

R E S O L U T I O N

Resolution E-4879. San Diego Gas & Electric Company's request for authorization to license intellectual property to Red Lion Chem Tech, LLC and HCOR Filters, LLC pursuant to Public Utilities Code § 851 and General Order 173.

PROPOSED OUTCOME:

- San Diego Gas and Electric's (SDG&E) request for Commission authorization to license its Sleeve Flue Invention to Red Lion Chem Tech, LLC and its wholly owned subsidiary, HCOR Filters, LLC, Pursuant to Public Utilities Code Section 851 and General Order 173 is approved.

SAFETY CONSIDERATIONS:

- There is no safety impact on utility operations. Licensing under the agreement allows expanded pollutant removal capabilities.

ESTIMATED COST:

- Ratepayers will receive 75% of royalties on profit earned by qualifying sales under the license agreement.

By Advice Letter 3092-E, filed on June 30, 2017.

SUMMARY

This Resolution approves SDG&E's request for authorization to license its filter sleeve attachment mechanism, a camlock and flue design (Sleeve Flue Invention), to Red Lion Chem Tech and its wholly owned subsidiary, HCOR Filters.

BACKGROUND

Most utilities have underground substructures. SDG&E uses sump pumps to remove water from subterraneous structures after rainstorms during maintenance visits. The maintenance crews often use a filter sleeve to remove any contaminants from the water in this process.

SDG&E and Red Lion Chem Tech “worked together to develop a new range of water filter sleeves called HCOR Filter Sleeves.” These sleeves are attached to portable sump pumps through the proprietary Sleeve Flue Invention owned by SDG&E.

Red Lion met with SDG&E in early March, 2013 to discuss selling filter bags to them. SDG&E’s interest in the product was dependent on whether the bags could fit into a sleeve that could then attach to the sump pumps that SDG&E uses.

By November 18, 2013, Red Lion had developed a sleeve design that removes the panel of priority pollutants outlined in the Clean Oceans Act, per the California State Water Resources Control Board¹.

On or about February 14, 2014, SDG&E and Red Lion entered in to a Standard Services Agreement (SSA) dated as of November 19, 2013. The SSA was entered into for the purpose of SDG&E paying Red Lion to modify its design so that the de-oiling and de-sanding water filtration sleeve with pollutant removal capability could be adapted to work with SDG&E’s portable sump pumps. Under the SSA, Red Lion developed a flue and camlock connection to be incorporated in the finished sleeve design.

Through the terms of the SSA, the intellectual property of the camlock and flue design developed by Red Lion belongs to SDG&E. The parties now wish to enter

¹ A list of priority pollutants is found in the Clean Oceans Act per California State Water Resources Control Board Order WQ 2014-0174-DWQ, NPDES Number CAG990002 in attachment G of that Document. The document can be found here:
http://www.waterboards.ca.gov/board_decisions/adopted_orders/water_quality/2014/wqo2014_0174_dwq.pdf

into an arrangement for the licensure and payment of royalties on Red Lion's use of the Sleeve Flue Invention.

On June 30, 2017, SDG&E filed AL 3092-E requesting authorization to license the attachment mechanism so that Red Lion Chem Tech and HCOR Filters can sell filters and products with the attachment mechanism to other utilities and entities that might be able to use them. This effort to commercialize intellectual property (IP) by SDG&E is consistent with D.13-05-010, where the Commission encourages commercialization of IP as beneficial to both ratepayers and shareholders².

General Order 173, Rule 3

Public Utilities (P.U.) Code Section 851 and General Order (G.O.) 173 are germane to this request. G.O. 173 Rule 3 establishes a series of conditions that must be met in order for a sale or licensing of assets to qualify for Advice Letter treatment. The criteria of G.O. 173 include California Environmental Quality Act compliance, no adverse effect on the public good, distribution of the financial proceeds from the transaction, and a total valuation under \$5 million.

Terms of the Licensing Agreement

The terms of the licensing agreement include the terms and conditions necessary to satisfy Section 851 and G.O. 173 as outlined above. The licensing agreement includes additional terms and conditions that provide further financial benefits and legal protections for SDG&E, its shareholders, and the ratepayers.

NOTICE

Notice of AL 3092-E was made by publication in the Commission's Daily Calendar. San Diego Gas & Electric states that a copy of the Advice Letter was mailed and distributed in accordance with Section 4 of General Order 96-B.

PROTESTS

Advice Letter 3092-E was not protested.

² D.13-05-010 at 600.

