

Energy Division - California Public Utilities Commission
March 7, 2022 Data Request regarding 2022 SB 695 Report
IOU Recommendations to Limit Cost and Rate Increases

Southern California Gas Company Response, March 29, 2022

Introduction

Southern California Gas Company (SoCalGas) appreciates the opportunity to respond to the California Public Utilities Commission (CPUC or Commission) Energy Division in compliance with Public Utilities Code Section 913.1, which requires that the utilities to annually “study and report to the commission on measures that they recommend be undertaken to limit costs and rate increases.”

In Section I below, SoCalGas reports to the Commission on measures SoCalGas recommends should be undertaken to limit costs and rate increases for gas utility customers. At the request of Energy Division Staff, SoCalGas also addresses topics raised by Staff from the Affordability Rulemaking Phase 3 En Banc held February 28th and March 1, 2022.

A. Recommendations to the CPUC Opening Comments

California’s Energy Landscape is Changing and Rate Design Approaches and Policies Must Reflect These Circumstances.

The rapidly changing energy environment in California is emphasizing the need for a comprehensive and holistic focus on the fundamentals of the ratemaking process. The guiding principles needed to meet the State’s climate goals require balancing customer choice and economically efficient decisions at all levels, which are critical to determining affordable rates that benefit the energy system and all customers. A combination of equity, transparency, and comprehensive customer education are necessary for all ratepayers to have access to safe, reliable, and affordable resources in a sustainable energy market.

In ASPIRE 2045, SoCalGas expressed its climate commitment to achieve net zero greenhouse gas emissions in our operations and delivery of energy by 2045 consistent with the State’s decarbonization goals and requirements. To achieve the shared goal of carbon-neutrality will require transformative changes to the way Californians produce, deliver, and consume energy. As such, current rate design and cost allocation mechanisms will likewise need to evolve to support and enable an equitable and affordable energy transition – supporting our collective goals while maintaining bill stability and affordability for our customers.

It is unlikely that there is one single solution to the affordability issues that customers, the Commission, and the IOUs are facing today. There are measures that the Commission and state should take in the near term. First, SoCalGas recommends that the

Commission approve a higher fixed charge (than the current \$5 per month fixed charge) for all residential customers in its forthcoming Triennial Cost Allocation Proceeding (TCAP). This will be a step in the right direction to align rate design with decarbonization goals and gas industry transition. Second, SoCalGas supports the creation of a comprehensive gas planning framework that evaluates both challenges and opportunities related to the gas system that occurs in a transparent process with input from stakeholders. It is becoming increasingly clear that natural gas and clean fuels like biomethane and hydrogen, as well as carbon management will all be critical tools to support meeting California's ambitious mid-century carbon neutrality goal. The natural gas system and other gas corporation assets can play a central role in effectively enabling the energy transition. Establishing a framework to develop and advance an integrated approach that supports decarbonization investments alongside rate reforms and physical and financial modification to support energy system reliability, affordability and equity throughout the transition will be crucial and invaluable compared to addressing each of these issues independently. Additionally, while SoCalGas supports fact-based, informed, and cost-effective decarbonization initiatives, including electrification where and when appropriate, natural gas fuel substitution has not yet materialized in a meaningful way. It would thus be prudent to proceed in a measured manner when adopting any significant rate design changes to address a customer transition before the customer transition is actually observed at scale.

The Current Volumetric Rate Structure May Present Equity and Affordability Challenges through the Energy Transition.

The current volumetric residential gas rate structure prioritizes overall conservation as an emission reduction strategy through a tiered residential rate structure. Residential gas rates include an inverted tier structure where usage beyond a baseline threshold is charged at a higher volumetric rate. While in the most basic form this rate structure creates an economic incentive for conservation, the calculus around conservation and decarbonization is becoming increasingly complicated and energy rate design can significantly impact equity outcomes, especially as the energy system is in transition. The heavy reliance on volumetric rates to recover fixed utility costs can contribute to undesirable equity outcomes as customers fuel switch from natural gas appliances. As customers switch individual gas appliances to other energy sources, their revenue contribution towards gas system cost recovery will be disproportionately reduced compared to their continued use of the gas system for their remaining low usage gas appliances resulting in shifting fixed costs of the gas system to other gas customers. This risk is somewhat analogous to negative equity outcomes that have presented themselves for electric ratepayers as a result of behind-the-meter solar with net energy metering rate structures. Increasing fixed charges to better align with fixed costs can help manage this equity risk during the energy transition. As technology continues to advance, more innovative approaches to rate design may be needed to balance the interests of all ratepayers, including minimizing cost shifts to non-participating customers (e.g., customers who cannot or do not fuel switch gas appliances), and making sure that all customers are treated fairly. Additionally, the State should carefully consider the potential opportunities and changes to the decarbonization calculus that will arise as a result of the recently approved Renewable Gas Standard. This program

will help to facilitate both end-use GHG reductions for gas customers and upstream methane emissions from organic waste streams. However, the State must also consider the impact of SB 1440 and decarbonization of natural gas in the system may have on rates. This would include whether a higher fixed charge would affect affordability in light of increased rates from the use of renewable gas.

