Decision No. C03-0899

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 02S-574G

RE: THE INVESTIGATION AND SUSPENSION OF TARIFF SHEETS FILED BY PUBLIC SERVICE COMPANY OF COLORADO WITH ADVICE LETTER NO. 598-GAS.

COMMISSION ORDER GRANTING PROPOSED LINE EXTENSION POLICY WITH MODIFICATIONS

Mailed Date: August 13, 2003
Adopted Date: July 23, 2003

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I. BY THE COMMISSION

A. Statement

1. This matter comes before the Colorado Public Utilities Commission (Commission) on Advice Letter No. 598-Gas, filed by Public Service Company of Colorado (Public Service or Company). According to Public Service, the purpose of the filing was to revise the Service Lateral Extension and Distribution Main Extension Policy in its P.U.C. No. 6 - Gas Tariff in response to Commission Decision No. C02-417. In the Advice Letter filing, Public Service proposed a new revenue-based gas construction allowance to replace the gross-embedded investment methodology it had utilized since 1983.

2. According to Public Service, under a revenue-based approach, the Construction Allowance (CA) is calculated based on the level of revenue it expects to receive from a new load or customer to its system. Public Service explains that an applicant pays a construction payment equal to the cost to construct the minimum system necessary to serve that customer less the applicable CA.

3. Public Service represents that it advocates the revenue-based CA because it provides a better price signal than its current average embedded cost methodology. Public Service explains that the revenue-based approach establishes the amount of investment that it should be willing to invest today based on the revenue it expects to receive from a new customer over the economic life of the facilities installed. As a result, Public Service maintains that the construction cost assessed to an applicant, in excess of the CA, would reflect the incremental

cost incurred by Public Service to serve that customer above the cost it will recover through the monthly rates the new customer pays for gas service.

4. Public Service also proposes to continue separating the gas CA into two parts: one applicable to the service lateral portion, and the other applicable to the distribution main portion of the new extension. According to Public Service, by bifurcating the CA this way, it can ensure that only an appropriate level of investment is distributed over time between service laterals and distribution mains.

5. Public Service further represented that it would avoid making additional investment in service laterals or distribution mains than the level that is currently supported by the revenues generated through the monthly Service and Facilities Charge, and through the Commodity Charge, respectively. By separating the CA into two parts on a going forward basis, Public Service asserts that the need to increase either the Service and Facilities Charge or the Commodity Charge to all customers in order to recover costs attributable to new growth should be avoided.

6. Finally, Public Service proposed to reduce the open extension period from ten years to three years. According to Public Service, this change reflects the Company's effort to shorten the open extension period to one that more closely reflects a reasonable planning horizon for new development.

II. PROCEDURAL HISTORY

7. This matter arose from our Decision No. C02-417 in combined Docket Nos. 01S-365G and 01S-404G, dealing with Public Service's Advice Letter Nos. 579 and 581. In Advice Letter No. 579, filed on July 23, 2001, Public Service updated and revised its Gas Construction

Allowance. This filing was made in compliance with our Decision No. C01-738, issued July 18, 2001, which required Public Service to file its revised and updated Gas Construction Allowance tariff by July 23, 2001. The updated CA in Advice Letter No. 579-Gas was computed in accordance with the existing gross embedded investment cost per customer method based on the cost allocation study approved by the Commission in Docket No. 99S-609G, which was Public Service's most recent rate case at that time.

8. On August 17, 2001, Public Service filed Advice Letter No. 581-Gas, proposing revisions to the Gas Extension Policy and adjustments to the CA that superceded Advice Letter No. 579-Gas. Advice Letter No. 581-Gas proposed to split the CA into a portion allocable to the service lateral part of the new extension and the other portion to the distribution main part of the extension. At that time, the residential CA, dating from October 1, 1995, was $360. Public Service proposed that the service lateral portion of the CA be set at $215, and the distribution main portion at $200. Public Service proposed to reduce the Distribution Main portion of the CA, calculated using the gross-embedded investment methodology, by a 22 percent adjustment factor, which, according to Public Service, reflected the average cost of new distribution facilities attributable to new growth, but which was not recovered from new customers under the existing Extension Policy. Public Service also proposed to eliminate the requirement for an annual update to the CA. Instead, Public Service sought to file an update to the CA within 30 days following the conclusion of a Phase II rate proceeding for the gas department.

