Cost Recovery Mechanisms for Energy Utilities

For exogenous events occurring between GRC proceedings

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Question

What mechanisms are available to energy utilities to recover costs for exogenous events that happen in between GRC cycles?

<u>Examples of exogenous events:</u>

Emergencies arising from Floods, Fires, Earthquakes

Available Mechanisms

- Catastrophic Event Memorandum Account (CEMA)
- Z-Factor
- Major Emergency Balancing Account "MEBA" (PG&E only)

Catastrophic Event Memorandum Account (CEMA)

- If a catastrophic event is declared a state of emergency by the state or federal government, then utilities can record costs caused by the event in this memorandum account.
- By recording these costs, the utilities can later ask for recovery of these costs from the Commission.
- The CPUC then reviews these costs and approves them as appropriate.

History of CEMA

- Established by Resolution E-3238 in 1991, pursuant to PUC Code Section 454.9
- Added by the passage of Senate Bill 1456
- The bill addressed concerns by regulated water utilities that the Commission's process for recovery of disaster-related costs is untimely, particularly following the 1989 Loma Prieta and 1994 Northridge earthquakes.

Limitations of the CEMA

- The event must be a declared disaster or state of emergency by the state or federal government.
- The utility cannot record or request recovery of costs incurred before the date the event is declared a state of emergency.

What about events that are NOT declared state of emergencies?

1. Z-factor (all 4 major IOUs)
2. Major Emergency Balancing Account (PG&E only)

Z-factor Recovery Mechanism

- Utilities can record costs of exogenous events that are not declared states of emergency, if these exogenous events qualify for Z-factor Recovery
- To qualify for Z-factor recovery, these exogenous events must be unforeseen at the time rates (revenue requirement) were established
- A list of 8 criteria for Z-factory recovery mechanism includes:
  - Events could not have been prevented by management
  - Events must have a significant financial impact on the utility
- Z-factor events can increase or decrease the utilities' cost of service

Other facts about Z-factor

- Z-factor mechanisms are reviewed and approved in the GRC proceedings
- Z-factor has a deductible ($5M-$10M, depending on the utility)
- Rules governing this mechanism are not consistent across the utilities
  - Utilities have different deductible amounts
  - PG&E’s Z-factor mechanism works differently compared to other utilities
    - Pending approval of PG&E’s 2017 GRC settlement, PG&E’s Z-factor would not be applicable during a test year
    - PG&E’s Z-factor also applies to their Gas Transmission and Storage Proceeding

PG&E's Major Emergency Balancing Account (MEBA)

SCE and Sempra do not have similar accounts

Major Emergency Balancing Account “MEBA” *(PG&E only)*

- PG&E can recover actual costs resulting from responding to major emergencies or catastrophes that are not declared state of emergencies.
- A recovery mechanism for costs that are not eligible for CEMA.

Origins

- Established in PG&E's 2014 GRC decision, D.14-08-032.
- PG&E requested a MEBA in its 2014 GRC
- In its request, PG&E mentioned D.07-07-041,
  - The decision defined CEMA-eligible costs to be for damages that occurred in a county or city in which the Governor of California or the President of the United States has declared a disaster or state of emergency.
- The January 2008 storms damaged PG&E facilities in 43 counties, costing the Company $89M.
- PG&E was only to recover only $28M, because only 13 of these counties and 2 of these cities were declared a state of emergency.
- As a result, PG&E incurred $61M in expenses that could not be recovered through CEMA.

What happened in PG&E's 2014 GRC?

- PG&E proposed to establish the MEBA.
- ORA opposed the MEBA
  - ORA's Argument: MEBA provides PG&E with a blank check.
- The decision:
  1. Approved the MEBA,
  2. Approved $99M for the MEBA to go into rates
  3. Cost recovery will be subject to scrutiny to ascertain that the costs incurred were prudent and necessary to respond to a major emergency.

Justification:

- In a major emergency, PG&E must spend what is required in order to restore service to all customers, and does not have discretion to avoid spending required to address major emergencies not covered under CEMA.

How does the MEBA work?

- PG&E is approved to recover in rates its forecasted costs of addressing non-CEMA emergencies.
- This is a 2-way balancing account.
  - PG&E cannot reprioritize the money to other purposes; money must be spent on non-CEMA emergencies
  - Unspent money will need to be returned to ratepayers.
  - If PG&E spent over the authorized amount, the costs must be reviewed for reasonableness before PG&E can recover them.
- The forecast of these costs are reviewed in the GRC.
  - In 2014, $99.1M was forecasted and approved for the MEBA. PG&E spent $60.4M in 2014.
  - In its 2017 GRC, PG&E forecasted $103.5M for the MEBA.
- Unlike the CEMA, definitions for emergencies for MEBA are not defined and unclear.

SCE and SDG&E

- In comparison, for SCE and SDG&E, forecasts for emergency preparedness and responses are approved as part of the GRC budget and not segregated in a balancing account.
- If SCE and SDG&E spent less than forecasted, the utility can keep the money.
- If SCE and SDG&E spent more than forecast, the utility will have to get the money from other areas of the GRC budget or pay for it from shareholders.