California is at a crucial turning point, and updating rate design priorities is critical to meeting long-term GHG emission reduction goals. Accordingly, the State should take this opportunity to carefully re-examine current rate design principles through the lens of California's future goals and consider which rate design principles may need updating to reach GHG emission reduction goals while maintaining system reliability, equity, and affordability.

1. Provide recommendations for the CPUC and Legislature to help minimize rate increases in the future

SoCalGas submits the following recommendations for minimizing rate increases and supporting equitable rate outcomes into the future:

1. Implement an enhanced fixed charge that better aligns with fixed costs
2. Explore mechanisms to recover gas system costs from new revenue sources (e.g., electric bill reliability surcharge, departing customer charge, and state general fund) if and as the gas customer base declines
3. Consider ratemaking and cost allocation policies that will re-allocate costs from small core customers to larger hard-to-electrify customers to reflect transition in gas system

As the interrelated gas and electric energy system in California continues to evolve, it will be critical to evaluate how energy rates will likewise need to be modified for ratepayers and which adjustments are appropriate to support desired outcomes. As core gas appliance electrification is explored as a tool for decarbonization, it will be critical to implement forward looking policies that prevent low income and vulnerable communities from being called to bear disproportionate costs for using the gas system or forced to adopt natural gas alternatives that offer less reliability, higher costs, and/or worse environmental impacts.

As discussed in the Opening Comments section of this response, gas system costs today are largely allocated to core customers which are recovered through volumetric rates. Without changes to current ratemaking policies, as gas demand for core customers declines, there will be growing rate pressure on remaining core customers. It is likely that gas customers who participate in fuel substitution will either:

- (a) replace one or more gas appliances but retain gas service to support at least one remaining appliance, such as, gas cooking, or

(b) fully fuel switch away from gas service altogether.

Customers in category (a), while continuing to pay for some use of the gas system, will have their gas service subsidized by gas system customers who do not participate in fuel substitution. Customers in category (b) will leave behind uncollected system costs altogether, which will be shifted to remaining gas system customers under the current cost allocation and rate design approach. Moreover, the gas grid provides reliability and resiliency attributes for integrated electric grid that inure to the benefit of customers in both categories. For instance, the gas system facilitates delivery of just-in-time fuel to meet the peak ramping needs of dispatchable electric generation that supports electric system reliability when renewables are otherwise unavailable. The gas system will also continue to provide benefit to these customers as a transportation mechanism for increasingly cleaner fuel sources such as renewable natural gas and hydrogen.

One option to address inequities driven by the transition of customers described in category (a) above can be to increase the fixed charge component of core bills to better align with fixed costs, as described in recommendation 1. Recommendations 2 and 3 can address inequities derived from either transition category and have the benefit of shifting recovery to longer-lived beneficiaries of the gas system – whether by increasing allocation to hard-to-electrify end-users, implementing more value-based rates for electric generators, or collecting revenue from a broader base of Californians who will all continue to benefit from the reliability, resiliency, and balancing services the gas system will provide to the State for the foreseeable future. All three recommendations can and should be pursued to manage ratepayer equity risks that may emerge over the long-term in California.

I. Assessment of Affordability Rulemaking Phase 3 En Banc Topics

SoCalGas provides the following comments on the requested topics drawn from the Affordability Rulemaking En Banc.

Implement an income-based fixed charge with the amount charged progressively increasing for higher income households.

As a preliminary matter, higher fixed charges create alignment between the fixed costs associated with operating the gas system to serve customers with the way customers pay for this service. As discussed previously, enhancing the fixed charge can mitigate future equity challenges associated with partial fuel substitution.

SoCalGas also believes there is merit in the concept of a progressive fixed charge that considers income levels, however, implementation of such a mechanism would be very challenging. A fixed charge stratified by income may enhance equity outcomes for customers while adhering to cost causation principle. While initial internal analysis has shown that even a single higher fixed charge with the current 20% CARE discount would result in better cost outcomes for remaining CARE customers as some customers undergo partial fuel switching, differentiation by income could further enhance these benefits for lower income customers.