9. The Colorado Office of Consumer Counsel (OCC), the Home Builders Association of Metropolitan Denver (HBA), and the Staff of the Commission (Staff) intervened in the matter.

10. As alternatives to Public Service's proposed CA methodology, Staff and HBA proposed their own CA methodologies. In Decision No. C02-417, we found that none of the CA methodologies presented merited adoption as a permanent methodology for the near future. As a result, we endorsed the proposal made by HBA and, in rebuttal testimony, agreed to by Public Service, that all interested parties work together to arrive at consensus concerning the approach to use in calculating the CA in the future. We also adopted Public Service's recommendation that September 30, 2002, be set as the date by which either a consensus filing or a unilateral filing by Public Service be made, in either case reflecting the outcome of the additional investigations. If consensus was not achieved, we directed Public Service to file its own proposal.

11. We urged the parties to seriously consider a revenue-based methodology for the CA calculations. We also instructed the parties to address several issues raised by HBA and Staff in Docket Nos. 01S-365G and 01S-404G. Those issues include: a) whether Public Service should use a revenue-based approach to compute its CA; b) whether Public Service should be required to track "pre-built" distribution mains just as it does open extensions; c) whether Public Service should use net instead of gross embedded investment in the CA computation; d) whether Public Service should apply a tax factor to arrive at the gross amount of construction payment for use in the CA computation; and e) whether Public Service should true-up construction estimates after the construction is completed. We further instructed the parties to pursue any other issues that they find relevant and to incorporate them into forthcoming filings as well.

12. Although we found Public Service's methodology of applying a 22 percent factor as an *ad hoc* methodology, we nonetheless allowed Public Service to utilize the residential CA of $415 (which was based on this 22 percent factor) as an interim measure until the matter was resolved.

13. We approved the February 12, 2002 Stipulation entered into between Public Service and OCC as well. In that Stipulation OCC withdrew its opposition to the separate main and service lateral CAs as proposed by Public Service, in return for an agreement that Public Service would update its CA tariffs within 30 days of a final Commission decision in a cost allocation rate proceeding.

14. On September 30, 2002, Public Service filed Advice Letter No. 598-Gas, proposing a revenue-based gas CA to replace the gross-embedded investment methodology described above.

15. On December 26, 2002, we granted HBA's motion to intervene and recognized Staff's and OCC's notices of intervention of right in this matter.

16. By Decision No. C02-1481, issued on January 6, 2003, we adopted the proposed procedural schedule regarding the filing of testimony and exhibits, as well as the cut off dates for discovery. A hearing in the matter was set for May 21 and 22, 2003, and post-hearing Statements of Position were to be due on June 3, 2003.

17. On January 10, 2003, Decision No. C03-0024 was issued which granted Public Service's change of the effective date of Advice Letter No. 598-Gas to December 5, 2002, in order to give further time for investigation of the issues involved in this docket. This necessitated the modification of the suspension period to April 4, 2003.

18. By Decision No. C03-0305, we suspended the effective date of Advice Letter No. 598-Gas an additional 90 days to July 7, 2003.

19. On June 12, 2003, we issued Decision No. C03-0643, which granted Public Service's motion to further extend the effective date of Advice Letter No. 598-Gas to January 20, 2003, and extended the filing date of Statements of Position in this matter to June 27, 2003. This required us to extend the suspension period to August 18, 2003.

III. DISCUSSION

A. Forum to Address the CA Issue

20. Staff raised the issue of whether this docket was the appropriate forum to decide the issues at hand. Staff first recommends that the issues be addressed in a Phase II rate proceeding. Staff argues that changing to Public Service's proposed revenue-based approach would result in improper piece-meal ratemaking. Alternately, Staff advocates addressing the matter in a rulemaking proceeding, where the resulting CA method would apply to all gas utilities.

21. HBA responds that this docket is the proper forum in which to address the issues. HBA states that there is no impediment to the Commission deciding the structure of the CA in this docket, and another case is not warranted.

