

Decision 08-04-024 April 10, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company (U 904 G), San Diego Gas & Electric Company (U 902 M) and Southern California Edison Company (U 338 E) for Approval of Changes to Natural Gas Operations and Service Offerings.

Application 06-08-026
(Filed August 28, 2006)

**OPINION DENYING PETITION FOR
MODIFICATION OF DECISION 07-12-019**

1. Summary

By this decision, we deny the Petition for Modification of Decision (D.) 07-12-019, filed January 9, 2008, by Southern California Gas Company (SoCalGas) and San Diego Gas and Electric Company (SDG&E) (hereinafter Petitioners). In D.07-12-019, the Commission approved, in part, and denied, in part, a number of proposed changes to the operations and service offerings of SoCalGas and SDG&E that were the product of two settlement agreements. The Continental Forge Settlement was entered into by Sempra Energy (Sempra), SoCalGas, SDG&E, and other Sempra affiliates.¹ Sempra, SoCalGas, SDG&E, other Sempra affiliates, Southern California Edison Company (Edison), and Edison International entered into a separate settlement (the Edison Settlement),

¹ SoCalGas and SDG&E are affiliated subsidiaries of Sempra.

which proposed additional changes to the operations and service offerings of SoCalGas and SDG&E.

Although SoCalGas, SDG&E, and Edison settled disputes among themselves, certain elements in the settlements were opposed by other parties in this proceeding. The proposed Edison Settlement included, among other things, a provision that called for continuing a 50/50 allocation of unbundled storage revenues between shareholders and ratepayers, but with an added feature of a \$20 million cap on the maximum amount that shareholders could retain.

In D.07-12-019, the Commission declined to adopt this particular proposal, noting that “a cap as high as \$20 million has not been justified as being necessary to provide utility incentives to market unbundled storage.” Instead, the Commission deferred the adoption “of any explicit revenue cap or percentage allocation applicable unbundled storage revenue to the Biennial Cost Allocation Proceeding (BCAP).”² At the same time, the Commission directed that unbundled storage revenues receive memorandum account treatment until a decision in the upcoming BCAP proceeding, stating:

On an interim basis between the effective date of this decision and a decision in the BCAP proceeding, we hereby direct that all noncore storage costs and revenues be recorded in a memorandum account. Based upon further analysis in the upcoming BCAP as to the appropriate shareholder percentage allocation and cap for unbundled storage revenues, the revenues recorded in BCAP memorandum account shall be allocated between shareholders and ratepayers.

With this approach, the Commission will preserve the option to apply any adopted findings in the upcoming BCAP to revenues booked into the memorandum account from the

² D.07-12-019, *mimeo.* at 76.

effective date of this decision going forward. Thus, any potential for ratepayer inequities resulting from an excessive shareholder allocation or revenue cap will be avoided. Likewise, the opportunity will be preserved to determine the appropriate shareholder allocation and cap to provide an adequate incentive to market unbundled storage and increase unbundled storage capacity consistent with the realities of the current market conditions. With this disposition, any potential for inequities resulting from an improper allocation of noncore storage revenues will be avoided, while additional time will be provided to develop a more complete record as a basis to determine the appropriate revenue sharing allocation formula and shareholder earnings cap to be applied on a longer-term basis in the upcoming BCAP.³

Petitioners, however, seek modification of D.07-12-019 specifically with respect to the deferral of determination of unbundled storage revenue allocations. Petitioners claim that memorandum account deferral for unbundled storage revenues eliminates any shareholder earnings from the sale of unbundled storage products and future storage expansions for a significant period of time. SoCalGas and SDG&E expect that a BCAP decision and implementation of BCAP-related tariffs will likely not take place until some time in 2009 (or perhaps even later, in the case of tariff implementation). Based on that assumption, they argue that the earnings shortfalls created by memorandum account treatment could be substantially greater, especially if months in 2009 with no shareholder earnings from unbundled storage are not somehow offset later that same year.

Petitioners claim that the memorandum account treatment constitutes an unfair financial penalty and significantly increases economic uncertainty as to

³ D.07-12-019, *mimeo.* at 76-77.

how much unbundled storage revenues would be allocated to shareholders in the BCAP.