DISCUSSION

The Commission finds that the proposed agreement meets each of the applicable criteria set forth in G.O. 173, Rule 3 as discussed below.

“a. The activity proposed in the transaction will not require environmental review by the Commission as a Lead Agency under the California Environmental Quality Act (CEQA), either because:

(1) A statutory or categorical exemption applies (the applicant must provide a Notice of Exemption from the Lead Agency or explain why it believes that an exemption applies, or (2) (2) The transaction is not a project under CEQA (the applicant must explain the reasons why it believes that the transaction is not a project), or (3) Another public agency, acting as the Lead Agency under CEQA, has completed environmental review of the project, and the Commission is required to perform environmental review of the project only as a Responsible Agency under CEQA

- a.** The sale reflects only a change in intellectual property rights; therefore, there are no direct or indirect environmental impacts that would occur as a result of the proposed transaction, thus exempting this transaction from further review under CEQA. CEQA §15378 defines “Project” under CEQA guidelines. §15378, (a) “‘Project’ means the whole of an action, which has a potential for resulting in either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment [...]” The licensure of this intellectual property will not result in any direct or indirect environmental impacts.

“b. The transaction will not have an adverse effect on the public interest or on the ability of the utility to provide safe and reliable service to customers at reasonable rates.”

- b.** The transaction does not constitute the exchange of material goods and SDG&E has taken numerous precautions to ensure that “in no event will ratepayers share in any loss³” resulting from the licensure of the intellectual property.

“c. Any financial proceeds from the transaction will be either:

³ SDG&E response to Energy Division data request, 08/18/2017

(1) Booked to a memorandum account for distribution between shareholders and ratepayers during the next general rate case or other applicable proceeding for that utility, or (2) Immediately divided between shareholders and ratepayers based on a specific distribution formula previously approved by the Commission for that utility.”

- c. SDG&E will receive royalties based on terms outlined in the sales agreement. The types of sales on which SDG&E can earn royalties have been limited by terms in the agreement. In order for SDG&E to earn royalties on Red Lion’s sale of a product utilizing the IP, it must be a “qualifying, third-party sale.” Third party sales are those sales to parties other than SDG&E, Sempra Energy or their affiliates, and qualifying sales are those in which the licensed property is being sold domestically to be used in a manner similar to its original intention.

SDG&E proposes a 75/25 split of the revenues from royalties on a gross, pre-tax basis between the ratepayers and shareholders, respectively⁴. General Order 173, Rule 2.C notes that proceeds from the transaction will be either booked to a memorandum account for distribution between shareholders and ratepayers during the next general rate case, or immediately divided between shareholders and ratepayers based on a specific distribution formula previously approved by the Commission for that utility. SDG&E provided justification for this proposed revenue split by response to Energy Division Data Request⁵. SDG&E states: “In the last general rate case, the Commission held that the 75/25 sharing mechanism would govern how revenues would be shared from any IP developed as part of research, development, and demonstration programs using ratepayer funds.” In Decision 13-05-010, the Commission argued at that time that the split was reasonable because the 75/25 allocation was equitable to ratepayers and incentivized SDG&E to commercialize its IP.

“d. If the transaction results in a fee interest transfer of real property, the property does not have a fair market value in excess of \$5 million.”

- d. Not Applicable

⁴ SDGE AL 3092-E, p.4

⁵ SDG&E response to Energy Division data request, 08/18/2017

“e. If the transaction results in a sale of a building or buildings (without an accompanying fee interest transfer of the underlying land), the building(s) does not have a fair market value in excess of \$5 million.”

e. Non Applicable

“f. If the transaction is for the sale of depreciable assets (other than a building or buildings), the assets do not have a fair market value in excess of \$5 million.”

f. Not Applicable

“g. If the transfer is a lease or a lease-equivalent, the total net present value of the lease payments, including any purchase option, does not have a fair market value in excess of \$5 million, and the term of the lease will not exceed 25 years.”

g. The term of the license SDG&E proposes to grant to Red Lion is 25 years. Therefore, the net present value of the forecasted royalty payments over the 25 year period must be less than \$5 million⁶.

The retail price of the HCOR filter developed by Red Lion and SDG&E is \$900. Given the revenue sharing agreement, the value of the transaction is not anticipated to exceed \$5 million. Considering the agreement grants a royalty on the *net revenue* earned by Red Lion on the sale of filters utilizing the Sleeve Flue Invention, and the lack of market depth for the product, the value of the transaction will very likely be under \$5 million over the term of the license.