22. We agree with HBA that this is the proper forum to address the CA and related issues. As discussed below, the CA amounts resulting from this proceeding are based on the outcome of Public Service's most recent rate proceeding, and do not result in piece-meal ratemaking. Further, the specific facts and circumstances of Public Service's CA can best be addressed in this proceeding rather than in a rulemaking that is applicable to all utilities.

B. Method Used to Determine the CA Amount

23. Public Service asserts that the principal goals of an extension policy should be: 1) to compensate the utility for its investment in facilities; 2) to promote equity between new and existing customers, and between customer classes; and 3) to perform a rationing function so that the decision to extend gas service is economically rational. As a result, Public Service proposes a revenue-based approach to replace its current embedded plant-based method of calculating a CA. This revenue-based method calculates the net revenue stream that would be received from an average customer[1] over a specified number of years under current rates, and applies a discount rate to calculate a present value dollar amount, which is the CA. This CA amount is the portion of the main and service lateral costs that the Company will pay for each new customer. The customer must then pay all additional costs. Public Service proposes to remove O&M and A&G from the calculation, and changes several other terms with respect to the current method, as discussed in separate issues below. Under Public Service's proposed method, the residential CA would be slightly higher than the current residential CA level of $415.

24. Staff proposed an average net Embedded Investment approach. This is essentially the same as the current gross embedded approach, except that average net plant per customer is used instead of average gross embedded plant per customer. Staff's proposal would result in a residential CA that is lower than the current $415. Alternately, Staff recommends that Public Service could continue the current gross embedded plant method, with a factor for pre-built plant and a requirement that Public Service change its practices to track and use actual construction costs for the actual configuration and gross-up customer advances for taxes.[2] Staff argues that

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[1] The CA for transportation, interruptible, and small commercial main is calculated on a per-decatherm basis.

[2] These issues are discussed as separate issues, below.

the current gross embedded plant approach meets the three objectives listed by Public Service and is not affected by parameters such as rate riders, interest rate, and average customer consumption. Staff maintains that a revenue-based approach is "promotional" (*i.e.,* it promotes the connection of additional customers through a higher CA) and will result in more frequent rate increases. Staff does concede however, that Public Service's approach is better than the previously used method of 1 ½ times gross revenue. If we adopt Public Service's revenue-based approach, Staff recommends that we also adopt Staff's modifications including the rejection of cash-flows from depreciation and an annual update to the CA.[3]

25. OCC states that it does not object to Public Service's revenue-based CA, albeit with three modifications: 1) include pre-built plant; 2) reject Public Service's proposed decrease in refund period from ten to three years; and 3) revise the CA to reflect the outcome of Public Service's rate case.[4] OCC states that the CA policy should treat new and existing customers equitably, and should treat new customers, as a group, equitably.

26. HBA disagrees with Staff's recommendation to continue a version of the current CA methodology. HBA also points out that Staff's proposed CA is lower than Public Service's current allowance, which is the lowest in the western U.S.

27. HBA criticizes Public Service's calculation of the CA because Public Service discounts the stream of future revenues incorrectly, uses average fully distributed costs instead of marginal costs, and uses average customer revenues instead of basing the CA on the characteristics of individual customers or at least individual housing developments. HBA does,

[3] These modifications are discussed as separate issues, below.
[4] These modifications are discussed as separate issues, below.

however, endorse the notion of moving from the gross embedded investment approach to a revenue-based approach. HBA proposes that the residential CA for distribution mains equal three times average non-gas, non-customer-related revenues, and that the residential CA for service laterals equal two times average annual non-gas customer-related revenues. Initially these multipliers are to be applied to average (*i.e.,* flat rate) customer revenue levels. Ultimately, HBA intends that the multipliers be implemented as a variable rate, applied to estimated revenues from individual applicants, or estimated average revenues per housing unit in a development.[5] The present application of this methodology yields a residential CA that is higher than the current CA, and higher than Public Service's proposed approach.

28. Public Service recommends that the Commission reject HBA's proposal to use marginal rather than average costs because doing so results in a high CA which, in turn, benefits new customers only. On the other hand, basing the CA on average cost ratemaking principles enables both old and new customers, through the rate case process, to benefit from marginal costs being lower than average.