Petitioners thus request that the Commission modify D.07-12-019 to eliminate the memorandum account treatment for unbundled storage revenues that was put in place until the next BCAP decision, and at least temporarily return SoCalGas' unbundled storage program to the 50/50 sharing the risk and reward established in the last BCAP. In proposing this modification, Petitioners omit their original settlement proposal for immediate implementation of a \$20 million cap on shareholders' retention of storage revenues, with any excess refunded to ratepayers. Under Petitioners' proposed modification of D.07-12-019, consideration of this additional protection to ratepayers would be deferred to the BCAP, but determination of shareholders' allocation of storage revenues would not be deferred. Petitioners propose that any subsequent changes in the shareholder allocation and cap on storage revenues adopted in the BCAP be applied only prospectively.

Petitioners state that the Petition for Modification is filed "pursuant to Rule 47 of the Commission's Rules of Practice and Procedure (Rules). In the updated version of the Rules, the requirements for a Petition for Modification are found in Rule 16.4. Accordingly, although Petitioners cited an outdated version of the Rules, the Petition for Modification meets the procedural requirements under Rule 16.4.

2. Opposing Parties' Positions

Responses in opposition to the Petition for Modification were timely filed on February 8, 2008, by the Division of Ratepayer Advocates (DRA) and by Southern California Generation Coalition (SCGC).

DRA and SCGC oppose granting Applicants' Petition for Modification. DRA disagrees with Petitioners' characterization of the Commission requirement for a memorandum account as being "punitive." DRA argues that there is no reason to think that SoCalGas is in danger of recovering less than its cost of providing noncore storage service or less than its authorized rate of return. DRA argues that Petitioners' proposed modification to D.07-12-019 would contravene the Commission's stated intent to decide issues regarding the appropriate allocation of noncore storage costs and revenues in the BCAP proceeding.

SCGC likewise opposes granting the Petition. SCGC argues to the extent the Commission gives any credence to Applicants' objections to use of a memorandum account, the appropriate alternative is not to adopt the 50/50 allocation proposal with no cap. Rather, SCGC advocates that if the Commission wants to eliminate the uncertainty of a memorandum account, the appropriate solution is to adopt the SCGC proposal which calls for imposing a \$5 million maximum cap on earnings from a 50/50 allocation of unbundled storage revenues. SCGC argues that its proposed \$5 million cap would provide certainty as to management incentives while ensuring that ratepayers are not deprived of what SCGC considers to be excessive revenues assigned to shareholders.

3. Discussion

Petitioners seek to modify D.07-12-019 in two respects. First they seek elimination of the memorandum account to track unbundled storage revenues. Secondly, they seek to ensure that shareholders receive a 50% share of unbundled storage revenues during the period from the effective date of D.07-12-019 until a decision is issued in the BCAP. In arguing for adoption of a guaranteed 50/50 sharing arrangement during the interim until the BCAP is concluded, Petitioners provided no new information that would just justify

modification of D.07-12-019. Accordingly, for the reasons discussed below, the Petition for Modification is denied.

In opposing the memorandum account treatment, Petitioners selectively focus on perceived detriments to utility shareholders due to the uncertainty regarding what specific share of revenues may ultimately be allocated as corporate earnings. We agree that under ideal circumstances, and absent other countervailing considerations, the design of a utility incentive mechanism would best be applied only on a prospective basis. With the incentive mechanism clearly defined in advance, the utility faces less uncertainty and knows the consequences of its management actions. We recognize that while the memorandum account is in effect, the utility will be required to manage its unbundled storage without certainty as to the precise share of unbundled storage costs and revenues that will ultimately be applied to shareholders.

Petitioners, however, focus only on one of the purposes of a mechanism for the sharing of unbundled storage revenues namely, as providing an incentive to manage the utilization of unbundled storage resources so as to maximize the earning of revenues, to the benefit of both shareholders and ratepayers. Another purpose of the sharing of revenues, however, is to protect ratepayers against excessively high charges for unbundled storage in relation to the profits retained by utility shareholders. While eliminating the memorandum account would remove shareholders' uncertainty as to their allocation of unbundled storage revenues, such elimination would also deprive ratepayers of any protection against excessive charges due to applying the 50/50 allocation without an adequate record to justify it.

Petitioners' request to eliminate memorandum account treatment for unbundled storage revenues would provide even less protection for ratepayers

than what they originally proposed under the Edison settlement. Petitioners' proposed modification would omit the \$20 million cap which was originally proposed as a protection to ratepayers against the risk of excessive profits accruing to shareholders from unbundled storage revenues.

