors for funds provided by them which are permanently committed to the business for the purpose of paying operating expenses in advance of receipt of offsetting revenues from its customers and in order to maintain minimum bank balances.”)

1 reflects the weighted-average of labor and non-labor O&M indexes, as noted in the escalation
2 testimony of Scott R. Wilder (Ex. SCG-31).

3 **B. Working Cash Requirements for Income Statement Accounts**

4 Working cash requirements for income statement accounts were determined by
5 performing a lead/lag study. The lead lag study consists of two major components: revenue lag
6 and expense lag.

7 **1. Revenue Lag**

8 Revenue lag is the average number of days for all utility customers between the mid-
9 point of their monthly service and receipt of payment by SCG (line 1 of Table SCG-MWF-3,
10 below). Because SCG customers pay for all categories of service with a single bill, the lead/lag
11 study uses a single value for revenue lag days.

12 **2. Expense Lag**

13 Expense lag is the number of days between the time the utility pays its suppliers and the
14 time its expenses are incurred. (see columns a and b of Table SCG-MWF-2, below). Because
15 SCG pays separately for each categories of service, each expense category has its own value for
16 lead/lag days.

17 **3. Expense Lag Methodology**

18 The expense lag analysis reflects 2013 as-recorded expenses and the associated average
19 expense lag days. To determine the number of expense lag days, SCG analyzed 12 months of
20 invoices from the most recent calendar year for account categories which represent the types of
21 expenses forecasted in the GRC (e.g., accounts payable records, operations and maintenance
22 expenses, payroll expense, taxes, and benefits, among others).

23 The method described below applies to both non-commodity expenses as well as
24 commodity purchases, which have no provision for working cash in their specific tariffs. The
25 weighted-average number of expense lag days for each category was derived by the following:

- 26 • identifying the lag days for each payment within the total population of invoices
27 for 2013 by comparing the service date (defined as either the date service was
28 provided or the midpoint of the service period) to the date cash payment was
29 made;
- 30 • multiplying the lag days for each payment by the dollar amount of each payment
31 to get “dollar days”; and

- summing the dollar days for each payment and dividing that total by the total of the 2013 payment amounts.

The overall weighted-average number of expense lag days for all non-commodity account categories was calculated, and applied to the total 2016 O&M costs forecasted in the GRC, using the following steps:

- annual 2013 expenses for each account category were multiplied by total lag days, generating dollar-days (column c in Table SCG-MWF-2, below);
- dollar-days and total expenses for all account categories except commodities were summed; and
- total dollar-days were divided by total expenses to determine non-commodity weighted average lag days (see line 18 of Table SCG-MWF-2, below).

Non-commodity weighted-average lag days were multiplied by total 2016 O&M costs forecasted in the GRC, plus forecasted deferred taxes, franchise fees on commodities, pass-through taxes, and refundable program costs, again generating dollar-days (see “All Other Expenses” on line 4 of Table SCG-MWF-3, below). For commodity purchases, specific, rather than weighted-average expense lag days were applied to the forecasted dollars to generate dollar-days.

The total of Commodity and All Other Expenses dollar-days were divided by total forecasted expenses to determine overall weighted-average expense lag days (see line 5 of Table SCG-MWF-3, below).

In the last step of the lead lag study, overall weighted-average expense lag days were subtracted from revenue lag days to get net revenue lag days (see line 6 of Table SCG-MWF-3, below), which is the average number of days between payment of expenses and collection of revenue. This value was then multiplied by total forecasted expenses and divided by 365 days to determine the total working cash requirement associated with revenue and expenses (see line 7 of Table SCG-MWF-3, below).

C. Derivation of the Total Working Cash Requirement

The final working cash allowance was determined by adding the balance sheet related working cash requirements to the lead-lag related working cash requirements (see line 10 of Table SCG-MWF-4, below).

1 **IV. SUMMARY REPORTS**

2 Table SCG-MWF-2 summarizes 2013 expense lag days, commodity expenses, non-
 3 commodity expenses, and associated dollar-days by account category. The overall 2013
 4 weighted-average non-commodity expense lag days are 25.7 days. These values were developed
 5 to apply to 2016 expense forecasts.

