Docket	:	A.12-05-006
Exhibit Number	:	DRA-02
Commissioner	:	Florio
ALJ	:	Barnett
Witness	:	Jaeger

DIVISION OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION

Report on the Results of Operations for West Coast Gas Company General Rate Case Test Year 2013

Operating Expenses, Uncollectibles,
Cost of Capital, and Attrition

San Francisco, California
October 23, 2012

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Operating Expenses, Uncollectibles, Cost of Capital, and Attrition

I. INTRODUCTION

This exhibit presents the analyses and recommendations of the Division of Ratepayer Advocates (DRA) regarding West Coast Gas Company's (WCG) forecasts of Test Year (TY) 2013 operating expenses, uncollectibles, and cost of capital, as well as WCG's proposed attrition mechanism for post-test years 2014, 2015, and 2016.

II. SUMMARY OF RECOMMENDATIONS

For Operating Expenses, DRA recommends:

- That the forecast for the majority of TY2013 operating expenses be based on a five-year average of historical expenses from 2007-2011, escalated to 2013 levels.
- That the forecast of TY2013 FERC Account 920 - Administrative & General (A&G) Salaries, be based on recorded base year 2011 expenses plus the incremental cost associated with converting a part-time employee to a full-time basis.
- That the forecast for TY2013 A&G expenses use Global Insight's forecasted rates for escalating health care benefits (health care, dental, and vision services) expenses in FERC Account 926 Pension and Benefits.

For Uncollectibles, DRA recommends:

- That WCG's uncollectible rate be set at 0.1643%, which is calculated by removing WCG's largest and smallest historical write-offs in the past eight years and taking a six-year average of WCG's remaining historical uncollectible rates.

For Cost of Capital, DRA recommends:

- That WCG's weighted return on rate base be set at 7.15%, with a common equity cost rate of 8.50% and a debt rate of 4.00%.

For Attrition, DRA recommends:

- That WCG's attrition rate be based on the forecasted CPI, reduced by a 0.5% productivity factor in attrition years 2014, 2015, and 2016.

III. DISCUSSION / ANALYSIS OF OPERATING EXPENSES

Gas distribution Operation and Maintenance (O&M) expenses are typically for work activities related to leakage surveys, leak repairs, maintenance on mains and services, application of corrosion control measures, valve maintenance, regulator station maintenance, monitoring meter accuracy, odorant, and locating and marking buried pipes to avoid damage caused from digging by others.

Customer Accounting expenses are typically for work activities related to meter reading, customer records and collections expenses, uncollectible accounts expense, and miscellaneous customer accounts expense.

The categories of Administrative and General (A&G) expenses typically cover general expenses not chargeable to a specific functional activity and are recorded in Federal Energy Regulatory Commission's (FERC) Uniform System of Accounts 920 through 935. Many items comprise A&G expenses, including: outside services employed; injuries and damages; employee pensions & benefits; franchise tax; regulatory commission expense; miscellaneous general expense; and maintenance of general plant.

A. Overview of WCG's Request

WCG's 2013 test year forecasts of operating expenses include Operation & Maintenance (O&M) expenses, Administrative & General (A&G) expenses, and Customer Accounting expenses and exclude capital related operating expenses such as depreciation expense, property taxes, and income taxes.[1] Most of WCG's forecasted operating expenses are based on normalized 2011 recorded expenses, escalated by 1.75% for 2012 and 2.00% for 2013.[2] For FERC Account #926, Pensions and Benefits, employee benefit expenses (medical insurance payments,

[1] Prepared Direct Testimony of Raymond J. Czahar, CPA, on Behalf of West Coast Gas Company (dated May 1, 2012), pg 7.