Moreover, while uncertainty over the precise allocation of storage revenues will exist until the allocations are determined in a BCAP decision, the utility is not deprived of all incentive to prudently manage its storage resources during this interim period. While utility management will not know the precise share of revenue that will ultimately be assigned to shareholders until a decision in the BCAP, the prospect still remains for the utility receiving some share of revenues applicable to this interim period, subject to the record developed in the BCAP. The memorandum account does not result in any disallowance of shareholder revenues, but merely defers the disposition of the specific allocation. Moreover, in addition to any allocation of unbundled storage revenues that may be assigned to shareholders pending further BCAP proceedings, SoCalGas shareholders continue to have the opportunity to earn their authorized rate of return.

The alternative interim treatment proposed by Petitioners would eliminate uncertainty as to the allocation of revenues for shareholders, but would do so only by unfairly shifting additional potential costs to ratepayers. In comments on the Proposed Decision, Petitioners contend that applying the 50/50 sharing arrangement on a prospective basis would not shift costs to ratepayers because the sharing allocation applies to revenues – not costs. The fact remains, however, that the magnitude of retail ratepayer charges are increased or decreased as a function of the percentage of revenues allocated between shareholders and ratepayers. As a higher percentage of revenue is allocated to shareholders a

correspondingly lower percentage remains available to offset ratepayer costs. Petitioners' proposal would perpetuate the previously applied 50/50 sharing allocation even though D.07-12-019 did not find an adequate record to continue such an allocation. The memorandum account treatment was adopted because none of the proposals advocated by the parties for allocation of unbundled storage revenues was found to have adequate support in the record.

Assuming that the memorandum account treatment was to be eliminated, we would still have to determine what sharing arrangement to apply during the interval between the effective date of D.07-12-019 and a decision in the BCAP. Applicants have not provided adequate justification as to the merits of their new proposal for a 50/50 sharing with no cap during this intervening time interval. Assuming unbundled storage revenues during the interim exceed the \$20 million cap, utility investors would permanently retain this excess notwithstanding the lack of record to justify it. By petitioning to eliminate the memorandum account, and instead, to assign 50% of unbundled storage revenues to shareholders with no cap, Applicants thus are asking the Commission to prejudge a disputed issue before an adequate record has been developed.

As noted in D.07-12-019, the 50/50 risk sharing mechanism was instituted in 1999 at a time when the potential for stranded storage capacity was of concern. Given market conditions at that time, the 50/50 sharing was perceived as a useful incentive for SoCalGas to market that storage. Yet in the intervening years, as noted in D.07-12-019, demand for storage capacity has increased dramatically. Due to the dramatic increase in demand for SoCalGas storage services, the resulting storage prices and revenues subsequently rose to unforeseen levels. Given these changes in market conditions, and the resulting effects on storage prices and revenues, we concluded in D.07-12-019 that a

further record needed to be developed regarding the appropriate allocation of unbundled storage revenues. We were not persuaded by the Edison Settlement proposal for continuation of the 50/50 sharing, even with a new \$20 million cap on the maximum allocation to shareholders. We concluded that a cap as high as \$20 million had not been justified as necessary to provide adequate incentives for the utility to market unbundled storage.

Yet, in adopting D.07-12-019, we faced timing considerations which precluded a final determination of the appropriate utility incentive mechanism for unbundled storage in this proceeding. Nonetheless, the limited record that had been developed was sufficient to call into question the validity of continuing the 50/50 allocation of unbundled storage revenues, even with the \$20 million cap originally proposed by Applicants.

In order to allow time for analysis of the appropriate allocation of revenue sharing, we adopted DRA's proposal in D.07-12-019 for all unbundled storage revenues and costs to be booked into a new memorandum account for disposition in the next BCAP proceeding where appropriate sharing allocations and earnings caps could be determined. In this manner, we preserved the option to apply any subsequent findings regarding the appropriate allocation of unbundled storage revenues from the effective date of D.07-12-019 until a BCAP decision could be issued.