6 **TABLE SCG-MWF-2**
 7 **Test Year 2016, 2013 Expense Lag Days, As-Recorded Expenses, and Dollar-Days (\$000)**

Line No.	Description	[a] Expense Lag Days	[b] Total Company Expenses	[c] Total Company Dollar-Days [a]*[b]
<u>Commodity Expense:</u>				
1	Purchased Gas Costs	38.59	\$ 1,537,994	\$ 59,351,195
<u>Non-Commodity Expense:</u>				
2	Payroll Expense	13.07	\$ 518,188	\$ 6,772,309
3	F.I.C.A.	12.42	30,731	381,775
4	Federal/State Unemployment Insurance	76.05	922	70,127
5	Incentive Compensation Plan	256.00	40,996	10,494,914
6	Employee Benefits	6.19	207,838	1,286,516
7	Goods & Services	34.04	425,521	14,484,751
8	Payments by Corporate Center	21.84	65,580	1,432,171
9	Real Estate Rental	(26.49)	18,984	(502,893)
10	Materials Issued from Stores	-	14,843	-
11	Property/Ad Valorem/Pass-Through Taxes	82.90	565,279	46,861,612
12	Federal Income Taxes--Current	(724.93)	15,273	(11,071,677)
13	CA Corporate Franchise Taxes	(573.92)	14,296	(8,204,980)
14	Depreciation Provision	-	366,151	-
15	Amortization of Insurance Premiums	-	16,184	-
16	Federal Income Taxes - Deferred	-	115,054	-
17	Total Non-Commodity Expenses		\$ 2,415,841	\$ 62,004,626
18	Weighted Average Non-Commodity Expense Lag Days		25.67	[17c/17b]

8
 9 Note: Values may not add to totals due to rounding.

1 Table SCG-MWF-3 summarizes 2013 revenue lag days; weighted-average expense lag
 2 days for energy commodity and non-commodity account categories; 2016 forecasted commodity
 3 and non-commodity expenses; associated dollar-days; overall weighted-average expense lag
 4 days; net revenue lag days; and the resulting total 2016 lead/lag working cash requirement of
 5 \$150.2 million.

6 **TABLE SCG-MWF-3**
 7 **Test Year 2016 Summary of Lead Lag Study**

8 **(\$000)**

Line No.	Description	[a] 2013 Expense Lag Days	[b] 2016 Expense Forecast	[c] 2016 Calculated Dollar-Days [a]*[b]
1	Revenue	<u>41.99</u>		
2	Expenses			
3	Commodity Purchases - Core Gas	38.59	\$ 1,343,245	\$ 51,835,833
4	All Other Expenses	<u>25.67</u>	<u>3,077,631</u>	<u>78,990,038</u>
5	Total Expenses - a: c/b; b&c: (3+4)	<u>29.59</u>	<u>\$ 4,420,876</u>	<u>\$ 130,825,871</u>
6	Net Revenue Lag Days [1a-5a]	<u>12.40</u>		
7	Total Lead-Lag Working Cash Requirement [5b*6a/365]		<u>\$ 150,207</u>	

9 Note: Values may not add to totals due to rounding.

1 Table SCG-MWF-4 summarizes 2013 and forecasted 2016 balance sheet sources and
 2 uses of working cash, lead/lag working cash requirements, and total working cash requirements
 3 of \$87.3 million.

4
 5 **TABLE SCG-MWF-4**
 6 **Test Year 2016 Summary of Working Cash Requirements**
 7 **(\$000)**

Line No.	Description	2013 As-Recorded	2016 Requirement
<u>Balance Sheet Account Uses of Working Cash</u>			
1	Cash Balances	\$ 3,130	\$ 3,356
2	Other Receivables	61,028	65,434
3	Prepayments and Current Assets	13,137	14,086
4	Deferred Debits	<u>370</u>	<u>397</u>
5	Sub-total Balance Sheet Account Uses of Working Cash	<u>77,665</u>	<u>83,272</u>
<u>Balance Sheet Account Sources of Working Cash</u>			
6	Employee Withholdings	(842)	(903)
7	Current and Accrued Liabilities	<u>(135,525)</u>	<u>(145,310)</u>
8	Sub-total Balance Sheet Account Sources of Working Cash	<u>(136,367)</u>	<u>(146,213)</u>
9	Net Balance Sheet Account Working Cash Requirement [5+8] *	<u>\$ (58,702)</u>	\$ (62,941)
<u>Lead/Lag Working Capital Requirement **</u>			<u>\$ 150,207</u>
10	Total Working Cash Requirement		<u>\$ 87,267</u>