In consideration of a higher fixed charge, SoCalGas recommends the Commission take into account the following factors:

- The composite tier methodology requires any revenues collected through a fixed charge to be put toward lowering the baseline rate. Therefore, implementing any level of fixed charge with the required composite tier will only provide rate relief to baseline rate and not to the non-baseline rate.
- Using cost-causation principles to derive fixed costs can yield a substantially higher fixed charge than the \$5/month currently used at SoCalGas. This should be weighed against potentially increased volumetric rates to understand the affordability impact of both rate design approaches.
- Customer privacy, implementation, and operational difficulties associated with the utility maintaining and verifying customer income data.
- Income does not always equate ability to pay.

As stated above, a fixed charge that varies by individual income would likely be extremely complicated to administer. The Commission should consider how income levels could be simplified to increase ease of administration and minimize implementation costs. Building off the current CARE discount structure could be easier to administer and be easier for customers to understand than implementing a new measure of income.

Currently, there is a structure in place for CARE customers (incomes 0-200% of Federal Poverty Guidelines) to receive a 20% effective discount. A structure that builds off the existing low-income programs could add additional stratification for middle-income customers.

For a rate design that is based on income, this will require a thoughtful approach to certification and verification. Currently, CARE customers self-certify that they qualify for the CARE program and there is a sampling process for post-enrollment verification and ongoing recertification. However, to administer a higher fixed charge based on income would likely require 100% verification to make certain that costs are allocated across classes equitably. Implementation of an income-based fixed charge would likely be fraught with customer privacy, California Consumer Privacy Act (CCPA) concerns and data collection and maintenance issues, to enable this income verification for all customers. If SoCalGas were required to verify incomes using annual tax filing data, it also has concerns about how to handle customers who do not file taxes, either in California or at all. Individuals and households with incomes below a certain threshold (likely the most vulnerable customers who are most in need of a discount on their utility bill) are not required to file taxes at all.¹ However, self-certification also comes with concerns. Customers could self-certify that they should be receiving a larger discount than they actually should, which could harm those customers who actually qualify.

Finally, income is not always indicative of wealth and ability to pay. There are cases in which wealthier households have low incomes, in which case the household would qualify for a larger discount than is desirable from a societal equity perspective.

¹ <https://www.ftb.ca.gov/file/personal/do-you-need-to-file.html>

Implement a percent of income payment plan program (PIPP) at scale, specifically commenting on potential sources of non-ratepayer funds to fund a full-scale program.

SoCalGas recommends that the Commission first learn from the current PIPP pilot programs that are beginning implementation to better understand what may be possible and appropriate in this area.

On October 11, 2021, the CPUC issued D.21-10-012 directing PG&E, SCE, SoCalGas, and SDG&E to work with interested energy partners in their service territory to propose an implementation plan for a PIPP pilot program to reduce residential disconnections of electric and gas service. As directed by the Commission, the PIPP Pilot will set a participant's utility bill at an affordable percentage (4%) of income using Federal Poverty Guidelines (FPG). The Commission authorized a statewide enrollment cap of 15,000 CARE customers who have either been personally impacted by disconnections or live in an area heavily impacted by disconnections. SoCalGas's PIPP Pilot enrollment cap is 5,000 customers. This will be a 4-year pilot and will include a 3rd party evaluation to determine success and inform decisions around the pilot becoming a full program.

Move wildfire mitigation costs to the General Fund.

SoCalGas does not have a position on this issue.

Reduce IOUs' authorized Return on Equity.

SoCalGas submits that arbitrarily lowering any IOU's authorized Return on Equity (ROE) is not a necessary or prudent means to promote affordability of energy rates, especially given the standard the CPUC considers for setting a fair rate of return.² The authorized ROEs are intended to reflect the company's business, financial, and regulatory risks, so that it can maintain a healthy credit rating (keep borrowing costs low), compete for and attract investment capital, and perform its duties for customers in a safe and reliable manner. Lowering SoCalGas' ROE would likely have a detrimental impact on the Company's credit rating and ability to raise capital at a time when significant investment is needed to facilitate a safe and reliable transition to the decarbonized future envisioned by the State.