29. Staff disagrees with HBA's proposal concerning the use of marginal cost in Public Service's methodology, if it is adopted. Since rates (and hence revenues) are based on average embedded costs, Staff argues that a similar average cost analysis should be used for determining the CA. Staff believes that HBA's multiplier analysis is arbitrary, promotional, and violates the concept of growth paying its own way. Staff also indicates that HBA failed to propose a methodology for calculating CAs for classes other than residential.

[5] The flat rate versus variable rate application is discussed as a separate issue, below.

30. We agree with the three principal goals as stated by Public Service. Consistent with our discussion in Decision No. C02-0417, a CA should establish a fair amount of costs to be borne by the utility in connecting a new customer. This CA amount should not cause the existing customers to subsidize the connection of new customers (*i.e.*, the CA amount should not be so high as to cause rates to increase because the costs required to connect and serve the new customers exceed the expected revenues from the new customers). Conversely, the CA should not be used to insulate existing customers from future rate cases. For example, a certain amount of utility system work will likely be required with or without customer growth, and the CA should not be designed to charge all system enhancement costs to new customers in order to prevent rate increases to existing customers.

31. We find that the revenue-based method proposed by Public Service best meets these objectives. First, Public Service's revenue based approach is more accurate than an embedded plant approach. The future revenue received from new and existing customers ultimately determines whether a CA provides an equitable cost responsibility for the new customer. The embedded plant approach appears to be a surrogate for a revenue-based approach, as a simplified measure that considers only one aspect of the rates and associated revenues. We disagree with Staff's assertion that any revenue-based approach is promotional, and find that Public Service's approach is more accurate than the embedded plant approach in computing a fair and equitable CA.

32. We find Public Service's approach to be more accurate than HBA's "times revenue" approach. While HBA's approach is simpler to implement, we agree with Staff that the CA proposed by HBA is promotional in nature. The method proposed by HBA appears to be designed to achieve significantly higher CA amounts for its own sake, largely because Public

Service's current CA rates are low compared to other utilities. We give this comparison little weight, as the CA should establish a utility cost for new connections that is equitable based on utility rates and associated revenues. The rates and considerations of other utilities are not at issue here, and the CA should be determined based on Public Service's rates.

33. Last, we agree with Public Service and Staff that HBA's marginal cost proposal should be rejected, even though we recognize that there could be a degree of merit to a marginal cost approach. For example, a utility does not require a new billing system to connect a new customer. Though Public Service incurs administrative costs to connect a customer, we find it likely that the costs that a new customer imposes on the system will be lower than the average cost of existing customers. While in theory an incremental approach could better represent actual costs of serving the new customers, the complexities and uncertainties associated with an incremental approach outweigh any possible benefits. Therefore, we direct Public Service to implement a CA based on average costs.

34. Therefore, we adopt Public Service's CA method as proposed in its rebuttal testimony.

C. Description of Method in Tariffs

35. Staff recommends that the Commission require Public Service to explicitly indicate the CA methodology in its tariffs. Staff points out that Public Service did not propose tariffs with the method described, though current tariffs contain a description.

36. We agree with Staff that Public Service should establish its CA method in its tariffs. By documenting the CA method in its tariffs now, it will likely save time and effort in the

future. We therefore direct Public Service to file tariffs that provide a detailed description of the CA method within 60 days after a final decision in this docket.[6]

D. Timing of CA Recalculation

37. Public Service proposes that it file a new CA within 30 days of a final order in either a Phase I or Phase II rate case. HBA agrees with this proposal. Staff also agrees but provides two caveats to the proposal: 1) that language be inserted into the tariff so that the filing is not strictly limited to a 30-day window; and 2) that Public Service be required to file an annual recalculation of the CA regardless of whether or not a Phase I or Phase II rate case has been completed during that time. To justify the first amendment, Staff observes that, without such language, the Commission has no flexibility in the matter because it cannot waive tariff requirements. Concerning the annual recalculation of the CA, Staff argues that variables such as interest rates and tax rates that have an impact on the CA can be expected to change during the course of a year, so the CA should be adjusted to reflect those changes. In cross-answer and rebuttal testimony, respectively, HBA and Public Service criticize the idea of recalculating the CA on an annual basis because doing so would be complex and contentious, involving the estimation of numerous elements from a Phase I and Phase II rate case.

