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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies, Processes, and Rules to Ensure Safe and Reliable Gas Systems in California and Perform Long-Term Gas System Planning.

Rulemaking 24-09-012

ADMINISTRATIVE LAW JUDGE’S RULING REQUESTING ADDITIONAL INFORMATION TO IMPLEMENT SENATE BILL 1221

This ruling seeks additional information from parties about implementation of Senate Bill (SB) 1221 (Min, Chapter 602, Statutes of 2024). Parties may file and serve comments on the questions no later than March 27, 2026, and reply comments no later than April 3, 2026.

On October 10, 2025, the Assigned Commissioner issued a Second Amended Scoping Memo and Ruling to add Tracks 3 and 4 to Phase 3 of the proceeding and to invite parties to file and serve comments on questions related to the establishment of SB 1221 zonal decarbonization pilot projects. Phase 3, Track 3 scoped the following issues:

- 19. What cost recovery process(es), provision(s), and/or mechanism(s) should the Commission authorize, if any ratepayer funds are approved, for a zonal decarbonization pilot project implemented per [Public Utilities Code (Pub. Util. Code)¹] Section 663(8) and Section 663(b)(9)?
- 20. Should the Commission provide guidance or criteria for gas corporations to request a rate of return and recovery

¹ All subsequent statutory references are to the Public Utilities Code unless otherwise specified.

period for costs eligible for recovery per Pub. Util. Code Section 663(b)(9)?

Parties were invited to comment on a set of questions related to the establishment of SB 1221 pilot program. While parties provided input on posed questions related to scoping issues 19 and 20, more information is necessary to support a Commission decision on these scoping issues.

To further develop the record for Phase 3, Track 3 of this proceeding and in light of Section 663(b)(8), which prohibits a gas corporation from recovering Behind the Meter (BTM) costs associated with the pilot projects as capital costs that are afforded a rate of return, and Section 663(b)(9), which directs the Commission to establish the appropriate rate of return and recovery period a gas corporation is eligible to receive for implementing a zero-emission alternative, parties are invited to respond to the additional questions below. These questions present alternative outcomes for issues 19 and 20 of this proceeding:

1. Are Pub. Util. Code Section 663(b)(8) and Section 663(b)(9) in conflict? If not, why not? If so, in what way and how can they be harmonized?
2. Should the Commission allow rate recovery of BTM zero-emission alternative (ZEA) implementation costs incurred by gas utilities (i.e., the utility may recover approved program costs from gas ratepayers)? Why or why not?
3. If the Commission authorizes utilities to recover approved BTM costs, should the Commission authorize expense treatment, where costs are recovered in rates in the year they are incurred? Why or why not?
4. If the Commission authorizes utilities to recover BTM costs, should the Commission authorize regulatory asset treatment? Why or why not?
5. If you recommend regulatory asset treatment, address the following questions:

- a. Which amortization period should the Commission adopt: five years, 10 years, 15 years, 20 years, or something else? Provide justification.
- b. What depreciation schedule(s) should apply to BTM costs if the Commission were to grant regulatory asset treatment? Should there be straight-line depreciation for an amortization period (e.g., 5 percent annual depreciation over a 20-year amortization period)? Should there be an accelerated depreciation schedule? Should a single depreciation schedule be applied to all BTM assets? Provide justification.
- c. Considering your responses to Questions 5(a) and 5(b), what would be the appropriate compensation for the gas corporation on the amortized expenditures and why? If the Commission were to grant regulatory asset treatment for BTM expenditures, what rate of return should be authorized? What clarifications would be necessary, if any, regarding allocation of BTM expenses to long-term debt? Consider the following three options and identify the most appropriate option and why:
 - **Option 1:** BTM expenditures are recorded as pilot program expenses and amortized over a period of time, with gas corporations receiving a carrying cost equal to their authorized cost of debt.²
 - **Option 2:** BTM expenditures are treated as regulatory assets that are afforded an adjusted rate of return that would differ from the authorized rate of return for capital investments to account for the fact that the utility would not own or maintain any BTM assets as capital assets. Those BTM expenditures would (1) be amortized over a shorter period of time compared to the gas capital asset (see Question 5(a) above), (2) would depreciate faster than the gas capital asset (as determined by responses to Question 5(b) above), and

² This figure is currently 5.04% for PG&E, 5.02% for SoCalGas, and 4.59% for SDG&E, pursuant to Decision (D.)25-12-043.

