Application of San Diego Gas & Electric Company (U902M) for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 2012.	A.10-12-005 (Filed December 15, 2010)
Application of Southern California Gas Company (U904G) for authority to update its gas revenue requirement and base rates effective on January 1, 2012.	A.10-12-006 (Filed December 15, 2010)

Application: A.10-12-006
Exhibit No.: SCG-211

PREPARED REBUTTAL TESTIMONY OF
HECTOR A. MADARIAGA
ON BEHALF OF SOUTHERN CALIFORNIA GAS COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

OCTOBER 2011

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PREPARED REBUTTAL TESTIMONY OF

HECTOR A. MADARIAGA

ON BEHALF OF SOUTHERN CALIFORNIA GAS COMPANY

I. INTRODUCTION

The following rebuttal testimony regarding Fleet Services addresses the intervener testimony dated September 2011 of:

- Division of Ratepayer Advocates ("DRA").

No other party challenged the forecast of Fleet Services. Accordingly, my testimony rebuts the following points:

- DRA did not acknowledge a single cost driver presented by Southern California Gas Company ("SCG") in its testimony, workpapers and data requests. Instead, DRA focused exclusively on generating lower forecasts;
- As part of DRA's adjustments process, DRA arbitrarily disconnects interrelated Ownership Costs (i.e., Amortization, Interest Expense, and Salvage Credits), which produces unrealistic and unsustainable results, to the detriment of funding a fleet necessary to service its customers and service territory; and
- DRA did not consider the regulatory and environmental mandates that SCG must comply with regarding its vehicles, thereby placing SCG at risk of fines and penalties for compliance failures.

II. OVERVIEW

DRA recommends that SCG's Test Year 2012 request of $50.691 million[1] be reduced to $43.240 million,[2] which is a $7.451 million reduction, and an amount that represents a $1.659 million increase from recorded 2009 levels. DRA's forecast does not constitute a more reasonable or supportable 2012 funding level than SCG's proposal. Further, DRA's proposed reduction to SCG's forecast will impair SCG's ability to effectively run its fleet operations and meet its compliance requirements in 2012. DRA focuses exclusively on mathematically deriving lower forecasts for several cost categories, and provides no explanation why SCG's analysis of its fleet operational needs or known cost drivers did not merit consideration. SCG needs adequate funding to its Fleet Services organization, which serves a vital function directly related to SCG's ability to perform its day-to-day operations to serve its vast service territory, respond to customer calls, and provide timely response to emergency situations. DRA cannot expect to propose funding cuts in this area while expecting no corresponding impacts to service.

III. NON-SHARED SERVICES

A. Cost Centers 2FS005.001, 2FS005.002, 2FS005.003, and 2FS005.004 – Ownership Costs

DRA proposes no reduction to two of the four cost centers under the Ownership Costs non-shared services category: Salvage Credits and License Fees. However, DRA proposes reductions to Amortization (2FS005.001) and Interest Expense (2FS005.002), for a total disallowance of $2.862 million. DRA uses a 3-year average for forecast Amortization,

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[1] See Exhibit SCG-11-R, p. HM-6.
[2] See Exhibit DRA-20, p. 3.

and the 2010 recorded amount to forecast Interest Expense.[3] However, by reducing Amortization and Interest Expense forecasts yet adopting the Salvage forecast, DRA severs the relationship that exists among those three integrated components. This produces strange and unintended consequences whereby no new vehicles could be purchased, while vehicles required for day-to-day service would have to be sold. This would result in a depleted fleet, which would disrupt service to SCG's customers and impact operational safety and reliability, which is not a prudent or acceptable outcome. Each of DRA's positions on the interrelated Ownership Costs categories is discussed below.