38. We agree that the CA should be revised 30 days after a final order in either a Phase I or Phase II rate case. We believe that the CA and Public Service's rates should correspond over time so that, when rates change, as they do at the end of a Phase I or Phase II rate case, the CA should be revised as well. For the same reason, we reject Staff's

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[6] We recognize that there may be disagreement over the description of the CA methodology we adopt in this decision. For this reason we encourage Public Service to work with the parties to achieve agreement on the language prior to filing the tariff

recommendation of an annual recalculation of the CA absent a rate case. While we agree that variables may change which could impact the CA (and rates), when rates remain fixed, the CA should also. We also find that the language proposed by Staff ("or within such period of time as ordered by the Commission") should be included in the tariff to provide flexibility in the event the 30-day window is not practical in some specific instances.

E. Depreciation in the Discounted Cash Flow Analysis

39. In its discounted cash flow analysis mechanism, after subtracting expenses from revenues, Public Service subtracts tax depreciation to arrive at net profits before taxes. It then subtracts taxes to compute net profits after taxes. Finally, it adds back in tax depreciation to obtain operating cash flows. Staff argues that it is inappropriate to add back in tax depreciation. It observes that the revenue requirement and, consequently, rates are based on net plant, *i.e.*, gross plant minus depreciation, so that, in order to keep the CA comparable, it should be based upon a discounted cash flow analysis that does not include depreciation. HBA, on the other hand, agrees with Public Service's approach.

40. We adopt Public Service's approach. We find that Staff has incorrectly concluded that the revenue requirements and the discounted cash flow analyses must treat depreciation in the same way. Further, we determine that Public Service's inclusion of depreciation in its cash flow analysis is the standard procedure used in financial accounting. Discounted cash flow analyses are intended to reflect, and accordingly discount, the actual flow of monies. Since depreciation creates residual cash flows,[7] they are properly included in a cash flow analysis. To

[7] Although depreciation expense is claimed for both financial and income tax reporting purposes, no actual expenditures are made by a company. Instead the depreciation expense acts to reduce the income upon which taxes are calculated. Thus, in effect, depreciation creates a cash flow for a company.

ignore depreciation expense in an analysis would overstate income tax expense and understate the after-tax cash flows.

F. Depreciation Lives

41. In its direct testimony, Public Service initially bases its discounted cash flow analysis on 40-year book[8] depreciation lives for both service laterals and distribution mains. HBA agrees with this approach. Staff, however, contends that these lives are too long. It observes that the general industry rule of thumb is for 30-year plant lives. Moreover it argues that Public Service has introduced an inappropriate mismatch by using 40-year book lives in its discounted cash flow analysis but only 20-year lives for tax depreciation purposes. Public Service responds by observing that there are no adverse consequences of relying upon a 40-year discounted cash flow model while using a 20-year tax depreciation. According to Public Service, it is often standard practice to set tax depreciation lives lower than accounting book lives. In addition, Public Service proposes to replace its original 40-year book lives with those adopted in the last gas rate case, namely, 50-year book lives for service laterals and 65-year book lives for distribution mains.

42. We find Public Service's revised position compelling. We recognize that there is no necessity for equating the lives used in the discounted cash flow analysis with those used for tax depreciation purposes. Moreover, we believe that the book lives from the last gas rate case (50 years for service laterals and 65 years for distribution mains) are the appropriate lives to be

[8] By the term "book" the Commission is drawing the distinction between financial items which impact what is reported on a company's financial statements and those financial items which impact what is reported on a company's income tax return.

employed in Public Service's discounted cash flow analysis because they have been reflected in current gas rates.

G. Discounting Method

43. Public Service, in its direct testimony, discounts every year of operating cash flows, including the first. HBA criticizes this approach, arguing that since the CA is not paid to the customer until after the meter is set and revenues start to flow, discounting should begin with operating cash flows in the second year, not the first. Public Service responds by proposing a mid-year discounting procedure to take into account that cash flows occur throughout the year.

