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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

RESOLUTION E-4280
December 3, 2009

R E S O L U T I O N

Resolution E-4280. Golden State Water Company (GSWC) requests tariff modifications to establish the Shell Agreement Memorandum Account (SAMA).

PROPOSED OUTCOME: Approves, with modifications, GSWC's request to add Part U to its Preliminary Statement, which establishes the SAMA to record unrealized gains or losses from its Shell Purchased Power Agreement.

ESTIMATED COST: None.

By Advice Letter 232-E filed on July 8, 2009.

SUMMARY

This Resolution approves, with modifications, Golden State Water Company's (GSWC) request to add Preliminary Statement Part U to its tariffs to establish the Shell Agreement Memorandum Account (SAMA). GSWC's proposed tariff language must be revised to clarify that contracts, other than the Shell Purchased Power Agreement (PPA), may be included in the account only if they existed as of the effective date of Decision (D.) 09-05-025, i.e. May 21, 2009. (D.09-05-025 addressed the PPA between GSWC's Bear Valley Electric Service Division (Bear Valley) and Shell Energy North America (US) L.P. (Shell)). Additionally, GSWC's proposed tariff shall be revised to specify that the SAMA is effective on the effective date of this Resolution.

The SAMA will allow GSWC to track, solely for financial reporting purposes, any unrealized market gains or losses associated with the Shell PPA. No costs recorded in this account may be recovered from or refunded to ratepayers.

BACKGROUND

Golden State Water Company filed Application (A.) 08-08-021 to request approval of its Shell Power Purchase Agreement

GSWC, on behalf of Bear Valley, filed A.08-08-021 to request Commission approval of its Power Purchase Agreement (PPA) with Shell Energy North America (Shell). The PPA covers four products: (1) Annual Baseload of 13 Megawatts (MW) of energy, (2) Seasonal Baseload of 7 MW of energy for December, January and February and 5 MW of energy for November, (3) Peak Call Option of 15 MW of energy for the Winter season and 5 MW of energy for other seasons, and (4) System Resource Adequacy Capacity of 18 to 35 MW of energy that fluctuates with the year and the month. All the products, except Seasonal Baseload, have terms of 4 years and 11 months. Seasonal Baseload has a term of 3 years.

In A.08-08-021, GSWC also requested a memorandum account for the Shell PPA contract to minimize volatile earnings and to prevent an increase in its cost of capital.

In A.08-08-021, GSWC also requested Commission authorization to establish a memorandum account to record unrealized gains and losses associated with the Shell PPA. Unrealized gains and losses result from differences between the market price of energy and the actual price of energy purchased by GSWC under the PPA.

Pursuant to Financial Account Standards Board's (FASB) Statement of Financial Account Standards (SFAS) No.133, "Accounting for Derivative Instruments and Hedging Activities", the PPA is a derivative instrument. GSWC thus stated in testimony, in A.08-08-021, that it must report unrealized gains and losses resulting from the PPA on its Income Statement as earnings. According to GSWC, reporting unrealized gains and losses on its income statement could create significant volatility in GSWC's reported earnings. This increased

volatility would increase GSWC's cost of capital, because volatile earnings increase GSWC's risk profile to investors.¹

GSWC stated that it could, however, avoid the potential higher cost of capital under SFAS No.71. According to GSWC, under SFAS No.71, "Accounting for the Effects of Certain Types of Regulation", GSWC could record the unrealized gains and losses from its derivative instruments, such as the PPA, in a memorandum account. The entries made in accordance with SFAS No. 133 and SFAS No. 71 would simultaneously offset each other in GSWC's financial statements.² As a result, unrealized gains or losses will not be recorded in its income statement, thus eliminating the problem of volatile earnings that result from complying with SFAS No. 133. GSWC proposed that the memorandum account be a non-interest bearing account to insure that the unrealized gains or losses recorded in the account will have no effect on GSWC's cash flow. At the end of the contract term, the memorandum account will have a zero balance.³

The Commission authorized GSWC to establish the memorandum account and ordered GSWC to file a Tier 3 advice letter to outline the terms of the account.