In their Petition for Modification, however, Petitioners disagree with the conclusions reached in D.07-12-019. They argue that "nothing in D.00-04-060 (in which the 50/50 allocation was adopted) indicates that the Commission failed to consider the possibility that storage prices and revenue could rise substantially over the BCAP period, or that some sort of intra-BCAP adjustment would be necessary if such increases indeed took place." (Petition at 9.) While Petitioners

disagree with conclusions reached in D.07-12-019 in this regard, mere disagreement with a conclusion reached in a Commission decision is not a sufficient basis to modify the decision.

The memorandum account treatment adopted in D.07-12-019 was a pragmatic solution which took into account the Commission's concerns over the validity of continuing the 50/50 allocation while recognizing the uncertainty as to what an appropriate allocation sharing of unbundled storage revenues should be.

Memorandum account treatment therefore provided a vehicle to defer the disposition of the allocation of unbundled storage costs and revenues until a further record could be developed and a decision issued in the BCAP. The memorandum account will provide the flexibility to allocate an appropriate share of revenues both to shareholders and ratepayers applicable to the period of time from the effective date of D.07-12-019 until a decision is issued in the BCAP. Therefore, the memorandum account does not eliminate the opportunity for shareholders to receive a reasonable share of unbundled storage revenues accrued during this interim period, but merely defers to the BCAP the determination of the specific shareholder allocation of those revenues. All interested parties, including Petitioners, will have the opportunity to present a showing in the BCAP regarding the appropriate manner in which to share unbundled storage costs and revenues.

By contrast, the modification sought by Petitioners would unfairly prejudice the outcome, and eliminate the flexibility to apply an appropriate allocation to the period from the effective date of D.07-12-019 until the issuance of a decision in the BCAP decision. Without a memorandum account, there would be no opportunity to adjust the revenue allocation during this period for

the protection of ratepayers. The result sought by Petitioners would thereby constitute an improper prejudgment of the disputed issue in favor of Petitioners' position.⁴

In comments on the Proposed Decision, Petitioners contend that eliminating memorandum account treatment would not constitute "impermissible prejudgment of a disputed issue" because the Commission would merely be maintaining the existing 50/50 sharing arrangement (Comments at 4). The fact remains, however, that the appropriate sharing arrangement for unbundled storage was a contested issue in this proceeding. Therefore, Commission authorization of any specific revenue sharing allocation prospectively--whether the existing 50/50 allocation or a different allocation--would constitute an affirmative judgment on the merits of the disputed issue. Making an affirmative judgment that the 50/50 sharing arrangement remains warranted would be prejudicial, particularly in view of the dramatic changes in market conditions in the intervening years since the 50/50 sharing arrangement was adopted, as noted in D.07-12-019.

We also reject Applicants' characterization of the memorandum account treatment as "penalizing" Applicants for settling their differences with Edison.

⁴ For similar reasons, the proposal of SCGC to adopt a \$5 million cap would likewise constitute on improper prejudgment.

The denial of one of the elements of the Edison settlement was not a “penalizing” act. The fact that a particular proposal was part of a broader settlement with Edison is incidental, but did not affect the Commission’s responsibility to adjudicate each element of the settlement proposal on its merits.

Moreover, the applicants did not invoke the Commission’s settlement rules in filing their original application, and did not ask the Commission to approve either of the settlements that formed the basis for their proposals. The Edison Settlement was entered into outside of any formal Commission proceeding and did not constitute the type of settlement governed by Article 12 of the Rules.⁵

The standard applied by the Commission in evaluating proposals contained in the Edison Settlement was whether it was in the public interest on its own merits. Applicants were placed on notice that they would have to justify the merits of their individual proposals, and could not simply rely upon the fact the proposals were part of a settlement with Edison in order to meet their burden of proof.⁶ Therefore, it is a mischaracterization of D.07-12-019 to attribute Commission adoption or rejection of individual elements of the Edison Settlement proposals as either “rewards” or “penalties” for entering into a settlement.

Moreover, the Commission’s consideration of whether or how to revise the 50/50 sharing mechanism in this proceeding was not dependent upon the fact

⁵ Article 12 applies only to settlements submitted after a PHC in a proceeding (Rule 12.1(a)). Rule 12.1(b) requires at least one noticed settlement conference prior to parties entering a settlement. No noticed settlement conference was convened in A.06-08-026 or any other Commission proceeding.

