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Decision 09-07-033 July 30, 2009

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Commission Rulemaking To Revise Time Schedule For Rate Case Plan And Fuel Offset Proceedings; Recommendations Filed By 1-11-88 With Certificate of Service.	Rulemaking 87-11-012 (Petition for Modification; filed April 7, 2009)
And Related Matter.	Application 95-06-002

DECISION DENYING SOUTHERN CALIFORNIA GAS COMPANY'S REQUEST FOR APPROVAL OF A PETITION TO MODIFY DECISION 97-07-054

1. Summary

This decision denies Southern California Gas Company's petition for modification of Decision 97-07-054 to immediately suspend its Market Indexed Capital Adjustment Mechanism.

2. Background

Pursuant to Decision (D.) 97-07-054 Southern California Gas Company (SoCalGas) was authorized to implement a Performance-Based Ratemaking (PBR) plan in 1997. The PBR plan replaced SoCalGas' general rate case (GRC) process with annual revisions of its rates based on an indexed industry-specific price inflation factor, less a productivity factor. The PBR plan does not provide for changes in SoCalGas' cost of capital. However, it does provide for a cost of capital adjustment in the event of a dramatic change in its cost of capital through a Market Indexed Capital Adjustment Mechanism (MICAM).

The MICAM utilizes two factors that must both be triggered to enact a change in SoCalGas' cost of capital. The first factor compares the most recent trailing 12-month average of the 30-year Treasury bond yields. The second factor reflects a 12-month forward forecast of 30-year Treasury bond yields by Global Insight.[1] If the change from the benchmark for both factors is 150 basis points or greater, the MICAM formula is triggered.[2] Upon being triggered, the embedded cost of debt and preferred stock are trued up to actual and the Return on Equity (ROE) is adjusted by one-half of the difference between the 12-month historical average and the benchmark.

An initial benchmark was established at 6.95% reflecting 30-year Treasury bond yields used in the 1997 cost of capital proceeding, D.96-11-060. This equated to a trigger point of 5.45% on the downside and 8.45% on the upside. To date, this benchmark was triggered only once, in 2002. As a result of that trigger, SoCalGas' authorized ROE was reduced to 10.82% from 11.60% and its rate of return to 8.68% from 9.49% beginning January 1, 2003.

Concurrent with the 2002 trigger, SoCalGas petitioned the Commission for suspension of its MICAM because 30-year Treasury bond yields no longer tracked utility bonds yields and were no longer an appropriate indicator of a utility's cost of capital. That petition was denied by D.03-01-008. Although that decision acknowledged that use of 30-year Treasury bond yields as a benchmark may be flawed, it stated that the benchmark was but one of the several

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[1] The 12-month forward forecast of 30-year Treasury bond yields was previously reported by Data Resource Inc.

[2] One basis point equals 0.01%.

components of SoCalGas' PBR and that the suspension of a possible flaw does not necessarily mitigate the impact that such flaw may have on the PBR. That decision also concluded that SoCalGas should address the merits of a replacement trigger mechanism as part of its December 2002 PBR/Cost of Service application.[3] Although SoCalGas sought to replace its 30-year Treasury bond yields index with Moody's Aa Utility Bonds in its 2002 PBR/Cost of Service application that proceeding resulted in a Joint Party settlement which did not adopt its proposed index change. SoCalGas did not propose any change to its trigger mechanism in its 2008 GRC.

3. Discussion

SoCalGas filed its current petition for modification of D.97-07-054 on April 7, 2009 to suspend its MICAM on an expedited basis by May 21, 2009. Two days later, on April 9, 2009 the Division of Ratepayer Advocates (DRA) filed an opposition to SoCalGas' expedited request and stated its intent to file a protest the petition. Subsequently, on April 21, 2009, the assigned Administrative Law Judge issued a ruling requesting that parties that were considering filing protests, instead prepare a list of issues to be considered in the proceeding for distribution at a May 1, 2009 Prehearing Conference (PHC).

SoCalGas, DRA, The Utility Reform Network (TURN) and Southern California Generation Coalition (SCGC) attended the PHC. All parties concurred that the merits of SoCalGas' petition should be briefed. DRA, TURN, and SCGC filed opposition briefs on May 15, 2009 and SoCalGas filed a reply brief on May 22, 2009.

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[3] D.03-01-008 at 4.

3.1. MICAM Suspension

SoCalGas seeks authority for an immediate one-year suspension of its MICAM to prevent a potential downward adjustment to its authorized ROE. As a condition of that suspension, SoCalGas would file a 2011 test year cost of capital application to address revisions to its cost of capital trigger mechanism. Its 2011 test year application would be filed at the same time Southern California Edison Company (SCE), Pacific Gas and Electric Company (PG&E), and San Diego Gas & Electric Company (SDG&E) file their 2011 test year cost of capital applications.