1. Cost Center 2FS005.001 - Amortization Expense

SCG requests $17.732 million for 2012, an increase of $2.668 million compared to base year 2009.[4] SCG derived its forecast with the aid of a multi-year cash-flow forecasting model ("cash-flow model") which was also provided to DRA. However, DRA recommends a 2012 forecast of $15.698 million in 2012, an increase of $634K compared to base year 2009, using a 3-year (2008-2010) average.[5] SCG disputes DRA's assertion that a 3-year mathematical average provides an appropriate method to forecast future Amortization expense for new vehicles being acquired to replace old ones. DRA's testimony reveals it derived its forecast without the cash-flow model, which is a critical tool designed to properly integrate the relationships among the components of Ownership Costs (i.e., Amortization, Interest Expense, Salvage). DRA's forecast is therefore overly simplistic.

Moreover, had DRA based its forecast on 2010 recorded as it does for Interest Expense, the 2012 forecast would result in a $2.398 million increase over 2009 levels, which

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[3] See Id. at 11.
[4] See Exhibit SCG-11-R at HM-8.
[5] See Exhibit DRA-20 at 10.

is in line with SCG's forecast. Furthermore, DRA's methodology is arbitrary. For example, DRA accepts the forecast for vehicle Salvage proceeds (a 56% increase per the cash-flow model); however, that forecast directly correlates to an increase in Amortization and Interest Expense for new vehicles. DRA cannot accept one without the other.

As explained in direct testimony, Amortization expense includes paying lease financing costs for existing vehicles, plus the financing of vehicle replacements that involve a number of variables that change with each forecast year. Such variables include (1) the number of vehicles that require replacement, (2) the types of vehicles to be replaced (service trucks cost more than automobiles), (3) the length of each amortization term (which differs by type of vehicle), (4) manufacturer production and delivery schedules, and (5) the cost of money in the replacement year.[6] The 2008 financial crisis created turmoil in the automotive manufacturing industry, resulting in fewer light duty vehicles being replaced than normal; the replacement of heavy duty vehicles was delayed because of new emissions requirements imposed on diesel engine manufacturers; and interest rates were reduced to historic lows – all resulting in abnormal Ownership Costs in the 2008-2010 time period.

DRA's selection of forecasting based on 2008-2010 data disregards the circumstances described above. SCG's forecast more appropriately computes the annual cash-flow associated with Amortization expense by using its cash-flow modeling methodology.[7] Therefore, SCG's forecast is sound and will ensure adequate funding for its vehicle needs in 2012.

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[6] SCG-11, page HM-8.
[7] SCG-11, pages HM-7 though HM-9, and SCG-11-WP, pages 9 through 20.

2. Cost Center 2FS005.002 - Interest Expense

SCG requests $2.389 million in 2012, an increase of $1.396 million from 2009 levels.[8] SCG's forecast was derived using its cash-flow model. DRA recommends a 2012 forecast based on the 2010 recorded amount of $1.561 million, an increase of $568K compared to base year 2009.[9] DRA's use of 2010 data to forecast Interest Expense versus a 3-year average it uses to forecast Amortization further demonstrates that the interrelationship among Amortization, Interest Expense, and Salvage was not considered.

For vehicles being lease financed, interest expense results from the multiplication of two variables: (1) the unpaid remaining balance due (including the acquisition cost of new vehicles placed in service during the year), and (2) the applicable interest rate in effect during each payment month. With both variables changing each month, historical interest expense is not a predictor of future interest expense, which is the reason why SCG used a non-standard cash-flow forecast methodology to prepare its 2012 estimate. This methodology produces a reasonable outcome, whereby DRA backs into its proposed methodology based on a desired result (i.e., a lower forecast).

3. Cost Center 2FS005.003 - Salvage Credits

As mentioned earlier, DRA does not dispute SCG's forecast for Salvage Credits. SCG's forecast of $1.180 million credit was also derived using its cash-flow model. However, DRA cannot accept this one output from the cash-flow model without accepting the other outputs for Amortization and Interest Expense. Salvage Credits should only be adopted as part of an integrated analysis. Therefore, DRA's acceptance of the Salvage

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[8] See Exhibit SCG-11-R at HM-8.
[9] See Exhibit DRA-20 at 10.

forecast cannot be reconciled with its rejection of SCG's forecasts for Amortization and Interest Expense.