[2] Prepared Direct Testimony of Raymond J. Czahar, CPA, on Behalf of West Coast Gas Company (dated May 1, 2012), pg 8.

vision benefits, and dental benefits.) are based on normalized 2011 recorded expenses, escalated by 5.4% for 2012 and 5.4% for 2013.[3]

B. DRA's Analysis

Table 2-1 compares DRA's and WCG's TY2013 forecasts of operating expenses:

Table 2-1
Operating Expenses for TY2013
(In Nominal Dollars)

Description (a)	DRA Recommended (b)	WCG Proposed[4] (c)	$ Amount WCG>DRA (d=c-b)	Percent WCG>DRA (e=d/b)
Distribution Operations	$347,907.14	$363,435.66	$15,528.52	4.46%
Distribution Maintenance	$46,875.63	$76,379.96	$29,504.33	62.94%
Customer Accounting	$105,704.52	$110,653.32	$4,948.80	4.68%
Administrative & General	$260,892.99	$264,587.21	$3,694.22	1.42%
Total	$761,380.28	$815,056.15	$53,675.87	7.05%

Tables 2-2, 2-3, 2-4, and 2-5 show WCG's 2007-2011 recorded expenses and DRA's 2013 forecasted expenses for O&M, A&G, and Customer Accounting Expenses.

[3] A.12-05-008, Ex. 1, Sheet 5, Page 1 of 1.

[4] A.12-05-008, Ex. 1, Sheet 1, Page 1 of 2 and 2 of 2.

Table 2-2

Distribution Operations Expenses
WCG's 2007-2011 Recorded / DRA's 2013 Forecast
(in 2011 Dollars)

Description	2007	2008	2009	2010	2011	2013
FERC Account 760	$183,636.45	$193,190.69	$155,496.83	$150,109.77	$174,939.47	$153,226.29
FERC Account 761	$9,698.06	$11,262.99	$9,972.68	$10,059.77	$6,516.61	$9,539.62
FERC Account 762	$9,544.04	$9,270.17	$9,450.29	$11,054.42	$10,564.51	$10,132.26
FERC Account 763	$5,789.71	$4,927.08	$5,616.42	$17,467.82	$7,431.02	$8,344.80
FERC Account 764	$14,380.12	$15,933.24	$5,371.64	$11,350.56	$12,324.09	$12,073.79
FERC Account 765	$72,158.94	$71,554.32	$75,800.99	$91,198.70	$91,412.26	$81,679.13
FERC Account 766	$83,494.78	$68,073.23	$73,896.03	$77,992.75	$80,843.73	$72,911.26
Total	$378,702.10	$374,211.73	$335,604.89	$369,233.78	$384,031.69	$347,907.14

<u>Source</u>: 2007-2011 data from WCG's response to data request DRA-WCG-05-EJ1

Table 2-3

Distribution Maintenance Expenses
WCG's 2007-2011 Recorded / DRA's 2013 Forecast
(in 2011 Dollars)

Description	2007	2008	2009	2010	2011	2013
FERC Account 767	$22,355.80	$23,928.11	$19,939.06	$15,386.93	$43,736.84	$25,460.26
FERC Account 768	$764.56	$1,065.73	$174.56	-	-	-
FERC Account 887	$10,693.36	$45,826.32	$14,657.91	$12,608.98	$34,149.05	$21,415.37
Total	$33,813.72	$70,820.16	$34,771.53	$27,995.91	$77,885.89	$46,875.63

<u>Source</u>: 2007-2011 data from WCG's response to data request DRA-WCG-05-EJ1

Table 2-4

Customer Accounting Expenses
WCG's 2007-2011 Recorded / DRA's 2013 Forecast
(in 2011 Dollars)

Description	2007	2008	2009	2010	2011	2013
FERC Account 901	$16,955.37	$16,931.40	$16,878.01	$17,892.37	$15,237.10	$17,342.88
FERC Account 902	$73.120.86	$79,813.19	$73,926.39	$79,886.73	$83,467.71	$75,148.14
FERC Account 903	$12,115.57	$11,724.66	$13,332.15	$12,760.88	$13,771.37	$13,213.49
FERC Account 904	$4,538.07	$6,224.77	$2,246.67	$2,958.94	$2,076.65	-
Total	$106,729.87	$114,694.03	$106.383.21	$113,498.92	$114,552.83	105,704.52

<u>Source</u>: 2007-2011 data from WCG's response to data request DRA-WCG-05-EJ1

Table 2-5

Administrative and General Expenses
WCG's 2007-2011 Recorded / DRA's 2013 Forecast
(in 2011 Dollars)