If SoCalGas does not have the same access to low-cost capital that it has long had, ratepayers will feel the long-term impact of higher borrowing costs and constrained capital access. Utilities play a key role in helping the State meet its ambitious climate change and other environmental goals, while providing safe, reliable, and affordable service to customers. California's ability to meet targets in areas like renewable energy and other decarbonization investments are likely either diminish or get out of reach without its public utilities being financially healthy to attract the private capital necessary to invest in needed public infrastructure.

² D.19-12-056, mimeo, pp. 15-16, citing Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944) and Bluefield Water Works & Improvement Company v. Public Service Commission of the State of Virginia, 262 U.S. 679 (1923).

Reduce GRC phase I anchor bias through evaluation of required alternative scenario(s).

The Commission should not require utilities to include alternative scenarios, such as the Consumers Price Index (CPI)-constrained proposal suggested by The Utility Reform Network (TURN), in their GRC Phase 1 Applications. The Commission sets just and reasonable rates based on the well-established principle that a utility is entitled to recovery of its reasonably incurred costs and expenses, as well as an opportunity to earn a rate of return on the utilities' rate base. These core elements of the regulatory compact should not be artificially constrained by external values such as the CPI Index. Rather, they must continue to be based on the cost incurred and potential returns of similar investments with comparable risk that accurately reflect financial and market circumstances as discussed above.

If an approach along these lines is deemed necessary, revenue requests in GRCs should be reviewed using an index that accurately reflects utility costs, not a generic CPI. Utilities already incorporate current and forecasted economic conditions (e.g., inflation and escalation) specifically for utility costs (up or down) in their GRC proposals. Further, the Commission has recently and routinely rejected the use of CPI escalators in GRC ratemaking mechanisms as it is a broad wholesale pricing index that does not reflect how utilities incur costs. This is the same as a general inflation-constrained approach.

Lastly, a presentation of an inflation-constrained scenario in a utility GRC filing is procedurally improper. The utility, as the party with the burden of proof, has the discretion to present evidence supporting its own requests. A required inflation-constrained proposal would require the utility to provide information essentially on behalf of the intervenors.

Implement rate or infrastructure planning mechanisms to avoid excessive gas infrastructure costs falling disproportionately on residential customers who cannot electrify.

System planning that considers a longer-term view with a target for GHG emission reduction can help inform where least regret clean fuel investments on the gas grid can be prioritized and strategic electrification and decommissioning is optimal. Considering customer evolution, decarbonization needs and existing infrastructure characteristics when system planning will be necessary to optimize energy system costs, overall economic impacts, and financial, energy, and environmental equity and sustainability for the State. The gas system of the future should be optimized to maintain reliability and resiliency, while delivering the deepest GHG emission reductions at least cost.

It is important to note that the large majority of gas system investment today is directed towards safety and reliability. As greater parts of the economy electrify, there is an increased need for the gas system to provide reliability to the electric grid via just in time dispatchable fuel to accommodate renewable volatility (both the steep ramp up and ramp down) and long duration storage. The importance and value of this service, which is enjoyed by all energy system users (including electric-only customers), is forecasted to

grow, despite overall annual throughput decline in natural gas being used for electric generation.

This evolving utilization of the gas system will necessitate an update to gas cost allocation and rate design practices. Additional work is needed to make sure that gas rates for electric generators are reflective of the value the gas system provides, and that electric generators remain solvent as their capacity factors may decline while their intermittent value may increase. Moreover, if fixed charges are not increased to better align with fixed costs, customers who retain standard gas appliances will end up paying for a disproportionate amount of gas system costs compared to customers who partially electrify or otherwise fuel switch. This can have significant equity consequences if not addressed ahead of policies that will actively accelerate the transition. As discussed previously, additional mechanisms should be explored to recover fixed costs, including cost recovery from departing load customers and cost recovery structures that span beyond the utilities' traditional ratebase. Also, to better understand the impact of declining gas demand on affordability, more sophisticated scenario analysis around customer evolution is needed to inform cost causation and value-based principles— key underpinnings to efficient and equitable cost allocation and rate making.

II. Conclusion

SoCalGas appreciates the opportunity to provide these Comments and respectfully requests that the Commission carefully consider reforming gas rates, particularly with regards to volumetric pricing and fixed cost recovery, in the upcoming TCAP. It is also imperative to accelerate the implementation of an integrated gas system planning framework to develop and advance holistic policies that support decarbonization investments alongside rate reforms and physical and financial modifications. Establishing this framework is currently within the scope the Long-term Gas Planning OIR and should be given due consideration ahead of independently developing related policies. These actions will support reliability, affordability, equity, and sustainability throughout the energy transition.