G.O. 173 requires the value of the transaction to be under \$5 million in order for the transaction to qualify for Advice Letter treatment. The utility clearly states that the total value of the transaction will be under \$5 million⁷. However, both in the advice letter, and then again in responding to Energy Division Data Request, SDG&E claims that the Net Present Value of the transaction is impossible to know given market fluctuations and lack of research into market depth. Given the specialty market characteristics, SDG&E's estimation that the NPV of the transaction will be under \$5 million is reasonable.

⁶ SDG&E response to Energy Division data request, 08/18/2017

⁷ SDGE AL 3092-E, p. 3; SDG&E response to Energy Division data request, 08/18/2017

h. If the transaction conveys an easement, right-of-way, or other less than fee interest in real property, the fair market value of the easement, right-of-way, or other interest in the property does not exceed \$5 million.

h. Not Applicable

i. The transaction will not materially impact the ratebase of the utility. (This requirement does not apply to telephone corporations subject to the Uniform Regulatory Framework (URF) or which are not subject to rate of return regulation.)

i. The proposed transaction will not materially impact the utility's ratebase. Given that the property is intellectual in nature, it is not reflected in the utility's ratebase. Furthermore, SDG&E will still own the IP, it is simply granting a non-exclusive license to Red Lion.

j. If the transaction is a transfer or change in ownership of facilities currently used in regulated utility operations, the transaction will not result in a significant physical or operational change in the facility.

j. Not Applicable

k. The transaction does not warrant a more comprehensive review that would be provided through a formal Section 851 application.

k. The transaction does not warrant a more comprehensive review. The IP was initially developed by Red Lion under an agreement with SDG&E. This agreement simply allows Red Lion to implement the technology they designed under that agreement into their products.

Conclusion

Under the SSA with SDG&E, Red Lion developed the IP, though SDG&E retains ownership rights over the IP. SDG&E cannot, on its own, exploit the commercialized potential of the product. Licensing the product through Red Lion provides the utility with the ability to earn back the estimated \$292,000⁸ that was spent developing the technology, and to make available to the market in the rest of the U.S. a filter that is claimed to meet some of the highest environmental quality standards. Furthermore, the commercialization of SDG&E's IP provides financial benefits to the ratepayers and shareholders.

⁸ SDG&E response to Energy Division data request, 08/18/2017

COMMENTS ON THE RESOLUTION

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from today.

FINDINGS AND CONCLUSIONS

1. On or about February 14, 2014 San Diego Gas and Electric and Red Lion Chem Tech, LLC entered into a Standard Services Agreement (SSA) (dated November 19, 2013). The SSA related to a sleeve filter that could be attached to sump pumps to decontaminate storm water accumulations in subterranean structures.
2. Pursuant to the SSA, Red Lion Chem Tech, LLC developed the camlock and flue design (Sleeve Flue Invention) for San Diego Gas & Electric to facilitate attachment of sleeve filters to sump pumps.
3. San Diego Gas & Electric submitted a Tier 3 Advice Letter on June 30, 2017 requesting authorization to license certain intellectual property to Red Lion and its subsidiary HCOR Filters, LLC .
4. The intellectual property to be licensed is the Sleeve Flue Invention developed by Red Lion Chem Tech, LLC under the Standard Services Agreement, used to attach HCOR Filters, LLC filters to sump pumps widely utilized by utilities.
5. Advice Letter 3092-E meets the Rules and Conditions of California Public Utilities Code §851, and General Order 173, Rule 3. Therefore, it is appropriate that SDG&E requested authorization for this license agreement by Advice Letter.

6. Under the proposed licensing agreement, San Diego Gas & Electric will earn royalties on the profit earned by qualifying sales (i.e. domestic sales not made to San Diego Gas & Electric, Sempra, or any of their affiliates) of products utilizing the Sleeve Flue Invention. These royalties will be split between ratepayers and shareholders at a 75%/25% split. This split was determined in San Diego Gas & Electric's most recent General Rate Case Decision 13-05-010 that addressed these issues. This allocation scheme is consistent with General Order 173.
7. The estimated cost of the development of the property is \$292,000⁹. This cost has already been paid by the utility ratepayers.
8. The license agreement in Advice Letter 3092-E will not increase rates or affect service. San Diego Gas & Electric has stated that customers have zero risk of bearing the cost of any loss as a result of the licensure.
9. Implementation of Advice Letter 3092-E will likely cause a small rate decrease than would otherwise be the case over the 25 year license period, due to ratepayers receiving 75% of the royalties from net revenue earned by Red Lion on qualified sales.
10. Authorization of San Diego Gas & Electric's request will benefit both ratepayers and shareholders, and support the commercialization of the IP developed by San Diego Gas & Electric.