* Proposed 2016 amount is derived by escalating the 2013 recorded value using the shared service index.

** Proposed 2016 working cash requirement is from the previous table (Table SCG-MWF-3).

1 **V. WORKING CASH DETAILS**

2 This section contains further details about each account category utilized in the
3 development of SCG's 2016 GRC working cash request.

4 **A. Balance Sheet Accounts**

5 These categories provide an overview of the main components of each operational cash
6 requirement. For a full list of all the components, please see Schedule P and Schedule P Detail
7 in my workpapers.

8 **1. Operational Cash Requirements**

9 These accounts represent accounts funded with cash supplied by investors, which thus
10 establishing the working cash requirement.

11 **a. Cash Balance** (see line 1 of Table SCG-MWF-4, above) – 2013 average actuals
12 of \$3.1 million.

13 **b. Other Receivables** (see line 2 of Table SCG-MWF-4, above) – 2013 average
14 actuals of \$61.0 million. This category includes sundry billing, A/R gas sales hub & swap and
15 other third party receivables (including claims) and miscellaneous receivables, such as A/R from
16 new business, customer unallocated collections, Miscellaneous Sales, Rentals and Jobbing, and
17 Unallocated Charges, as well as receivables from other services.

- 18 • SCG's sundry billing process addresses customer requested construction projects,
19 governmental programs, and marketing services. Receivables for such activity
20 remain on the books until payment is received from a third party. SCG does not
21 charge interest on the balances.

- 22 • A/R Gas Sales Hub & Swap contains pending receivables from Hub & Swap
23 transactions. SCG does not charge counterparties interest on accounts receivable
24 balances.

25 **c. Prepayments and Current Assets** (see line 3 of Table SCG-MWF-4, above) –
26 2013 average actuals of \$13.1 million. This category includes accounts that SCG uses to make
27 prepayments, which do not earn interest on the balances. These accounts include prepayments
28 (including insurance and software), deferred debit sundry (current portion of unbilled work
29 performed on behalf of third parties) and current emissions credits (credits bought by SCG on
30 behalf of its customers).

31 **d. Deferred Debits** (see line 4 of Table SCG-MWF-4, above) – 2013 average
32 actuals of \$0.4 million. These accounts include deferred emissions credits (non-current portion

1 of SCG emission credits purchased on behalf of its customers) and survey and investigation costs
2 (costs incurred on potential capital projects, before they are added to rate base).

3 **2. Working Capital Not Supplied by Investors**

4 These accounts represent sources of working cash supplied by other than utility investors,
5 which thus reduce the working cash requirement.

6 **a. Employee Withholdings** (see line 6 of Table SCG-MWF-4, above) – 2013
7 average actuals of (\$0.8) million. This category includes the employee paid portion of benefits
8 costs and taxes.

9 **b. Current and Accrued Liabilities** (see line 7 of Table SCG-MWF-4, above) –
10 2013 average actuals of (\$135.5) million. These accounts include workers compensation
11 reserves, invoice received clearing account and accrued vacation.

