Date of Hearing: April 3, 2024

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY
Cottie Petrie-Norris, Chair
AB 2847 (Addis) – As Amended March 21, 2024

SUBJECT: Electrical and gas corporations: capital expenditures: request for authorization or recovery

SUMMARY: Requires electrical and gas corporations in their request for capital expenditures to provide their best estimation, alongside supporting documents, of the impact of the proposed expenditures on the utility's authorized revenue for each year of the life of the capital asset, as well as the asset's net present value (NPV).

EXISTING LAW:

1) Establishes the CPUC has regulatory authority over public utilities, including electrical corporations. (California Constitution Article XII, §§ 3 and 4)

2) Authorizes the commission to fix the rates and charges for every public utility and requires that those rates and charges be just and reasonable. (Public Utilities Code § 451)

3) Prohibits a public utility from changing any rate, except upon a showing before the commission and a finding by the commission that the new rate is justified. (Public Utilities Code § 454)

4) Authorizes the CPUC to require a public utility to correct any rates, practices, equipment or behavior that is unjust, unreasonable, unsafe, improper, inadequate, or insufficient. (Public Utilities Code § 761)

FISCAL EFFECT: Unknown. This bill is keyed fiscal and will be referred to the Committee on Appropriations for its review

BACKGROUND:

Financial Literacy – The following terms are commonly used to describe and categorize monies – either collected or spent – by utilities.[1]

- Capital expenditures (CapEx) – longer-term costs, such as costs to build and maintain physical assets; i.e. power plants, overhead lines, and pipes. Utilities earn a return on their CapEx.

- Operational expenditures (OpEx) – recurring or short-term costs, such as labor, fuel, vegetation management, and taxes. Utilities do not earn a return on their OpEx. They

[1] Definitions heavily borrowed from Lazar's *Electricity Regulation in the US: A Guide*, Second Edition, 2016.

may earn or lose money depending on how their projected OpEx lines up with their actual expenditures.

- Revenue Requirement – the total amount of revenue the utility would need to collect from ratepayers in order to provide a reasonable opportunity to earn a fair rate of return on its investment.

- Rate of Return – i.e. profit. Established under the regulatory compact, utilities are allowed the opportunity to earn (not guaranteed) an annual rate of return on their rate base.[2] Legal precedent requires the rate be sufficient to allow the utility to attract investment under prudent management, given the level of risk that the utility business model faces.

- Rate base – total of all long-term investments made by the utility to serve customers, net depreciation, such as buildings, power plants, fleet vehicles, poles, wires, transformers, pipes, and even offices and their furniture – i.e. the physical belongings.[3]

- Depreciation/Amortization – accounting practices that allow utility customers to pay for investments over the asset's lifetime. Depreciation is the financial recovery over time of a capital investment; amortization is the recovery over time of an intangible investment; e.g., a regular payment to a city for a franchise agreement.

- Net present value (NPV) – calculation of cash-in, cash-out over time for a given investment. It is often used to determine whether an investment will be profitable in the future. It calculates the value of an investment over a given time period, recognizing that project efficiencies, loans, payouts from insurance, taxes, and other factors will evolve over the lifetime (usually 30+ years) of the asset, and may show an investment that looks wasteful or inefficient in the short-term actually proving profitable in the long-term. Caution must be exercised in reviewing NPVs, however, as the calculation is dependent on estimates for future year cash flows. In other words, the calculation is only as good as its inputs.

COMMENTS:

1) *Author's statement.* According to the author, "As energy rates increase across the state, it's important to ensure that every cost included in ratepayers' bills is just and reasonable. This is especially true for capital costs, which will have a long-term impact on rates. The CPUC needs a clear and accurate view of the long-term financial impact of a project to assess whether the cost of the project is reasonable to pass along to ratepayers. AB 2847 will provide that transparency."

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[2] Two US Supreme Court decisions, *Hope* and *Bluefield*, established general principles around commissions setting rates of return.
[3] And some other items like deferred taxes, etc.

2) *Profit Drivers and Uncertain Calculations.* The utility business model encourages investment in physical infrastructure, as these capital assets earn a profit for utility shareholders. This model helps encourage utility investment in expensive projects that otherwise may be deemed too risky by financial investors. In the context of growing demand for electricity, as is expected in California as more housing and transportation electrify, this model can encourage utilities to expand and upgrade the infrastructure needed to meet that demand. However, as noted by the author, this model can also motivate utilities to propose higher cost projects in order to maximize their return.

   Capital projects depreciate. They are paid off over many years, often over decades. Throughout that time, the costs are passed along to ratepayers. The durability of these capital costs, the author notes, makes the request for capital expenses deserving of enhanced scrutiny, as decisions made today could impact ratepayers for years. This measure seeks enhanced scrutiny for electrical or gas corporation capital projects by requiring the utilities provide estimations of a requested asset's impact to the revenue requirement for every year that asset will remain in the rate base, alongside a calculation of the net present value of the asset's impact to the revenue requirement.

   Writing in opposition, San Diego Gas & Electric (SDG&E) and the Southern California Gas Company (SoCalGas) note the evaluations called for under this bill are infeasible, given the uncertainty of how a utility's revenue requirement may change over decades as well as the delay between receiving approval for an asset versus its in-service date. This uncertainty could skew the required calculations, leading to values with little basis in reality.

   Despite the concern, SDG&E has provided such calculations for their projects. As part of their 2014 application[4] for a vehicle-to-grid pilot, SDG&E provided annual revenue requirement impacts through 2037.[5] Those projections demonstrated annual cost escalations from $1 million in the first year to $10 million by year four, and showed actual total project costs at approximately $194 million, despite the initial application showing "total capital and O&M costs" at $102 million.[6] In a recent project update, SDG&E compared actual project costs versus costs forecasts at the beginning of the project. They found cost overruns of approximately $24 million as of December 2020.[7] This would suggest that the goal behind this measure – greater transparency of how utility capital requests will impact future rates – is valuable, as actual project costs in this

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[4] A. 14-04-014
[5] Appendix B, A.14-04-014, "Prepared Direct Testimony of Jonathan B. Atun, Chapter 4 on behalf of SDG&E Company," April 11, 2014.
https://www.sdge.com/sites/default/files/regulatory/Chapter_4_Atun_Testimony_VGI.pdf
[6] Pg. 5, *Application of SDG&E for authority to implement a pilot program for electric VGI,* A. 14-04-014, April 11, 2014.
[7] Table 9, pg. 24, SDG&E, *Power Your Drive Research Report,* April 2021;
https://www.sdge.com/sites/default/files/regulatory/SDG%26E%20FINAL%20Power%20Your%20Drive%20Research%20Report%20April%202021.pdf

example have even exceeded those forecast by the more granular calculations. However, it also demonstrates SDG&E's concern that findings from such exercises should be viewed cautiously, as the variables inherent to these calculations are assumptions that can often lead to informed, but inaccurate, conclusions.

Moreover, in focusing long-term rate impact calculations solely on capital expenses, this bill may result in utility applications that always give the impression that operational expenses are more favorable to ratepayers, as the associated ancillary costs (taxes, interest, profit, etc.) of OpEx are often less than CapEx. However, as has been shown with vegetation management for wildfire mitigation, operational expenses can also arise suddenly and persist over many years. While this bill rightly acknowledges these uncertainties by requiring electric and gas utilities' "best estimate," the CPUC and parties should be cautious in drawing rigid conclusions from the data provided.

REGISTERED SUPPORT / OPPOSITION:

Support

The Utility Reform Network (TURN)

Oppose

Sempra Energy and Its Affiliates: San Diego Gas & Electric Company and Southern California Gas Company

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