3.1.1. SoCalGas' Position

SoCalGas contends that the facts and circumstances have changed since its 2002 petition seeking authority to suspend its MICAM. For example, SoCalGas has gone through two subsequent PBR decisions for test years 2004 and 2008 which involved the adoption of a package of PBR components that have added, eliminated, and/or modified various PBR components first adopted by D.97-07-054. The Commission found in a 2008 consolidated cost of capital decision (D.08-05-035) for SCE, PG&E, and SDG&E that utility bond yields were better indicators of a utility's costs of capital than Treasury bond yields. Further, the global economy is in a crisis, with the collapse of the banking and financial industries resulting in a tightening of the credit markets. Finally, SoCalGas contends that it is likely that the trailing 12-month average Treasury bond yields will fall below 3.88% during the second quarter of 2009 thereby triggering its MICAM and require a ROE reduction of at least 75 basis points below its current 10.82% ROE, making it difficult to attract capital and harming ratepayers through increased financing costs.

3.1.2. DRA's Position

DRA opposes the petition because SoCalGas' MICAM trigger mechanism is but one part of a package of all its PBR components, as addressed in the Commission's denial of SoCalGas' 2002 petition to suspend its MICAM. Although SoCalGas followed the Commission's D.03-01-008 direction to address the merits of replacing its MICAM 30-year treasury bond yields index with a utility bond index as part of its 2002 PBR/Cost of Service proceeding, that change did not become part of the decision (D.05-03-023) in that proceeding which adopted a joint party settlement. Although SoCalGas had a second opportunity to modify its trigger mechanism in its 2008 test year GRC which resulted in a negotiated settlement (D.08-07-046), SoCalGas opted not to seek any change in the trigger mechanism. Further, SoCalGas' current petition is based on the same reason used in SoCalGas' prior petition for suspension of its MICAM index. DRA concludes that SoCalGas' GRC/PBR is the correct proceeding to change its MICAM trigger mechanism.

3.1.3. TURN's Position

TURN also opposes the petition because SoCalGas seeks to address the MICAM trigger mechanism separate from the other PBR components. Although TURN does not dispute SoCalGas' claim that a global financial and economic crisis exists today, it finds no evidence that a reduction in SoCalGas' authorized ROE would actually impact its ability to raise capital or result in downward pressure on credit ratings and higher borrowing costs. This is because rating agencies consider many facts, financial metrics, and future earnings potential. Further, SoCalGas' actual ROEs have surpassed its authorized ROEs by an average of 223 basis points for the eleven year period beginning 1997 and ending

2007. TURN concludes that the proper forum for SoCalGas to address its MICAM trigger is its next GRC scheduled for test year 2012.

3.1.4. Southern California Generation Coalition Position

SCGC opposes the petition because SoCalGas has not substantiated that a reduction in its ROE, if it occurs, would adversely impact SoCalGas and its ratepayers because it failed to consider the net revenues that it receives through its various mechanisms such as its gas cost incentive mechanism and unbundled storage program that are excluded from the PBR mechanism. These excluded earnings have ranged between 84 and 220 basis points, averaging 144 basis points over the six year period 2001 through 2006. SCGC concludes that any modification to SoCalGas' MICAM should be addressed through a separate application where the entire mechanism can be reviewed.

3.1.5. Discussion

SoCalGas filed its petition on the basis that a 30-year Treasury bond yields index is not an appropriate trigger mechanism and that its MICAM, which has not yet triggered, is *likely* to trigger requiring a downward adjustment to its ROE.

There is no dispute that the spread (difference) between utility bond yields and Treasury bond yields have increased over and above historic levels. This issue was raised in 2002 when SoCalGas filed its first petition to change its trigger mechanism. This occurred after the mechanism was triggered and SoCalGas filed an advice letter to reduce its authorized ROE. SoCalGas was directed at that time to seek a change in its trigger mechanism in its 2002 PBR/Cost of Service application. Although it did seek a trigger mechanism change in that proceeding, SoCalGas entered into a settlement agreement excluding any change in the trigger mechanism. Now seven years later and one year after its 2008 GRC (in which SoCalGas did not seek a change in its trigger

mechanism) SoCalGas again raises the issue of an appropriate trigger mechanism.

The purpose of a PBR is to establish incentives to reduce costs, to pass some of the resulting savings onto ratepayers, and to reduce regulatory burdens. The disputed trigger mechanism was established so that shareholders and ratepayers of SoCalGas would share in the burden and benefit on interest rate changes while eliminating the regulatory burden of submitting cost of capital applications. SoCalGas' PBR, except for its MICAM component, underwent a significant change as part of its 2008 GRC. This resulted in a negotiated settlement agreement as set forth in D.08-07-046. PBR changes included an elimination of SoCalGas' earnings sharing mechanism and modifications to the categories, benchmarks, and available dollars for performance incentives. Although the MICAM itself was not changed, it is not known what impact, if any, it had on the substantial PBR changes that were adopted as part of the negotiated settlement agreement, which also provides for SoCalGas' to file a 2012 test year GRC.