- 12 • Workers' compensation reserves represents estimated future costs payable to
13 employees for work related injuries already incurred. This amount was tax
14 affected at a rate of 40.75% to reflect the fact that the revenues collected are taxed
15 in the year received, and only a portion of this is available as working cash.
- 16 • Invoice Received Clearing Account includes accounts payable for purchased
17 materials that have been received and will be capitalized, but the company has not
18 yet received a corresponding invoice.
- 19 • Accrued vacation account was added in order to be in accordance with the
20 deductions outlined in Chapter 3, section 25 of SP U-16. However, SCG does not
21 agree with the inclusion that is outlined by SP U-16 which states "These amounts
22 represent monies accrued through operating expenses for future liabilities which
23 the utility has available until payments to employees for vacation are paid."
24 GRC forecasted total labor expenses are based on actual productive labor plus an
25 overhead rate that is determined solely from actual expenses, not liability
26 accruals. Liabilities are maintained on the balance sheet for financial reporting
27 purposes, but only actual expenses are proposed in the GRC forecast. Employees
28 are paid for 2,080 working hours per year whether they take vacation or not and
29 that is what is in rates; therefore, there is no working cash benefit being derived.
30 As such, SCG includes the accrued vacation reduction to working cash as part of
31 "Current and Accrued Liabilities" (See line 7 on Table SCG-MWF-4, above) to
32 conform to SP U-16 but continues to feel the reduction understates the Working
33 Cash need.
- 34 • Customer Deposits are excluded as a working cash item because the utility pays
35 interest at the Federal Reserve published prime non-financial 3-month
36 commercial paper rate. This treatment is consistent with SP U-16 whereby
37 interest bearing accounts are excluded from working cash. SCG is applying the
38 same methodology it has advocated in past GRCs. SP U-16 states under the

1 Customers' Deposits heading that "Only non-interest bearing customer deposits
2 are to be considered" (see Chapter 3, Section 22). Furthermore, the customer
3 Deposit balance can decrease depending upon the economy and building demand,
4 and these balances do not have the same characteristics as permanent sources of
5 financing.

6 • Public Liability and Property Damage ("PLPD") reserves are
7 excluded as a working cash item because SCG is not requesting recovery of
8 PLPD reserves in the GRC.

9 **B. Income Statement Accounts (Lead-Lag Working Cash Requirements)**

10 **1. Revenue Lag (line 1 of Table SCG-MWF-3, above, and Schedule C of**
11 **the workpapers) – Year 2013 actual of 41.99 lag days.**

12 **a. Collection lag** (23.29 days) is based upon an analysis of accounts receivable
13 balances and revenues for 2013. Annual revenues divided by the average monthly accounts
14 receivable balance results in the average number of accounts receivable turnovers per year.
15 Revenue collection lag is equal to 365 days divided by the average number of accounts
16 receivable turnovers per year.

17 **b. Meter reading lag** (2.50 days) reflects the lag from the date the meter is read
18 until the time the bill is prepared and mailed to the customer. SCG performed a detailed query of
19 all meters read in 2013 that resulted in 2.50 lag days.

20 **c. Billing lag** (15.21 days) is calculated from the midpoint of each month's
21 consumption to when the meter is read. Meters are read 12 times a year, so the average time
22 between the meter reading periods is 30.4 days (365/12). This study assumes that service is
23 rendered evenly before and after the meter is read, which results in an average lag of 15.2 days.

24 **d. Bank lag** (1.00 day) describes the amount of days between the in-flow of funds
25 and when those funds are made available.

26 **2. 2013 Expense Lag Categories**

27 **a. Purchased Commodities, Gas** (line 1 of Table SCG-MWF-2, above) – 2013
28 actuals of \$1,538.0 million, 38.6 lag days. The ratemaking mechanisms associated with these
29 costs presume collection of revenues as supply is consumed and payment of expenses when
30 supply is delivered. Therefore, this line item is necessary in order to recover a working cash
31 allowance for the net revenue lag associated with commodity purchases. The 2013 purchased

1 gas costs were derived by summing the net payments made each month for Transportation
2 payments, California payments, Interstate Payments, and Secondary Market Services⁴. Lag days
3 reflect the weighted-average of all net gas commodity payments. Each category has the total
4 invoice amounts and its corresponding dollar weighted days. These dollar days were calculated
5 by multiplying the invoice amount by the number of lag days. The total dollar days for all the
6 categories were divided by the total invoice amounts to come up with the number of lag days for
7 this category. Please see my workpaper Schedule D for more detail (Ex. SCG-29-WP).