⁶ See D.06-12-034, *mimeo.* at 12.

that SoCalGas and SDG&E included unbundled storage revenue allocation issues in their settlement with Edison. The Commission independently had reason to address the reasonableness of the shareholder/ratepayer allocation of unbundled storage revenues in this proceeding. SCGC had previously asked for the Commission to address the reasonableness of the noncore storage revenue sharing allocations in R.04-01-025. The Commission declined to address the issue in that proceeding, but directed in D.06-09-039 that “[c]harges for SoCalGas’ unbundled storage services and other storage issues may be addressed by the Commission in Application (A.) 06-08-026.”⁷ Therefore, the Commission’s consideration of the treatment of unbundled storage revenues in a memorandum account was not limited by how SoCalGas and SDG&E negotiated their settlement with Edison.

The memorandum account provides a reasonable compromise whereby both shareholders and ratepayers share uncertainty as to the predetermined allocation of unbundled storage revenues that will be adopted. Nonetheless, all parties will have an opportunity to advocate for their position regarding the appropriate sharing in the BCAP. Moreover, SoCalGas and SDG&E have presented a proposal in the BCAP proceeding (A.08-02-001) to prioritize unbundled storage issues for consideration on a more expedited basis. A prehearing conference has been scheduled in the BCAP proceeding where this proposal for expedited treatment will be considered. To the extent that priority is given to addressing unbundled storage issues in the BCAP, the period that the memorandum account would apply could be significantly shortened. In this

⁷ See D.06-09-039, p. 6 and Conclusion of Law 8, p. 180.

manner, the uncertainty concerns raised by the Petitioner regarding the precise allocation of storage revenues would be mitigated.

4. Comments on Proposed Decision

The proposed decision in this matter was mailed to parties in accordance with § 311 of the Pub. Util. Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on April 1, 2008 and reply comments were filed on April 8, 2008. We have reviewed the comments in finalizing this decision.

Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Thomas R. Pulsifer is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. D.07-12-019, among other things, adopted memorandum account treatment for unbundled storage revenues pending a decision on the appropriate allocation and cap on unbundled storage revenues in the next BCAP.
2. SoCalGas and SDG&E timely filed a Petition for Modification of D.07-12-019.
3. Applicants' proposal for 50/50 ratepayer/shareholder revenue allocation with a \$20 million cap for unbundled storage services revenue was denied by D.07-12-019, while consideration of the appropriate revenue allocation sharing and earnings cap was deferred to the next BCAP.
4. In view of the subsequent increase in demand for SoCalGas storage services, and the resulting rise in storage prices and revenues to unforeseen levels, the Commission concluded in D.07-12-019 that the original rationale for the 50/50 sharing as an incentive for SoCalGas to market that storage was called into question.

5. While granting the Petition for Modification would give shareholders' certainty as to their allocation of unbundled storage revenues, without the memorandum account, ratepayers would lose protection against excessive charges due to applying the 50/50 allocation without an adequate record to justify it.

6. Applicants' proposed modification provides even less protection to ratepayers than did their original proposal which limited the maximum annual unbundled storage earnings allocated to shareholders to \$20 million.

7. While D.07-12-019 left uncertainty as to the precise allocation of storage revenues which until the allocations are determined in a BCAP decision based on a sufficient record, the utility is not deprived of all incentive to prudently manage its storage resources during this interim period.

Conclusions of Law

1. The Petition for Modification should be denied.

2. The modification proposed by Applicants would constitute a prejudgment of a disputed issue before the record has been sufficiently developed.

3. The adoption of memorandum account treatment for unbundled storage revenues in D.07-12-019 did not penalize Applicants for settling with Edison.

4. Applicants' disagreement with a conclusion reached by the Commission is not a valid basis to justify granting a Petition to modify.

5. The adoption of the memorandum account for unbundled storage revenues does not constitute denial of the opportunity for shareholders to recover a reasonable allocation of revenues, but merely defers the timing of a Commission decision on the allocation to the BCAP.

O R D E R

IT IS ORDERED that:

1. Petition for Modification of Decision 07-12-019, as filed by Southern California Gas Company and San Diego Gas & Electric Company is hereby denied.

2. Application 06-08-026 is closed.

This order is effective today.

Dated April 10, 2008, at San Francisco, California.

MICHAEL R. PEEVEY

President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

TIMOTHY ALAN SIMON

Commissioners