B. Cost Centers 2FS002.000, 2FS002.001, and 2FS002.002 - Maintenance Operations

1. Cost Center 2FS002.000 - Maintenance & Repair Services

SCG requests $12.882 million for 2012, an increase of $1.311 million over base year 2009, reflecting the 2009 recorded amount plus full time equivalent ("FTE") additions required to meet new emissions reduction regulations.[10] DRA recommended $11.325 million for 2012, a reduction of $246K from base year 2009 recorded, using a 3-year average.[11]

However, DRA's methodology does not take into account a critical known cost driver which was raised in testimony: regulatory compliance with emissions reduction requirements from the California Air Resources Board ("CARB").[12] Technicians must be trained and certified to perform maintenance on new particulate trap and selective catalytic reduction systems that have been mandated for installation on all diesel-powered vehicles by CARB. These additional expenses are borne from a 2007 mandate under Title 13, California Code of Regulations[13] that phases in compliance from 2008-2013, making a 3-year historical average based on 2008-2010 data incomplete for this activity. Both labor and non-labor costs associated with maintaining this new equipment will increase annually through the completion of the phase-in period for vehicle replacements and retrofits, and the prospect of spending less to maintain this equipment than was spent in the base year before

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[10] See Exhibit SCG-11-R at HM-10 and Exhibit SCG-11-WP, pp. 37 and 43.
[11] See Exhibit DRA-20 at 10.
[12] See Exhibit SCG-11-R at HM-11.
[13] See CA Code Sections 2020, 2022 and 2022.1.

these regulations were fully in effect, is simply not feasible. SCG's methodology appropriately reflects this known compliance cost increase in its forecast, therefore, produces a more reasonable forecast for 2012.

2. Cost Center 2FS002.002 - ATCM Diesel Engine Retrofits

SCG requests $3.510 million for 2012, an increase of $1.913 million over base year 2009, reflecting the actual vehicles requiring retrofit in 2012 pursuant to the Airborne Toxic Control Measure ("ATCM") regulations described in my direct testimony.[14] DRA recommends $745K for 2012, a reduction of $852K from base year 2009 recorded, using a 3-year average.[15]

SCG explains in its testimony and workpapers that engine retrofit costs in each year calculated based on the number of vehicles that must undergo retrofit each year (which is mandated), multiplied by the cost per retrofit according to the type of retrofit mandated for a particular vehicle.[16] A zero-based forecast is the only reasonable method that can be used to project these costs. Historical costs in this area are not a reliable indicator of future retrofitting activities since retrofits are driven by particular vehicle type and expected dates for when those vehicles are up for mandatory retrofitting. SCG's forecast was developed with these known cost drivers, whereas DRA's forecast provides no such acknowledgement of these incremental expenses which can be calculated based on vehicle data.

Failure on the part of SCG to perform mandatory retrofits would subject SCG to fines and penalties as specified in Health and Safety Code Section 39674 (reproduced in Attachment 1). DRA's proposed adjustment significantly underfunds costs needed to meet

[14] See Exhibit SCG-11-R at HM-10.
[15] See Exhibit DRA-20 at 10.
[16] See Exhibit SCG-11-R at HM-11 and Exhibit SCG-11-WP at 56.

the requirements set forth by the Health and Safety Code. SCG's forecasts are therefore more reasonable and prudent and should be adopted.

3. Cost Center 2FS003.000 - Maintenance Management

SCG requests $1.223 million for 2012, an increase of $191K over base year 2009, using a 5-year linear forecast,[17] while DRA recommends the 2010 recorded total of $1.015 million for 2012, a decrease of $17K from 2009 authorized levels.[18] DRA's own Table 20-9 displays a readily-observable cost trend in this cost center,[19] which supports SCG's linear forecast.

SCG's testimony and workpapers show that additional technicians are needed in SCG's garage supervision and support to institute training and tools needed to keep pace with technological changes in vehicle maintenance and emissions monitoring associated with its vehicles, including hybrid and alternative fuel vehicles.[20] Without any indication that DRA disputes the need for an adequately-staffed and resourced Maintenance Management function within Fleet Services, SCG requests that its forecast be adopted, as it better reflects the needs for this cost area.