8 **b. Payroll Expense** (line 2 of Table SCG-MWF-2, above) – 2013 actuals of \$518.2
9 million, 13.4 lag days. This category includes O&M and the O&M portion of clearing and
10 refundable labor costs. Payroll expenses are incurred every other Friday and have 12.4 lag days.
11 This filing has updated the payroll expense calculation to take into account holidays, which
12 results in early payroll moving the lag days down. Withholding taxes are paid the day before
13 payday to the outsourcing company that makes all tax payments on behalf of SCG, and therefore
14 the resulting net lag is 13.1 lag days. Please see my workpaper Schedule E for more detail.

15 **c. Federal Insurance Contributions Act Tax (“FICA”)** (line 3 of Table SCG-
16 MWF-2, above) – 2013 actuals of \$30.7 million, 12.4 lag days. As with the tax portion of
17 payroll expenses above, FICA (which includes Old-Age, Survivor’s, and Disability Insurance
18 [“OASDI”] and Medicare) expenses are paid the day before payday to SCG’s payroll
19 outsourcing company. Please see my workpaper Schedule F for more detail.

20 **d. Federal Unemployment Tax Act (“FUTA”) and State Unemployment**
21 **Insurance (“SUI”)** (line 4 of Table SCG-MWF-2, above) – 2013 actuals of \$0.9 million, 76.1
22 lag days. These costs are paid electronically to SCG’s payroll outsourcing company one month
23 after each quarter end. This study reflects both FUTA and SUI, net of capital. Please see my
24 workpaper Schedule F for more detail.

25 **e. Incentive Compensation Plan (“ICP”)** (line 5 of Table SCG-MWF-2, above) –
26 2013 actuals of \$41.0 million, 256.0 lag days. This compensation is earned and reflected as an
27 expense in the preceding year (2013), but paid out in 2014. Please see my workpaper Schedule
28 G for more detail.

⁴ Transportation payments included capacity and transportation costs from several pipelines to transport gas to our system. California payments include payments to three California producers that supply gas from oil productions. Interstate Payments include proceeds and expenditures from gas suppliers for SCG and SDG&E core

1 **f. Employee Benefits** (line 6 of Table SCG-MWF-2, above) – 2013 actuals of
2 \$207.8 million, 6.2 lag days. Please see my workpaper Schedule H for more detail.

3 For both pensions and postretirement benefits other than pension (“PBOPs”), ratepayers
4 are compensated for the actual payment lags since this account is balanced. As explained above,
5 it is a long-established working cash principle that a zero lag day is proper in the case of accrued
6 expenses for which interest is paid on the accumulated balance.

7 **g. Goods and Services** (line 7 of Table SCG-MWF-2, above) – 2013 expense of
8 \$425.5 million, 34.0 lag days. The Goods and Services expense amount includes all other
9 expenses that have not been identified separately on the lead lag study, such as Inventory, Small
10 Price Difference, Goods Received/Invoice Received (“O&M”). Please see my workpaper
11 Schedules I for more detail.

12 **h. Payments by Corporate Center** (line 8 of Table SCG-MWF-2, above) – 2013
13 actuals of \$65.6 million, 21.8 lag days. SCG pays for its share of expenses incurred by
14 Corporate Center on behalf of the utility. The lead/lag days from corresponding expense
15 categories in this lead/lag study are applied to Corporate Center payments to calculate overall lag
16 days. Please see my workpaper Schedule J for more detail.

17 **i. Real Estate Lease Payments** (line 9 of Table SCG-MWF-2, above) – 2013
18 actuals of \$19.0 million, (26.5) lead days. Leases are paid in advance. Overall expense lag is
19 negative because payments are made prior to the midpoint of the occupancy period. Please see
20 my workpapers Schedule K-1, K-2 and K-3 for more detail.

21 **j. Materials Issued from Stores** (line 10 of Table SCG-MWF-2, above) – 2013
22 actuals of \$14.8 million, 0.0 lag days. This category includes materials issued for O&M, such as
23 tools, pipe and other material. Please see my workpaper Schedule L for more detail.