Description	2007	2008	2009	2010	2011	2013
FERC Account 920	$128,149.98	$128,191.63	$113,218.97	$101,464.55	$89,201.99	$95,866.07
FERC Account 921	$14,641.92	$11,807.32	$11,122.75	$9,797.14	$14,659.95	$12,287.01
FERC Account 922	$(499.97)	-	-	(5,258.38)	-	$(1,101.74)
FERC Account 923	$8,995.34	$17,660.10	$17,334.71	$13,254.34	$16,319.43	$14,607.69
FERC Account 924	$32,786.20	$43,658.82	$35,799.47	$45,084.18	$43,213.13	$37,325.03
FERC Account 926	$53,323.63	$61,462.06	$53,180.43	$50,857.58	$57,328.05	$57,388.87
FERC Account 927	$18,631.70	$22,094.47	$16,295.22	$15,961.38	$15,801.24	-
FERC Account 928	-	$2,564.20	$1,177.16	$1,151.09	$4,529.08	$1,884.30
FERC Account 930	$3,458.62	$4,753.35	$9,078.13	$4,678.36	$8,472.47	$6,000.29
FERC Account 931	-	$20,337.26	$24,632.01	$25,997.58	$26,947.91	$18,733.99
FERC Account 933	$2,697.71	$2,365.14	$717.78	$2,921.97	-	-
FERC Account 935	$15,711.39	$20,141.85	$17,239.91	$19,134.17	$17,924.08	$17,901.49
Total	$277,896.52	$335,036.19	$299,796.53	$285,043.95	$294,397.33	$260,892.99

Source: 2007-2011 data from WCG's response to data request DRA-WCG-05-EJ1

WCG did not forecast any TY2013 expenses in Maintenance of Meters (Account 768) and Transportation Expense (Account 933). DRA similarly assumes zero TY2013 expenses in Accounts 768 and 933.

1. WCG Has Been Granting Significant Wage Increases to its Distribution Maintenance Employees

From WCG's response to data request DRA-WCG-06-EJ1, Question 1, DRA notes that WCG has been granting significant wage increases to its Distribution Maintenance employees during the 2007-2011 period. In general, those employees have been receiving annual increases in their hourly pay rate ranging from 7% to 10%, excluding 2009. In one instance, an employee received a 33% increase in 2007. DRA is concerned that WCG has granted wage increases of that magnitude, with seemingly little consideration for the fact that these costs are ultimately funded by its ratepayers. DRA believes that its recommended forecasting methodology for operating expenses, as discussed in the next section, will help mitigate the impacts from WCG's increasing distribution maintenance O&M labor costs from the past five years.

2. DRA's Forecasting Methodology for Operating Expenses

DRA recommends that nearly all forecasted O&M, A&G, and Customer Accounting expenses be based on a five-year average of historical expense data over the period 2007-2011, escalated by WCG's proposed rates of 1.75% for 2012 and 2.00% for 2013. DRA takes issue with WCG's methodology of forecasting 2013 expenses by escalating 2011 recorded expenses because expenses in 2011 are uncharacteristically high compared to previous years in many accounts. The total 2011 expenses are the highest recorded expenses in the past five years (2007-2011) by a significant margin.[5] In addition, WCG did not present any evidence that the workload and expenses in 2012 and 2013 would be the same as in 2011.

Table 2-6 compares 2011 recorded expenses with a three- and five-year average of historical expense data. Total expenses for 2011 were $45,989.08 higher than the five-year average of historical expenses for the period 2007-2011 and $56,469.92 higher than the three-year average of historical expenses for the period 2009-2011. The historical data for WCG's operating expenses do not reflect upward trending expense levels; rather, the data shows that WCG's operating expenses tend to fluctuate from year-to-year. Therefore, DRA recommends using a five-year average of historical expense data as the basis for forecasting TY2013 operating expenses. Note that while the three-year average of historical expenses is lower than the five-year average of historical expenses by $10,480.84, DRA believes that a five-year average is more reasonable in this case.