(3) would receive a lower rate of return set at the midpoint value of the IOU's cost of long-term debt and its prevailing authorized rate of return for capital expenses. This would result in a BTM expenditure rate of return of 6.325% for PG&E, 6.27% for SoCalGas, and 6.00% for SDG&E, as compared to their capital asset rates of return of 7.61% for PG&E, 7.52% for SoCalGas and 7.41% for SDG&E, as approved in D.25-12-043.

- **Option 3:** BTM expenditures are recorded as pilot program expenses and amortized over a period of time, with gas corporations receiving a carrying cost equal to their authorized cost of debt, as with Option 1 above. In addition, the gas corporation is eligible for a one-time shareholder incentive tied to program outcomes. Gas utility shareholders and remaining gas customers share the net cost savings³ from successful pilot projects. The following example illustrates one way such an incentive could be structured. Parties may wish to propose alternative incentive structures, which must be tied to program outcomes and can be implemented with data collected from pilot implementation.

Option 3 Example

Contingent on the eligibility threshold being met, the utility receives up to 25 percent of the net savings subject to a performance multiplier and an earnings cap. The performance score is based on normalized metrics for:

- main and service line miles decommissioned,
- customer conversions, and...

³ Net Savings refers to the difference between the gas system costs the utility would have incurred absent the Zero Emissions Alternative and the actual costs of implementing the ZEA pilot, representing the avoided gas infrastructure costs attributable to the pilot after accounting for full ZEA costs.

- whether approved pilot costs are within or exceeded the approved budget once the zero emissions alternative is implemented.

Formula

Utility Shareholder Incentive = 25% * (Avoided Cost Savings - Zero Emissions Alternative Costs) * $f(S)$

The combined Performance Score (S) is:

$$S = 100 \cdot (w_S m_S^* + w_C m_C^* + w_B m_B^*)$$

Where:

- m_S^* = normalized miles of main and service line metric
- m_C^* = normalized customer conversion metric
- $m_B^* = 1$ if the project is at or below budget
- $m_B^* = 0$ if the project is over the approved budget
- $w_S, w_C, w_B =$ weights (0.35, 0.35, 0.30) and $\sum w_i = 1$

$f(S)$ is a tiered-factor performance score bounded between 0 and 1.0. The following is an example of how the performance score could be structured:

- $0 \leq f(S) \leq 1$
- S=0-14: $f(S) = 0.0$
- S=14-24: $f(S) = 0.25$
- S=25-79: $f(S) = 0.5$
- S=80-89: $f(S) = 0.75$
- S=90-100: $f(S) = 1.0$

For illustration, assume a gas utility retires a set of service lines and electrifies a group of customers, resulting in \$100 million in approved

avoided gas system costs and \$70 million in verified BTM costs, producing \$30 million in net savings. If the project achieves a performance score above the minimum threshold, the utility would be eligible to receive up to 25 percent of those net savings, adjusted by the applicable performance multiplier. For example, if the performance score placed the project in the mid-tier range ($S=0.50$), the utility's shareholder reward would equal $0.25 \times \$30 \text{ million} \times 0.50$, or \$3.75 million. The remaining savings would accrue to gas customers through reduced future gas system costs.

Parties may file and serve comments on the questions above no later than March 27, 2026, and reply comments no later than April 3, 2026.

IT IS RULED that:

1. Parties may file and serve comments on the ruling questions no later than March 27, 2026, and reply comments no later than April 3, 2026.

Dated March 17, 2026, at San Francisco, California.

/s/ PAULA GRUENDLING
Paula Gruending
Administrative Law Judge