24 **k. Property/Ad Valorem/Pass-through Taxes** (line 11 of Table SCG-MWF-2,
25 above) – 2013 actuals of \$565.3 million, 82.9 lag days. Most of these payments are made
26 electronically. Please see my workpaper Schedules Ma and Mb for more detail. This category
27 includes property/ad valorem taxes, franchise fees, and pass through taxes collected on behalf of
28 government agencies.

1 Although pass-through taxes do not flow through the income statement, they are a source
2 of working cash and are appropriately included in the lead/lag study⁵. The taxes are collected
3 from ratepayers, and payments are made later to taxing authorities.

4 **l. Federal Income Taxes, Current** (line 12 of Table SCG-MWF-2, above) – 2013
5 actuals of \$15.3 million, (724.9) lag days. Tax expense lags are based on statutory due dates:
6 April 15 of each year for the first quarter, June 15 for the second quarter, September 15 for the
7 third quarter, and December 15 for the fourth quarter. The tax lag days of each payment are
8 calculated between the midpoint of the year and the wire payment date. Federal Income Taxes
9 also include tax refunds from previous periods which result in negative lag days. A federal tax
10 true up of \$100.9 million was received in 2013. SCG believes the size of this true-up to be
11 anomalous, so instead used the average of the last 5 years' federal true-ups. The 5-year average
12 federal true-up of \$20.8 was assumed instead of \$100.9 million, giving the lag days noted above
13 and significantly reducing the company's working cash request. Using the 5-year average true-
14 up as opposed to the 2013 actual reduces our working cash forecast by \$128.6 million,
15 decreasing our TY 2016 working cash forecast from \$215.8 million to \$87.3 million. These
16 were funds held by the IRS instead of SCG and therefore result in negative lag days. Please see
17 my workpaper Schedule N-1 for more detail.

18 **m. California Corporate Franchise Taxes, Current** (line 13 of Table SCG-MWF-
19 2, above) – 2013 actuals of \$14.3 million, (573.9) lag days. Statutory due dates are the same as
20 noted above for Federal Income Taxes, and the method of calculating the lag days is the same,
21 although the dollar weighting is different. California Franchise Taxes also include tax refunds of
22 \$15.6 million. Please see my workpaper Schedule N-2 for more detail.

23 **n. Depreciation** (line 14 of Table SCG-MWF-2, above) – 2013 actuals of \$366.2
24 million, 0.0 lag days. When a capital investment is made, the expense of the investment is
25 allocated systematically and periodically over the life of the investment through depreciation
26 expense. Capital investments are included as rate base and therefore should not be included as
27 part of working cash. Depreciating an asset over its useful life allows the timing of the expense
28 recognition to closely match that of the use of the asset. Therefore the lag associated with

⁵ CPUC Standard Practices U-16-W, March, 2006, Chapter 3, section 27.

1 depreciation expense should be set to zero as it is assumed that depreciation expense occurs
2 when the use of the asset occurs. CPUC standard practices endorse this treatment.⁶

3 Revenue lag exists between the time the depreciation is recognized and the time
4 customers revenue is received for that depreciation. This lag is captured as part of the revenue
5 lag forecast. Please see my workpaper Schedule O-2 for more detail.

6 **o. Amortization of Insurance Premiums** (line 15 of Table SCG-MWF-2, above) –
7 2013 actuals of \$16.2 million, 0.0 lag days. Amortization (the systematic and periodic
8 recognition of the insurance premium expense over the policy life) is weighted at zero days
9 recognizing that investor funding has occurred but has not yet been recovered. Please see my
10 workpaper Schedule O-3 for more detail.

11 **p. Federal/State Income Taxes, Deferred** (line 16 of Table SCG-MWF-2, above) –
12 2013 actuals of \$115.1 million, 0.0 lag days. This amount reflects the change of deferred federal
13 and state taxes in 2013. Accumulated deferred income taxes (“ADIT”) are deducted from rate
14 base as cost-free funds available for investment. However, the financial recording of deferred
15 income taxes does not produce cost-free capital and the funds do not become available until
16 customers pay their bills. Therefore, the recorded amount of ADIT overstates the actual amount
17 of cost-free funds that are available. The inclusion of deferred income taxes at zero lag days in
18 the overall expense lag weighted-average corrects this condition by increasing net revenue lag, in
19 the same manner as Depreciation, described above⁷. Please see my workpaper Schedule O-1 for
20 more detail.