[5] 2007-2011 data from WCG's response to data request DRA-WCG-05-EJ1

Table 2-6
Comparison Chart of Base Expenses Used to Forecast 2013 Expenses
(In 2011 Dollars)

	2011 Recorded Expenses[6]	5-Year Average 2007-2011	$ Amount 2011 Expenses > 5 Year Avg.	3-Year Average 2009-2011	$ Amount 2011 Expenses > 3 Year Avg.
Operating Expenses	$384,031.69	$368,356.84	$15,674.85	$362,956.79	$21,074.90
Maintenance Expenses	$77,885.89	$48,656.47	$29,229.42	$46,884.44	$31,001.45
Customer Accounting	$114,552.83	$111,171.77	$3,381.06	$111,478.32	$3,074.51
Administrative & General	$294,397.33	$296,693.58	($2,296.25)	$293,078.27	$1,319.06
Total	$870,867.74	$824,878.66	$45,989.08	$814,397.82	$56,469.92

DRA recommends using the same 5-year average methodology for all of WCG's operating expenses accounts except for FERC Accounts 920 and 926, as explained below.

3. FERC Account 920 – A&G Salaries

DRA accepts WCG's methodology of forecasting TY2013 A&G Salaries (Account 920), based on recorded base year 2011 expenses escalated to 2013 levels, and recommends that WCG receive an additional $18,090.56 to cover the incremental cost associated with converting a part-time employee to a full-time basis.[7] In discovery, DRA asked: "Does WCG forecast any changes in staffing levels for Test Year 2013?" In response, WCG stated: "A field technician has been moved up from part time to full time work in 2012" and "therefore, the 2013 Cost of Service is understated by $18,089.56." DRA's forecast of $95,866.07 reflects WCG's only predicted TY2013 changes in staffing levels.

[6] 2011 data from A.12-05-008, Ex. 1, Sheet 1, Page 1 of 2 and Page 2 of 2.

[7] Response to data request DRA-WCG-09-EJ1, Question 2.

4. FERC Account 926 – Pensions & Benefits

DRA accepts WCG's methodology of escalating 2011 expenses in its TY2013 forecast for Pensions and Benefits expenses. However, DRA recommends that the forecast for TY2013 Pensions & Benefits expenses use more recent forecasted rates, from Global Insight, for escalating health care benefits (health care, dental, and vision services). DRA proposes that the 2011 normalized expenses for medical insurance payments be escalated by 3.4% in 2012 and by 4.4% in 2013,[8] expenses for dental benefits be escalated by 2.4% in 2012 and 2.1% in 2013,[9] and vision benefits be escalated by 1.1% in 2012 and 1.4% in 2013.[10] DRA's proposed adjustments result in a forecast of $57,388.83 for Account 926 compared to the WCG forecast of $58,561.69.

IV. DISCUSSION / ANALYSIS OF UNCOLLECTIBLES

Utilities are compensated for bad debt write-offs with an uncollectibles rate based on historic data that is multiplied by the utility's energy revenues.

A. Overview of WCG's Request

WCG seeks to increase its uncollectibles rate from the currently authorized level of 0.1160% to 0.285%. WCG's requested escalation rate is the average of the historical uncollectibles rate for the 3-year period 2009 through 2011.[11]

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[8] IHS Global Insight Cost Planner First-Quarter 2012, p.147, Additional Forecast Tables, Table A1, Corporate Expenses, Health Care Benefits, ECI, Group Health Insurance (ECIHI %).

[9] IHS Global Insight Cost Planner First-Quarter 2012, p.147, Additional Forecast Tables, Table A1, Corporate Expenses, Health Care Benefits, CPI, Dental Services (CUSEMC02NS %).

[10] IHS Global Insight Cost Planner First-Quarter 2012, p.147, Additional Forecast Tables, Table A1, Corporate Expenses, Health Care Benefits, CPI, Eye Care (CUSEMC03NS %).

[11] A.12-05-008, Ex. 1, Sheet 25, Page 1 of 1.

B. DRA's Analysis

DRA recommends an uncollectible accounts rate of 0.1643%. DRA calculated this rate using a six-year average of historical uncollectible account rates for the period 2005-2010. The least recent (2004) and most recent (2011) historical write-offs were excluded from the average because they are respectively unusually low and high write offs, and not representative of standard uncollectible account rates for WCG during this time period. Taking an eight-year average for the period 2004-2011 produces an uncollectible accounts rate of 0.1597%, which is lower than the six-year average if 0.1643%. Table 2-7 provides WCG's historical write-offs and uncollectible rates for the past eight years.