44. We adopt Public Service's compromise mid-year discounting, offered in its rebuttal testimony. We find this approach to be reasonable to address when discounting should begin. Public Service's initial position implicitly assumes that all cash flows are received at the end of each year. HBA's position, on the other hand, implicitly assumes that all cash flows are received at the beginning of the year. We find neither of these assumptions correct since cash flows occur throughout the year. Moreover, the errors of either method are always in the same direction, introducing a consistent bias in the analysis. We also find the mid-year discounting convention to be arbitrary to the extent that it assumes all cash flows occur in the middle of the year. However, since some cash flows are received earlier and some later, the errors tend to cancel each other out, making this approach a better estimate of reality than the others.

H. Flat-Rate Versus Variable-Rate CA

45. Public Service proposes using a flat-rate CA that incorporates a fixed dollar amount per customer for the residential CA for both service laterals and distribution mains and for the commercial CA for service laterals. On the other hand, it proposes a variable-rate CA which is based on decatherm usage for the commercial CA for distribution mains and for the CA

for both service laterals and distribution mains for the interruptible gas, transportation firm, and transportation interruptible classes. Staff recommends a flat-rate CA for all service laterals. It argues that Earnings Before Interest, Taxes, Depreciation and Amortization upon which the CA is based, is developed on a per-customer basis so that the conversion to a decatherm basis for the large commercial and industrial classes is unnecessary. HBA requests that the Commission require Public Service to conduct research into individuals' gas usage patterns so that eventually the residential CA can be de-averaged down to the level of the individual customer or, at least, the individual housing development. Public Service opposes these suggestions. It contends that the large commercial and industrial classes are, relatively speaking, less homogeneous than the residential class, so that it is reasonable to base CA for the former classes on usage. Furthermore, the relative homogeneity of the residential class suggests that differences in usage within it are probably not substantial enough to warrant Public Service incurring the cost of an elaborate usage study of that class, as HBA proposes.[9]

46. As such, we adopt Public Service's choice of flat-rate versus variable-rate CA. We find the residential and, to a lesser extent, the small commercial class to be relatively homogeneous, a finding which warrants the use of a flat-rate CA. The other rate classes are sufficiently heterogeneous, however, that a usage-based CA is appropriate. Finally, we do not require Public Service to initiate a study into residential gas usage patterns since any benefits from de-averaging the residential CA would be outweighed by the cost of the study for the reasons indicated by Public Service.

[9] In addition to the differences not being as substantial for the residential class as they would be for the other classes, they are apt to be more difficult to predict as well. For example, just because a home is designed to accommodate certain gas appliances, this does not necessarily mean that they will actually be installed and used.

I. Refund Period

47. The first new gas customer into an area can later receive refunds from other, new gas customers who subsequently attach to the system and use some of the main capacity initially paid for by the original new customer. Currently, the time period over which such refunds may be paid is ten years. Public Service proposes that this time period be reduced to 3 years as this would encourage development to fill in more quickly, as well as reduce the administrative costs of managing the refund process. HBA and Staff both argue that the ten-year time period should be retained since shortening it will result in some potential refund payments not being realized. OCC prefers retaining the ten-year time period also, but is willing to compromise on seven years. Public Service responds to these alternatives by offering five years as a balance between administrative costs and developer interests.

48. We believe that the ten-year time period for refunds should be retained. Relying on the historical data introduced in this case, it is only after ten years that we can be confident that all potential refunds have been paid; therefore, it would not be desirable to truncate the process before then. In addition, since Public Service has indicated that it is transforming the refund process from a manual to a computerized operation, we find that future administrative costs in this area will likely be more manageable.[10] Finally, requiring Public Service to continue to administer the refund program for the entire ten years provides it with an incentive to execute the program efficiently.

[10] It should be noted that such costs are typically recoverable in a rate case anyway.

J. Tax Gross-Up of Customer Contributions

49. Public Service does not gross-up customer contributions for taxes, arguing in general that doing so would be complicated and burdensome. Specifically, Public Service maintains that to do so would require it to estimate its tax liability; to establish and maintain a separate deferred account; to determine the precise timing of tax payments; to true-up the deferred account variances periodically; to include municipal taxes[11] as well as federal and state income taxes; and to track tax refunds as a part of the overall refund process. HBA agrees with this position and points out an additional complication, namely, that since the capital contributions depreciate over time the tax liability would have to be adjusted to reflect the depreciation. Staff, on the other hand, contends that Public Service should gross-up customer contributions for taxes. Since Public Service recognizes the tax effect in its discounted cash flow analysis, it should do so, according to Staff, with customer contributions as well. Moreover, Staff notes that several other gas utilities in Colorado gross-up for taxes on customer advances so it sees no reason why Public Service cannot accomplish this as well.