With uncertainty that its MICAM will actually trigger, SoCalGas does not propose any change to its trigger mechanism. Instead, it seeks to freeze its authorized ROE, irrespective of the purpose of a PBR, while keeping the remaining components of its PBR operational. The ROE would remain frozen until SoCalGas files a cost of capital application at the same time that SCE, PG&E, and SDG&E file their 2011 cost of capital applications and a decision is rendered on those filings. However, to the extent that SoCalGas' petition was approved and utility bond yields decline to a level that triggers the other utilities

cost of capital mechanism, those utilities would be required to reduce their authorized ROEs while SoCalGas' ROE would remain fixed.[4]

Although SoCalGas has had ample opportunity since 2002 to change in its MICAM, it has not done so. SoCalGas has not convinced us that its ROE should be frozen because of a *possibility* that its trigger mechanism *may* be activated requiring a lower ROE. The petition for modification of D.97-07-054 is denied.

3.2. Expedited Request

SoCalGas requested expedited approval of its petition. To accomplish its request, SoCalGas proposed that responses to its petition should be reduced to 15 days from the 30 days set forth in Rule 16.4(f) of the Commission's Rules of Practice and Procedure and that comments on a proposed decision be shortened to ensure a decision is issued no later than May 21, 2009, within 44 days after the filing of its petition. The reason SoCalGas provided for this expedited schedule was to prevent the potential negative adjustments to its cost of capital due to the extremely fragile and dysfunctional condition of today's financial markets with a proven recovery plan yet to be implemented.[5]

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[4] SoCalGas' trigger mechanism is based on 30 year Treasury bond yields while the other major energy utilities SCE, PG&E, and SDG&E's trigger mechanism are based on utility bond yields.

[5] Petition at 1.

A utility's request to expedite the processing of a proceeding and decision, as in this case, requires the Commission and its staff to re-prioritize its workload by placing the matter above other important regulatory matters to ensure that the utility requesting expedited treatment and its ratepayers are not adversely impacted if the matter is not expedited.

However, SoCalGas, itself, stated at the PHC that its MICAM mechanism had not yet triggered and, even if it did trigger in this calendar year, it would not become effective until January 1, 2010.[6] Therefore, even if SoCalGas' MICAM triggered this year there would be no impact until January 1, 2010, seven months past the date of its targeted decision. SoCalGas' expedited request is an unnecessary regulatory burden on the Commission and its staff. Any future expedited request by SoCalGas should be scrutinized with skepticism.

4. Comments on the Proposed Decision

The proposed decision of the assigned Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on July 15, 2009 by SoCalGas, and reply comments were filed on July 20, 2009 by TURN and SCGC. These comments did not result in any changes to the proposed decision.

5. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Michael J. Galvin is the assigned ALJ in this proceeding.

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[6] Reporter's Transcript, PHC 4, at 138.

Findings of Fact

1. SoCalGas' PBR plan provides for a cost of capital adjustment in the event of a dramatic change in its cost of capital through a MICAM.

2. The MICAM utilizes two factors that must both be triggered to enact a change in SoCalGas' cost of capital. These factors are the most recent trailing 12-month average of the 30-year Treasury bond yields and 12-month forward forecast of the 30-year Treasury bond yields.

3. SoCalGas' 2002 petition to suspend its MICAM because 30-year Treasury bond yields no longer tracked utility bonds yields was denied.

4. SoCalGas' request to replace its 30-year Treasury bond yields index with Moody's Aa Utility Bonds in its 2002 PBR/Cost of Service application was not adopted.

5. SoCalGas' PBR, except for its MICAM component, underwent a significant change as part of its 2008 test year GRC that resulted in a negotiated settlement agreement.

6. A negotiated settlement agreement provides for SoCalGas to file a 2012 test year GRC.

7. SoCalGas seeks an immediate one-year suspension of its MICAM to prevent a potential downward adjustment to its authorized ROE.

8. The purpose of a PBR is to establish incentives to reduce costs, to pass some of the resulting savings onto ratepayers, and to reduce regulatory burdens.

9. SoCalGas requested expedited approval of its petition through a shortened response time and shortened comment period on a proposed decision to ensure the issuance of a decision no later than May 21, 2009.

10. SoCalGas' MICAM mechanism has not yet triggered and, even if it did trigger in this calendar year, it would not become effective until January 1, 2010.

Conclusions of Law

1. The petition should be denied.

2. SoCalGas' expedited request is without merit and has created a regulatory burden on the Commission and its staff.

3. This decision should be effective today to ensure the continued operation of SoCalGas' MICAM.

O R D E R

IT IS ORDERED that:

1. Southern California Gas Company's April 7, 2009 petition to modify Decision 97-07-054 is denied.

2. Rulemaking 87-11-012 and Application 95-06-002 are closed.

Dated July 30, 2009, San Francisco, California.

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

INFORMATION REGARDING SERVICE

I have provided notification of filing to the electronic mail addresses on the attached service list.

Upon confirmation of this document's acceptance for filing, I will cause a Notice of Availability of the filed document to be served upon the service list to this proceeding by U.S. mail. The service list I will use to serve the Notice of Availability of the filed document is current as of today's date.

Dated July 31, 2009, at San Francisco, California.

/s/ GLADYS M. DINGLASAN
Gladys M. Dinglasan