Table 2-7
WCG's 2004-2011 Recorded Uncollectible Amount and Rate

Year	Gross Revenue	Uncollectible Amount (Write-offs)	Uncollectible Rate
2011	$ 1,869,914.28	$ 5,084.20	0.2719%
2010	1,819,960.91	3,341.55	0.1836%
2009	1,872,175.14	3,738.39	0.1997%
2008	2,273,362.02	5,853.73	0.2575%
2007	2,086,011.28	4,183.89	0.2006%
2006	2,141,892.71	1,417.13	0.0662%
2005	1,897,688.13	1,480.29	0.0780%
2004	1,703,565.13	334.94	0.0197%

Source: 2002-2011 data from WCG's response to data request DRA-WCG-01-CKT, Q.8

V. DISCUSSION / ANALYSIS OF COST OF CAPITAL

The rate of return, or weighted cost of capital, is defined as the cost of common equity, preferred equity, and long-term debt weighted by the shares of common equity, preferred equity, and long-term debt in the capital structure. In this case, WCG's capital structure does not have a preferred equity component.

A. Overview of WCG's Request

WCG requests a weighted cost of capital (rate of return) of 8.2%. This is based on 10% return on equity (ROE) and a 4% cost of long-term debt, and the continued use of the imputed 30% debt and 70% common equity ratio that was agreed to in the previous settlement and adopted by the Commission.[12]

B. DRA's Analysis

1. Capital Structure

DRA does not take issue with the capital structure that WCG has proposed and that the Commission has previously authorized in WCG's last rate case.[13]

2. Cost of Long-Term Debt

DRA does not take issue with the 4% cost of long-term debt that WCG has proposed.

3. Return on Common Equity

DRA proposes a rate of return on common equity of 8.5% compared to WCG's request of 10.0%. The DRA recommendation of 8.5% is a reasonable rate of return on equity for WCG in contrast to the 10.0% figure proposed by WCG for the reasons discussed below.

First, the proposal of WCG is much higher than the figure authorized by the Commission in WCG's last GRC. In D.08-11-010, the Commission approved a settlement agreement in WCG's TY 2009 GRC which adopted a rate of return of equity of 9.4%.[14] The changes in interest rates and related factors support a reduction in the rate of return on equity for TY 2013 compared to rates adopted in 2009.

Second, the proposed 10% ROE of WCG is too high in light of what DRA has recommended for other utilities in the generic Cost of Capital (COC) proceeding,

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[12] Prepared Direct Testimony of Raymond J. Czahar, CPA, on Behalf of West Coast Gas Company (dated May 1, 2012), pages 10-11.

[13] A.08-04-007, pg 4.

[14] D.08-11-010, p 4, FOF 2.

Application (A.) 12-04-015.[15] DRA's recommended rate of return on common equity of 8.5% is consistent with its cost of capital recommendation for San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) in the generic COC proceeding. The 8.5% figure is appropriate in light of the fact that WCG has a common equity ratio of 70% compared to the 52% equity weighting of SoCalGas and SDG&E. The fact that WCG common equity weighting is well above that of SoCalGas and SDG&E supports a lower return on common equity for WCG than the 8.5% being proposed.

Third, interest rates are currently much lower as compared to the interest rates that existed during WCG's last GRC. The Aa Utility bond rate was 6.18% in 2008 and 5.75 % in 2009 during the time of WCG's last GRC decision. The same interest rate for Aa Utility bonds is 3.91% for 2012 and is forecast to be 4.37% in 2013. The current interest rate figures are over 100 basis points below the interest rates in effect at the time of WCG's last GRC in which a rate of return on equity of 9.4% was adopted. This factor further supports DRA's proposed rate of return on equity of 8.5%.

4. Weighted Cost of Capital

DRA's recommended return on common equity produces a weighted cost of capital of 7.15%. Table 2-8 compares DRA's and WCG's TY2013 forecasts of Cost of Capital.