50. We will not require Public Service to gross-up customer contributions for taxes. We are persuaded by the arguments of Public Service and HBA that such a requirement would impose many additional costs and complexities on the Company (specific examples of which are outlined above) without generating corresponding benefits.

K. Pre-Built Plant, Actual Versus Estimated Construction Costs

51. Public Service proposes to continue to charge new customers based on “minimum system” cost estimates, which do not include any costs for the capacity needs of future

[11] The Company notes that since tax rates vary between municipalities, the Company would have to track these tax rates over time to ensure that an accurate repayment would occur.

customers, or for additional capacity that was installed in the past to meet the needs of the current applicant. This additional capacity is referred to as “pre-built plant.” Public Service then proposes to charge customers based on estimated costs with no true-up to actual costs, as the estimate is based on a minimum system whereas the actual construction may include pre-built plant.

52. Staff recommends that the Commission require Public Service to base its cost estimates on the actual configuration rather than on the minimum system. It argues that the current “minimum system” approach cannot be tracked because Public Service charges customers the minimum system cost but builds facilities that include pre-built plant. This discrepancy prevents a post-construction comparison in prudence reviews. Staff also argues that Public Service should not pre-build capacity in all situations. Further, Staff recommends that the Commission require Public Service to track and charge customers for actual construction costs.

53. OCC maintains that Public Service is not proposing to recover pre-built costs from customers using that capacity, likely triggering rate cases. It acknowledges that pre-building plant is sensible and provides lower costs in the long-run, but argues that Public Service’s approach will require all customers to subsidize growth. OCC recommends that the Commission require new customers to pay for all pre-built plant. It suggests three possible solutions: 1) assign the entire cost of the new project to the new customer; 2) estimate the cost of pre-built plant and charge it to the customers who use it; or 3) pool all pre-built plant costs and apply a surcharge to all new customers for five years. OCC recommends that the Commission require Public Service to determine and implement a method to assign pre-built plant costs that is as equitable as possible but not overly burdensome. OCC argues that precision is preferred, but not essential.

54. HBA recommends continuing the “minimum system” approach. HBA argues that Staff’s proposal to bill homebuilders for excess capacity built into an extension project is unfair and would encourage Public Service to build needless capacity as the customer would have to pay for all of it. HBA states that it unfairly burdens and places risk on new customers. Similarly, HBA recommends that OCC’s first option should be rejected. HBA states that Public Service should not be required to track pre-built investment (so long as it does not resubmit its proposal in the earlier docket which charged all new customers for pre-built plant based on a 22 percent CA adjustment factor). If necessary, Public Service should track pre-built plant costs and assign them to the new customers that use capacity, similar to the way Public Service tracks “open extensions.”

55. Public Service opposes the three OCC suggestions to assign the cost of pre-built plant. According to Public Service, the first suggestion, to assign all costs to a new customer, requires the new customer to pay for future growth that they do not cause. As such, Public Service concludes that OCC’s first option, as well as Staff’s recommendation, should be rejected. The second method of minimum system plus an estimate of pre-built plant used by the customer requires Public Service to track and allocate pre-built costs to new customers. Public Service argues that the total cost to develop and administer the tracking system outweighs its benefits. The third method, to pool costs and charge a surcharge for five years, has the same problems as the second, and is piecemeal ratemaking, according to Public Service. Further, the Commission rejected Public Service’s previous proposal to assign these costs on an average basis in the last docket. Public Service states that its proposed method mitigates the pre-built plant issue as it does not include any allowance for system regulators or land and structures (included in the

current method). Further, it proposes to include reinforcement costs for residential subdivisions in the estimated Construction Costs that are charged to the new customer or developer.