21 **3. TY 2016 Forecasted Expense Components** (line 5 of Table SCG-MWF-
22 3, above, and workpaper B-1)

23 TY 2016 forecast of \$4,443.0 million. Forecasted expenditures for commodity costs,
24 O&M non-commodity costs, franchise fees on commodity costs, pass-through taxes, and
25 balancing account costs are utilized in the working cash computation.

26 **a. TY Forecasted Commodity Costs** (line 3 column b of Table SCG-MWF-3,
27 above) – \$1,343.2 million. For commodity costs, 2013 actual weighted-average lag days are

⁶ CPUC Standard Practices U-16-W, March, 2006, Chapter 3, section 40: “Since book depreciation expense is occurring uniformly day by day and accumulated depreciation is deducted from the rate base, the practice is to include depreciation provisions at zero lag days.”

⁷ CPUC Standard Practices U-16-W, March, 2006, Chapter 3, section 45.

1 applied to forecasted 2016 costs. Forecasted gas costs are computed by multiplying the
2 forecasted 2016 monthly demand by the monthly weighted-average cost of gas (“WACOG”).
3 The monthly WACOG reflects purchase and interstate transportation costs.

4 **b. Other TY Non-Commodity Costs** (line 4 column b of Table SCG-MWF-3,
5 above) – \$3,103.8 million, 25.7 lag days. The 2013 overall weighted-average number of lag
6 days for expenses excluding commodities is applied to projected test year O&M expenses. This
7 category includes non-commodity O&M expenses, deferred income taxes, franchise fees on
8 commodity, pass through taxes, and refundable program costs.

9 **VI. CONCLUSION**

10 The foregoing testimony describes the methodology used by SCG resulting in a total TY
11 2016 working cash request requirement for SCG of \$87.3 million (Table SCG-MWF-1, above).
12 As shown above in the lead/lag study, I have calculated a lower overall weighted average for
13 expense lag days and an increase in net revenue lag days. Lead/lag categories with expense lags
14 greater than revenue lag provide working cash. These items raise the overall weighted average
15 for expense lag days and decrease net revenue lag days.

16 For all of the reasons stated above, SCG’s total 2016 working cash requirement of \$87.3
17 million is reasonable and appropriate.

18 This concludes my prepared direct testimony.

1 **VII. WITNESS QUALIFICATIONS**

2 My name is Michael W. Foster. My business address is 555 West 5th Street, Los
3 Angeles, CA 90013-1011. I received a Bachelor of Arts degree in Economics from the
4 University of California, Santa Barbara in 1995. I received a Master of Business Administration
5 degree from the Darden School of Business at the University of Virginia, Charlottesville in 2000.

6 I am employed as a Project Manager in the Rate Base and Treasury area of the Finance
7 department of SoCalGas. I have worked for SoCalGas since June 2011, and prior to that I
8 worked for SDG&E since December 2001. In my current capacity, I am responsible for
9 providing financial analysis and support for the treasury and rate base management function.

10 I have previously testified before this Commission.

APPENDIX A - [GLOSSARY OF TERMS]

Glossary of Terms

ADIT: accumulated deferred income tax
A/R: Accounts Receivable
CA: California
CAC: Customer Advances for Construction
CAISO: California Independent System Operator
CPUC: California Public Utilities Commission
Ex.: exhibit
FICA: Federal Insurance Contributions Act
FUTA: Federal Unemployment Tax Act
GRC: general rate case
ICP: Incentive Compensation Plan
NOI: Notice of Intent
OASDI: Old Age, Survivors, and Disability Insurance
O&M: operations and maintenance
PBOBs: postretirement benefits other than pension
PLPD: Public Liability and Property Damage
SDG&E: San Diego Gas & Electric Company
SCG: Southern California Gas Company
SP: Standard Practice
SUI: State Unemployment Insurance
TY: Test Year
WACOG: Weighted Average Cost of Gas
WP: Workpaper