THEREFORE IT IS ORDERED THAT:

1. The request of the San Diego Gas & Electric to license intellectual property to Red Lion Chem Tech, LLC and HCOR, LLC, as requested in Advice Letter 3092-E, is approved.

⁹ SDG&E response to Energy Division data request, 08/18/2017

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on January 11, 2018; the following Commissioners voting favorably thereon:

TIMOTHY J. SULLIVAN
Executive Director

APPENDIX

I. Data Request

**Energy Division's Data Request 1 for SDG&E Advice Letter 3092-E
Dated August 4, 2017
Submitted: August 18, 2017**

Q1. Please confirm whether or not the Camlock and Flue design that SDG&E is seeking authorization to license to Red Lion Chem Tech is patented.

SDG&E Response Q1:

It is not patented.

Q2. If possible, please provide pictures or drawings that show a clear visual description of the device.

SDG&E Response Q2:



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- Q3. SDG&E states that royalties from qualified sales will be split between the ratepayers and shareholders 75%/25% respectively. Please provide rationale for the proposed royalty revenue split between ratepayers and shareholders.

SDG&E Response Q3:

This sharing mechanism is identical with the sharing mechanism approved by the Commission in prior proceedings. In the last SDG&E General Rate Case ("GRC") decision to examine this issue of sharing mechanisms for IP – the TY2012 GRC –the Commission held that the 75/25 sharing mechanism would govern how revenues would be shared from any IP developed as part of research, development, and demonstration ("RD&D") programs using ratepayer funds.¹ The Commission stated that this sharing mechanism was reasonable because it was equitable to ratepayers while providing an incentive to SDG&E to commercialize the IP.² Later the Commission adopted the same 75/25 sharing mechanism to govern how "financial benefits of IP", like royalties and license fees, would be shared for RD&D resulting from the EPIC program. In that decision, the Commission stated that "[t]he 75 percent/25 percent allocation between ratepayers and shareholders is a fair and reasonable allocation... because it maximizes the value of ratepayers' investment while recognizing the IOUs' successful effort... ultimately to develop beneficial IP."³ SDG&E believes that the same motivations are present now – the Commission wants a sharing mechanism that is equitable to ratepayers while providing an incentive to SDG&E to pursue the commercialization of beneficial IP. Therefore, SDG&E believes the proposed revenue sharing mechanism of 75/25 is reasonable.

¹ D.13-05-010 at 600 stated, "... to provide an incentive to SDG&E to seek out investments which may benefit both ratepayers and shareholders, we adopt a modified version of SDG&E's 60 (ratepayer) /

² Id. ("This sharing is equitable in that it will reward ratepayers for providing all of the funds for the venture, while providing an incentive to SDG&E to market such a venture.")

³ D.13-11-025 at 82-83; see also id. at Ordering Paragraph 34.

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- Q4. Please provide rationale for the 30% discount SDG&E will receive on its purchases of the filter sleeves.

SDG&E Response Q4:

This is the result of negotiation between SDG&E Red Lion which guarantees SDG&E will always pay the lowest price for the filter sleeves of any customer.

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- Q5. Please describe how AL 3092-E meets the requirements in G.O. 173, Rule 3, Paragraph c(2), and in Rule 3, Paragraph G. If neither of these criteria are applicable, which criteria is SDG&E applying under?

SDG&E Response Q5:

SDG&E's AL 3092-E has satisfied the eligibility criteria under GO 173 because under:

Rule 3 c.(2) - Financial proceeds from the transaction will be immediately divided between shareholders and ratepayers based on the ratios approved in the General Rate Case ruling outlined in D.13-05-010.

Rule 3 g. - The proposed transaction qualified for advice letter treatment under GO 173 as the property being licensed does not have a fair market value in excess of \$5 million.

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- Q6. Please provide evidence that the expected value of the transaction will be less than \$5 million,

SDG&E Response Q6:

The expected value of the transaction is unknown at this time. The ultimate value will be based on revenue levels RED LION is able to achieve in the marketplace. Given the developmental stage of this product and the many uncertainties in the utility marketplace, there is no accurate way to determine reliable revenue estimates at this time. However, in no event will ratepayers share in any loss.

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- Q7. Please provide an estimate for R&D cost for the IP including staff time and materials.

SDG&E Response Q7:

Total estimated costs are approximately \$292,000.