A Tool Available to the Utilities:

Memorandum Accounts

Memorandum Accounts

- The utilities can record costs in a memorandum account for events not covered by a GRC.
- The utilities must receive Commission permission prior to establishing a memorandum account.
- The utilities would need to make a compelling case to request recovery of these costs from the Commission.

Memorandum Account

PRO

- Memo accounts can be used to get around retroactive ratemaking prohibition.
- The utilities must prove reasonableness before it can recover these costs.

CON

- The utilities may not feel that they have secure funding for responding to non-CEMA emergency events, because costs booked in memo accounts carry risk of non-recovery.

CONCLUSIONS

Key Observations

- Because the attrition year ratemaking mechanisms are established individually in each utility's general rate case, these mechanisms are different for all 4 major IOUs.
- The utilities have many mechanisms to reduce risks to ensure that they earn their authorized rate of return.
- PG&E has an additional cost recovery mechanism, the MEBA.

Questions?

Appendices

- Appendix 1: How does CEMA work?
- Appendix 2: How does the Z-factor work?
- Appendix 3: The Eight Criteria for Z-factor recovery
- Appendix 4: One-way Balancing Account
- Appendix 5: Two-way Balancing Account
- Appendix 6: A Z-factor event - SDG&E's Wildfire Insurance
- Appendix 7: Wildfire Expense Memorandum Account (WEMA)

Appendix 1: How does CEMA work?

1) Record Costs and Notify CPUC:
    - After a state of emergency occurs and the utility begins booking costs resulting from the event, the utility must send a letter to the Executive Director within 30 days.
    - In the letter, the utility shall provide not only the details of the disaster but also an estimate of the costs to be incurred.
2) Cost Recovery
    - Utilities request cost recovery of the CEMA in a formal proceeding.

Appendix 2: How does the Z-factor work?

- A Z-factor may be identified by the utility or ORA.
- When a Z-factor is identified, the utility or ORA must send a letter to notify CPUC
  - Executive Director of CPUC
  - Energy Director (copy)
  - ORA Director (copy)
- Utilities begin recording costs as a Z-factor.
- Utilities request approval from the Commission to recover (or refund) these costs in a formal proceeding.

Appendix 3: The Eight Criteria for Z-factor recovery

The eight criteria are:

1. The event must be exogenous to the utility;
2. The event must occur after implementation of rates;
3. The costs are beyond the control of the utility management;
4. The costs are not a normal part of doing business;
5. The costs must have a disproportionate impact on the utility;
6. The costs must have a major impact on overall costs;
7. The cost impact must be measurable; and
8. The utility must incur the cost reasonably.

- This framework is established over several Commission decisions.
- It was first established in D.89-10-031 to allow rate adjustments for things other than inflation.
- Z-factors were last set in D.94-06-011

Appendix 4: One-way Balancing Account

The utilities recover in rates a forecasted amount for a defined cause, e.g. responding to emergency events.

PRO

- The utilities do have some form of secured funding.
- Unspent money is returned to ratepayers.

CON

- The forecasted amount is already paid by ratepayers, but was not reviewed for reasonableness.
- Costs that are above the forecast will not be able to be recovered.

Appendix 5: Two-way Balancing Account

- The utility presents a forecasted amount in the GRC and is guaranteed the money to spend on an identified cause, e.g. responding to emergencies.
- Additional costs would be recorded and reviewed for reasonableness before the utilities can recover the costs.

PRO

- The utilities are guaranteed funding and have full discretion on how to spend the money on the specified cause, e.g responding on emergencies.

CON

- The forecasted amount is already paid by ratepayers, but was not reviewed for reasonableness.

Appendix 6
A Z-factor event: SDG&E's Wildfire Insurance

- After the 2008 wildfires in Southern California, SDG&E experienced significant insurance premium increases in 2009
  - Was 1000% greater than forecasted in 2008.
  - $4.5M in 2008, $47M in 2009
- April 2009, SDG&E recorded the insurance cost increases as a Z-factor under its Z-factor Memo Account (ZFMA).
- August 2009, SDG&E filed an application before the Commission, A.09-08-09, to recover the insurance costs as a Z-factor event.
- December 2010, the Commission approved the expenses for recovery and instructed SDG&E to file ALs to recover insurance cost expenses for subsequent years prior to its next GRC.

Appendix 7
Wildfire Expense Memorandum Account (WEMA)

- In Sept 2009, following the 2008 wildfires in Southern California, PG&E, SCE, SDG&E, and SoCalGas each filed an advice letter to establish a Wildfire Expense Memo Account (WEMA).
- The WEMA is an interim mechanism while the Commission considers an application the utilities jointly filed to recover wildfire-related costs in a balancing account, the Wildfire Expense Balancing Account (WEBA).
- Energy Division drafted a resolution approving the establishment of a WEMA.
  - The Resolution specified that cost recovery is only through a formal proceeding, i.e. the WEBA proceeding.
- The Commission approved the resolution in July 2010.