In May 2009, the Commission issued D.09-05-025. The decision determined that GSWC's Bear Valley Division may recover the actual costs of the Shell PPA incurred before August 31, 2011, subject to the cap approved in the settlement

¹ A08-08-021, Ex. BV-5, Bear Valley Prepared Testimony, Chapter 4

² According to SFAS No. 133, an unrealized gain or loss will be recorded in the Income Statement. It will be offset by a counter entry in the Liabilities account under the Balance Sheet. After implementing the memorandum account, SFAS No. 133 allows GSWC to record any unrealized gain or loss in the memorandum account instead of the Income Statement. The counter entry, similar to prior the memorandum account, will be recorded under the Liabilities account in the Balance Sheet. Because the memorandum account is listed as an asset under the Balance Sheet, all entries will be recorded in the Balance Sheet, offsetting each other. Any unrealized gains or loss from the derivative will not be recorded in the Income Statement.

³ A.08-08-021, Ex. BV-5, Bear Valley Prepared Testimony, Chapter 4.

agreement adopted in D.02-10-054. D.09-05-025 also authorized GSWC's Bear Valley Division to recover the actual costs of energy delivered to retail customers after August 31, 2011 for the remainder of its Shell PPA, subject to prudent contract administration.⁴

D.09-05-025 also required GSWC to establish a non-interest bearing memorandum account to track the unrealized gains and losses otherwise imputed to the Shell PPA as a result of complying with the FASB's SFAS No. 133. The decision required GSWC to file a Tier 3 advice letter that will propose the specific tariff language for the memorandum account. GSWC will record and recover only the actual costs it incurs. No amounts recorded in the account will be recovered from or refunded to the ratepayers.⁵

D.09-05-025 allows GSWC to include in the account any then-existing contracts preapproved by the Commission and the Shell PPA. GSWC must file for authority from the Commission before including any subsequent energy contracts in the account.⁶

On July 9, 2009, GSWC filed Advice Letter (AL) 232-E, proposing to add Preliminary Statement (PS) Part U to its tariffs to establish the SAMA.

NOTICE

Notice of AL 232-E was made by publication in the Commission's Daily Calendar. GSWC states that copies of the Advice Letter were mailed and distributed in accordance with Section IV of General Order 96-B.

PROTESTS

No party protested GSWC Advice Letter 232-E.

⁴ D.09-05-025, Ordering Paragraphs 1 and 2.

⁵ D.09-05-025, Section 5.3, and Ordering Paragraph 3.

⁶ D.09-05-025, Sections 5.1 and 5.3.

DISCUSSION

GSWC proposes to establish the SAMA in compliance with D.09-05-025.

Ordering Paragraph 3 of Decision D.09-05-025 requires GSWC to establish a non-interest bearing memorandum account to record unrealized gains or losses that result from the Shell PPA. The decision also requires GSWC to file a Tier 3 advice letter with the Commission's Energy division to propose the specific terms and language for the memorandum account. Subsequently, GSWC filed AL 232-E, requesting to add Part U to its Preliminary Statement which outlines the establishment of the SAMA.

To ensure compliance with Decision D.09-05-025, the terms of the SAMA proposed by GSWC shall be modified.

As ordered by Decision D.09-05-025, GSWC proposes that the SAMA be a non-interest bearing memorandum account. The purpose of the account is to track unrealized gains and losses that result from the Shell PPA. At the end of the term of the contract, the account will carry a zero balance. No costs recorded in the SAMA will be recovered from or refunded to ratepayers. GSWC proposes that the account become effective on the effective date of Advice Letter 232-E. GSWC also proposes to make monthly entries to the account at the end of each month to record unrealized gains or losses that result from applying SFAS. 133 to the Shell PPA and other contracts preapproved by the Commission.

The tariff language that GSWC proposes for the SAMA must be revised to ensure compliance with D.09-05-025 in two respects. GSWC shall file a supplement to AL 232-E to make the revisions described below.

First, GSWC must revise the language it proposes in PS Part U.4.a which reads:

“Entries shall be made to the SAMA at the end of each month to record the unrealized gain or loss attributable to the application of SFAS 133 to the Shell agreement and any other contracts preapproved by the Commission.”