[15] See DRA's report served in response to A.12-04-015, http://www.dra.ca.gov/uploadedFiles/Content/Energy/Customer_Rates/Cost_of_Capital/Report%20on%20the%20Cost%20of%20Capital%20for%20Test%20Year%202013%20(Exhibit%20DRA-01).pdf

Table 2-8
2013 Cost of Capital for WCG

Description	DRA Recommended			WCG Proposed[16]		
Component (a)	***Ratio (b)***	***Rate (c)***	***Wtd. Cost (d=b*c)***	***Ratio (e)***	***Rate (f)***	***Wtd. Cost (g=e*f)***
Long-Term Debt	30.00%	4.00%	1.20%	30.00%	4.00%	1.20%
Common Equity	70.00%	8.50%	5.95%	70.00%	10.00%	7.00%
Total	100.00%		7.15%	100.00%		8.20%

VI. DISCUSSION / ANALYSIS OF ATTRITION

The General Rate Case (GRC) proceeding is used to periodically review and set reasonable rates for utilities for a specific test year, in this case, 2013. For the period between GRC proceedings, the Commission has, in some cases, granted attrition-type revenue increases and, in other cases, has not provided such increases.

A. Overview of WCG's Request

WCG requests to use the same attrition mechanism for attrition years 2014, 2015, and 2016 that was adopted in WCG's last GRC. Under these provisions, WCG must submit an annual advice letter with changes in the revenue requirement prior to the start of each attrition year. The attrition rate would be calculated based on a simple average of the forecasted changes in the Consumer Price Index ("CPI") as published by Data Resources Inc. and Global Insight in the month and on the day closest to July 1 of the year before the attrition year.[17]

B. DRA's Analysis

For this GRC, DRA does not oppose an attrition mechanism which will provide WCG with some reasonable level of revenue increases in 2014, 2015, and

[16] Prepared Direct Testimony of Raymond J. Czahar, CPA, on Behalf of West Coast Gas Company (dated May 1, 2012), pages 10-11.

[17] Prepared Direct Testimony of Raymond J. Czahar, CPA, on Behalf of West Coast Gas Company (dated May 1, 2012), pages 14-15.

2016. DRA recommends a similar attrition methodology as previously authorized in WCG's last rate case, but with one modification—that a productivity factor of 0.5% be factored in for attrition years 2014, 2015, and 2016.

DRA's recommended 0.5% productivity factor is consistent with DRA's approach in Sierra Pacific Power Company's[18] 2009 general rate case, in which the Commission authorized a Post Test Year Adjustment Mechanism (PTAM) mandating a 0.5% productivity factor be subtracted from the forecasted CPI.[19] Similarly, in Pacificorp's 2011 general rate case, the Commission adopted a PTAM that utilized an offsetting productivity factor of 0.5% or zero.[20]

WCG's annual attrition increase would be calculated by taking the prior year's authorized revenue requirement and multiplying it by an adjustment factor equal to the average of forecasted CPI from Global Insight and Data Resources, less 0.5%.

[18] Now known as the California Pacific Electric Company, or CalPeco.

[19] D.09-10-041, *mimeo.*, p. 9.

[20] D.10-09-010, *mimeo.*, 9-10.

VII. WITNESS QUALIFICATIONS

Q.1 Please state your name and business address.

A.1 My name is Eleanor M. Jaeger. My business address is 505 Van Ness Avenue, San Francisco, California 94102.

Q.2 By whom are you employed and in what capacity?

A.2 I am employed by the California Public Utilities Commission as a Public Utilities Regulatory Analyst in the Division of Ratepayer Advocates, Energy Cost of Service and Natural Gas Branch.

Q.3 Please describe briefly your educational background and work experience.

A.3 I have a B.S. in Environmental Economics and Policy from the University of California, Berkeley.

Since joining the Commission in May 2012, I have worked on Pacific Gas and Electric Company's (PG&E) Notice of Intent (NOI) to file a 2014 GRC.

Prior to joining the Commission, I interned as an International Trade Analyst with the United States Department of Commerce; my primary responsibilities included analyzing micro- and macro-economic changes in the clean technology market and connecting local clean-technology businesses to international markets.

Q.4 What is the purpose of your testimony in this proceeding?

A.4 I am responsible for Exhibit DRA-2, which addresses West Coast Gas Company's Operating Expenses, Uncollectibles, Cost of Capital, and Attrition.

Q.5 Does that complete your witness qualifications?

A.5 Yes, it does.