IV. SHARED SERVICES

1. Cost Center 2200-2148.000 - Director, Fleet Services

SCG requests $353K in 2012,[21] using base year 2009 costs $268K with a labor adjustment adder of $85K.[22] DRA recommends $188K in 2012, a decrease of $80K compared to base year 2009, using a 3-year average (2008 to 2010).[23]

[17] See Id. at HM-12 and Id. at 59.
[18] See Exhibit DRA-20 at 10.
[19] See Id.
[20] See Exhibit SCG-11-R at HM-10 and Exhibit SCG-11-WP at 39 and 43.
[21] See Id. at HM-18.

DRA uses an incorrect 2010 recorded labor amount in its calculation. The correct 2010 adjusted labor expense, which was provided to DRA, is $495K, not the $295K shown in DRA's testimony[24] and workpapers. Therefore, DRA's use of 2010 data in its 3-year average results in a significantly lower outcome. Notwithstanding this error, DRA did not factor in the known incremental need for an additional natural gas vehicle engineer in 2011, as presented in SCG's workpapers.[25] SCG's forecast, which proposes to keep 2009 authorized funding unchanged, but accounts for its incremental need, is a more reasonable and accurate forecast of its actual 2012 needs in this area.

2. Cost Center 2200-0802.000 - Asset Management

SCG requests $276K in 2012,[26] using base year 2009 of $176K with an adder of $100K.[27] DRA recommends $173K in 2012, a decrease of $3K to base year 2009, using a 3-year average (2008 to 2010).

DRA did not factor the known incremental need for a vehicle technology project manager position, as presented in workpapers, to perform evaluation and establish strategic planning addressing the impact of changing technologies on the fleet mix at both utilities.[28] DRA's forecast and SCG's starting point of base year 2009 recorded yield approximately the same amount; therefore, the incremental need for an added position better reflects SCG's actual need in 2012.

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[22] See Id. at HM-17 and Exhibit SCG-11-WP at 77.
[23] See Exhibit DRA-20 at 13.
[24] See Id.
[25] See Exhibit SCG-11-WP at 77.
[26] See Exhibit SCG-11-R at HM-15.
[27] See SCG-11-WP at 85 and 89.
[28] See Id. at 89.

V. SUMMARY AND CONCLUSION

Fleet Services is an integral part of SCG's ability to provide service to its customers and respond to routine as well as emergency situations. SCG's forecasts were developed using reasonable forecasts, known cost drivers, and a cash-flow model which were all subject to review during a 9-month period since the GRC Application was filed (and over 12 months since the Notice of Intent was tendered). However, DRA focuses primarily on deriving lower 2012 forecasts without giving any consideration to forecasted operational needs or known cost drivers. DRA's reductions therefore leave this vital utility service function vulnerable to the effects of underfunding, which directly impacts the company's ability to provide operational and customer service and to meet its compliance obligations. Therefore, SCG should be granted its full funding request to ensure against these impacts.

This concludes my prepared rebuttal testimony.

ATTACHMENT 1

CALIFORNIA HEALTH AND SAFETY CODE §39674

39674. (a) Except as otherwise provided in subdivision (b), any person who violates any rule or regulation, emission limitation, or permit condition adopted pursuant to Section 39659 or Article 4 (commencing with Section 39665) or which is implemented and enforced as authorized by subdivision (b) of Section 39658 is strictly liable for a civil penalty not to exceed one thousand dollars ($1,000) for each day in which the violation occurs. (b) (1) Any person who violates any rule or regulation, emission limitation, permit condition, order fee requirement, filing requirement, duty to allow or carry out inspection or monitoring activities, or duty to allow entry for which delegation or approval of implementation and enforcement authority has been obtained pursuant to subdivision (l) of Section 112 of the Clean Air Act (42 U.S.C. Section 7412(l)) or the regulations adopted pursuant thereto, adopted pursuant to Section 39659 or Article 4 (commencing with Section 39665) or which is implemented and enforced as authorized by subdivision (b) of Section 39658 is strictly liable for a civil penalty not to exceed ten thousand dollars ($10,000) for each day in which the violation occurs.