D.09-05-025 allows “any existing contracts preapproved by the Commission”, in addition to the Shell PPA, to be included in the account.⁷ Existing contracts in this context are those that existed on the effective date of D.09-05-025, i.e., May 21, 2009. GSWC must revise its language to clarify that the “other contracts” stated above must be existing contracts as of the effective date of D.09-05-025. GSWC must revise PS Part U.4.a so that it reads as follows:

“Entries shall be made to the SAMA at the end of each month to record the unrealized gain or loss attributable to the application of SFAS 133 to the Shell agreement, and any other contracts that were preapproved by the Commission and that existed on the effective date of Decision 09-05-025, May 21, 2009.”

In addition, GSWC must revise the language it proposes in Preliminary Statement (PS) Part U.5, which reads:

“The SAMA is effective on the effective date of Advice Letter 232-E.”

Because AL 232-E must be revised via a supplemental advice letter, the SAMA will not be effective on the effective date of AL 232-E, but shall be effective on the effective date of the supplement to AL-232-E. The supplement to AL 232-E that we require will be effective on the date of this Resolution. Thus, GSWC must revise PS Part U.5 so that it reads as follows:

“The SAMA is effective on the effective date of Commission Resolution E-4280.”

With the changes described above, the SAMA will comply with D.09-05-025.

COMMENTS

Public Utilities Code section 311(g) (1) generally provides that resolutions must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Accordingly, this draft resolution

⁷ D.09-05-025, Section 5.1, emphasis added.

was mailed to GSWC, the only party, for comments, and will be placed on the Commission's agenda no earlier than 30 days from the date issued for comments.

No comments were submitted on this draft resolution.

FINDINGS AND CONCLUSIONS

1. In A.08-08-021, GSWC requested to establish a new memorandum account to avoid volatile earnings that result from the PPA. According to FASB rules, GSWC can record unrealized gains and losses in a memorandum account in place of the Income Statement, thus preventing unrealized earnings from adding volatility to the company's earnings.
2. D.09-05-025 authorized GSWC to establish a non-interest bearing memorandum account to record unrealized gains and losses resulting from the Shell PPA. No amounts recorded in the account will be recovered from or refunded to ratepayers.
3. D.09-05-025 required GSWC to file a Tier 3 advice letter to propose tariff language for the memorandum account.
4. In addition to the Shell PPA, then-existing contracts preapproved by the Commission may be included in the memorandum account pursuant to D.09-05-025.
5. D.09-05-025 requires that GSWC file for Commission authority to include subsequent contracts in the memorandum account.
6. On July 8, 2009, GSWC filed a Tier 3 advice letter, AL 232-E, with the Commission's Energy Division to request approval to add Preliminary Statement Part U to its tariffs to establish the Shell Agreement Memorandum Account. No party protested AL 232-E.
7. To ensure compliance with D.09-05-025, GSWC should revise the tariff language it proposed in AL 232-E to specify a) that contracts preapproved by the Commission and existing on the effective date of D.09-05-025 may be included in the SAMA, and b) that the effective date of the SAMA is the effective date of this Resolution.

THEREFORE IT IS ORDERED THAT:

1. GSWC shall revise the tariff language proposed in AL 232-E, as set forth in the Ordering Paragraphs listed below.

2. GSWC shall revise its Preliminary Statement Part U.4.a, proposed in AL 232-E, so that it reads:
“Entries shall be made to the SAMA at the end of each month to record the unrealized gain or loss attributable to the application of SFAS 133 to the Shell agreement, and any other contracts that were preapproved by the Commission and that existed on the effective date of Decision 09-05-025, May 21, 2009.”
3. GSWC shall revise Preliminary Statement Part U.5, proposed in AL 232-E, so that it reads:
“The SAMA is effective on the effective date of Commission Resolution E-4280.”
4. Within 20 days of today’s date, GSWC shall file a supplement to AL 232-E to make the revisions required in the Ordering Paragraphs listed above. The supplemental advice letter shall be numbered Advice Letter 232-E-A and shall replace AL 232-E in its entirety. The supplemental advice letter shall be effective on today’s date, subject to Energy Division’s review for compliance with this Resolution.

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 December 3, 2009; the following Commissioners voting favorably thereon:

/s/ Paul Clanon
Paul Clanon
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