56. We adopt Public Service's proposed method, to charge customers based only on minimum system costs. While we should always strive to assign costs to appropriate cost-causers, it does not appear to be economically feasible here. The simple assignment of actual costs to the current developer will not result in a fair allocation of pre-built plant. Future capacity needs may be significant in one situation and nonexistent in the next. Assignment of such future capacity costs to the current applicant would be arbitrary and would not equitably recover costs for previous pre-built plant that is used by the current applicant. Any other options involve a complicated tracking mechanism. The benefits of these tracking mechanisms are outweighed by their costs. Further, Public Service has mitigated the problem by excluding system regulator and land and structure costs from the CA calculation, and by directly assigning residential reinforcement costs. Since pre-built plant is included in individual projects, true up to actual costs is not appropriate. We direct Public Service to continue to charge customers based on estimated costs.

L. Separate Main and Service Lateral CA Amounts

57. Public Service proposes to set separate main and service lateral CA amounts, without allowing excess service lateral amounts to be applied to main costs. The previous practice of combining the CA amounts resulted in disproportionate booking of investment of mains as opposed to service laterals. Public Service also argues that the rates are uniformly applied under its proposed method.

58. HBA recommends that excess service lateral amounts should be applied to main extensions. To not do so is unfair to developments such as townhouses and condominiums, is

inconsistent with extension policies in other states, and requires a change from past practice in Colorado.

59. Staff opposes applying any remaining service lateral CA to the cost of distribution mains.

60. We direct Public Service to implement separate main and service lateral CA amounts, without applying excess service lateral costs to main extensions or applying excess main extension costs to service laterals. We agree with Public Service that past practices resulted in disproportionate books of accounts for mains and service laterals. We recognize that less than the total CA amount is then granted on average, but we find that the need for separate CA amounts outweighs the inequity considerations.

M. Adjust CA to Reflect Recent Rate Case

61. Public Service's most recent rate case resulted in negative riders, which should be included. We direct Public Service to include the results of the rate case in its compliance filing that implements the new CA.

N. Self-Build Option

62. There was some indication at the hearing that the self-build option pilot program is not being pursued vigorously at this time. If the parties for whatever reason do not wish to pursue this option, we will not require them to do so. We do, however, wish to make two observations concerning the self-build option in general: 1) if a pilot program does commence at any time in the future, the Commission's gas pipeline safety group must be included in the process; and 2) before any self-build option is introduced as a permanent offering, a formal application must be made with the Commission.

IV. CONCLUSION

63. We find that Public Service's proposed CA, with appropriate modifications as described in this decision, presents a fair and economically justified CA amount that the utility will pay to connect a new customer. The CA levels we are adopting here provide a reasonable balance between the interests of new and existing customers. We note that many of the factors and considerations that we have addressed here cannot be determined with a high degree of accuracy. Rather, our determinations here provide "rough justice" when considering the overall balance of CA factors. For example, using average rather than incremental costs to calculate the CA likely decreases the CA payment and associated utility costs. Applying separate main and service lateral amounts likely decreases the total level of CA payments, and associated utility costs. Not applying a tax gross-up factor to customer contributions likely increases utility costs. Lastly, not adopting a method to charge customers for pre-built plant likely increases utility costs. The overall level of the resulting CA we adopt in this decision provides a proper balance between the issues.

V. ORDER

A. The Commission Orders That:

1. We adopt the CA proposed by Public Service Company of Colorado with the modifications discussed above.

2. Within 30 days of the effective date of this Order, Public Service Company of Colorado shall file an advice letter with accompanying tariffs modifying its rates for construction allowances, consistent with the above discussion. These tariffs shall be filed to become effective on not less than one day's notice to the Commission.

3. Within 60 days of the effective date of this Order, Public Service Company of Colorado shall make a subsequent advice letter filing with accompanying tariffs that provide a detailed description of the Construction Allowance methodology, consistent with the above discussion. These tariffs shall be filed to become effective on not less than 30 days' notice to the Commission.

4. The 20-day period provided for in § 40-6-114, C.R.S., within which to file applications for rehearing, reargument, or reconsideration begins on the first day following the Mailed Date of this Decision.

5. This Order is effective on its Mailed Date.

B. ADOPTED IN COMMISSIONERS' DELIBERATIONS MEETING July 23, 2003.

(S E A L)

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

GREGORY E. SOPKIN

POLLY PAGE

JIM DYER

Commissioners

ATTEST: A TRUE COPY

Bruce N. Smith
Director

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