

140 FERC ¶ 61,108
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

San Diego Gas & Electric Company

Docket No. ER11-4318-001

ORDER ON COMPLIANCE FILING

(Issued August 3, 2012)

1. On November 14, 2011, San Diego Gas & Electric Company (SDG&E) filed its compliance filing to comply with the Commission's directive in an October 14, 2011 order issued in this proceeding.¹ In this order we reject SDG&E's compliance filing because its proposed accounting treatment for its uninsured, wildfire-related, third-party property losses and legal expenses (Wildfire Property Costs), and wildfire insurance premiums is inconsistent with the Commission's accounting regulations, and direct a further compliance filing.

I. Background

2. On August 15, 2011, SDG&E filed its annual Transmission Owner (TO3) formula rate mechanism informational filing as required by a previously approved settlement (TO3 Settlement).² SDG&E's filing included costs associated with several wildfires that occurred in SDG&E's service area. SDG&E stated that three specific wildfires occurred in 2007: the Witch, Rice, and Guejito wildfires. SDG&E stated that, as a result of the 2007 wildfires, the cost of wildfire insurance increased significantly and, beginning in 2009, insurance policies reflected a bifurcation of general liability insurance coverage

¹ *San Diego Gas & Elec. Co.*, 137 FERC ¶ 61,041 (2011) (October 14 Order).

² *San Diego Gas & Elec. Co.*, 119 FERC ¶ 61,169 (2007). Pursuant to the terms of SDG&E's TO3 Settlement, which is in effect from July 1, 2007 through August 31, 2013, SDG&E is required to file an annual informational filing that reflects adjustments to its transmission formula rate mechanism based on certain recorded and estimated costs.

between wildfire-related and non-wildfire-related coverage and premiums. SDG&E stated that one of the factors that contributed to SDG&E's insurers increasing their premiums and the bifurcation of the insurance coverage is that the insurers were concerned about California's imposition of inverse condemnation on utilities in California that imposed strict liability for third-party property damages caused by the wildfires.³ SDG&E stated that, as a result of California's inverse condemnation law, SDG&E incurred costs related to land owners affected by the wildfires who are pursuing compensation from SDG&E for the "taking" of private property for public use, i.e., Wildfire Property Costs. As described by SDG&E, these Wildfire Property Costs include the legal expenses and claims paid by SDG&E that were not covered by insurance. Consequently, SDG&E represented that it incurred injuries and damages of \$128.3 million in 2010, including \$68.4 million related to wildfire insurance premiums, \$44.5 million related to Wildfire Property Costs, and \$15.4 million related to other injuries and damages.⁴

3. SDG&E's informational filing proposed that the Wildfire Property Costs be classified as condemnation costs related to the acquisition of a limited-term interest in land, and capitalized as transmission and distribution utility plant in Account 350 (Land and Land Rights) and Account 360 (Land and Land Rights) of the Uniform System of Accounts (USofA).⁵ SDG&E also proposed to expense 100 percent of capitalized Wildfire Property Costs in Account 404 (Amortization of Limited-Term Electric Plant) in the same month.

4. In its October 14 Order, the Commission found that SDG&E improperly capitalized Wildfire Property Costs that should have been expensed to Account 925 (Injuries and Damages). The Commission stated that, in so doing, SDG&E bypassed using the labor ratio allocation required by its current formula, and therefore failed to

³ SDG&E defines an "inverse condemnation" action as "an eminent domain proceeding initiated by the property owner instead of by the public utility in which the property owner claims that his or her property was taken or damaged, either on a temporary or permanent basis, for a public use without justification." SDG&E T03-Cycle 5 Filing, Volume 2-A, Part I-D. SDG&E stated that, because the land owners affected by the Witch Fire are pursuing compensation for the "taking" of private property for public use, as defined under California law, SDG&E proposed to account for these real property-related costs in its Cycle 5 filing.

⁴ SDG&E T03-Cycle 5 Filing, Volume 3, Statement AH, Page AH3 – Administrative & General Expenses.

⁵ 18 C.F.R. Part 101 (2012).

charge the rate on file with the Commission. Having made this determination, the Commission rejected SDG&E's proposed accounting treatment for its Wildfire Property Costs, finding it inconsistent with the USofA. The October 14 Order directed SDG&E to file revised worksheets recording Wildfire Property Costs in Account 925 instead of using Account 350, Account 360, and Account 404, as SDG&E proposed in its August 15, 2011 informational filing. The October 14 Order also directed SDG&E to allocate the Wildfire Property Cost using labor ratios.

II. Compliance Filing

5. On November 14, 2011, SDG&E filed revised worksheets to comply with the October 14 Order. SDG&E recorded the Wildfire Property Costs as an administrative and general (A&G) expense in Account 925 and capitalized \$4.8 million of the total \$44.5 million in Wildfire Property Costs. SDG&E proposed to capitalize the Wildfire Property Costs to future construction projects.⁶

III. Deficiency Letter

6. In response to the November 14, 2011 compliance filing, a deficiency letter was issued on February 24, 2012 directing SDG&E to provide a written explanation supporting the capitalization of the Wildfire Property Costs. The deficiency letter requested that SDG&E explain its rationale for capitalizing any portion of any wildfire costs, including Wildfire Property Costs and the bifurcated insurance premiums, under the Commission's accounting regulations. In addition, the deficiency letter sought information connecting the wildfire costs with specific construction projects to justify the capitalization of these costs. Finally, the deficiency letter requested information regarding the impact of capitalizing wildfire costs on retail rates.

⁶ SDG&E stated that the reclassification of uninsured wildfire related losses as inverse condemnation from Accounts 350, 360, and 404 to Account 925 impacted the following cost statements: the Cost of Plant under Cost Statement AD was reduced by \$820,000; Accumulated Depreciation and Amortization under Cost Statement AE decreased by \$820,000; Operating and Maintenance expenses under Cost Statement AH increased by \$2.373 million; Transmission-related Depreciation and Amortization expenses decreased by \$19.687 million; Taxes Other than Income Taxes under Cost Statement AK increased by \$14,000; Working Capital under Cost Statement AL increased by \$297,000 (as a result of the increase to A&G expenses); and the transmission rate base increased by \$314,000 under Cost Statement AV (Rate of Return). Compliance Filing Attachment 1 at 2-3.

IV. SDG&E's Response to Deficiency Letter

7. On April 25, 2012, SDG&E provided a response to the February 24, 2012 deficiency letter. SDG&E asserted that its proposed accounting treatment complies with the USofA, the October 14 Order, and SDG&E's currently effective TO3 formula rate.

8. SDG&E stated that its capitalization of Wildfire Property Costs complies with the Commission's accounting requirements in Account 925, Note B, which expressly requires that "the costs of injuries and damages or reserve accruals capitalized shall be charged to construction directly or by transfer to construction work orders from this account." SDG&E explained that it did not interpret the Commission's finding in the October 14 Order – that SDG&E improperly capitalized costs to Account 350 and Account 360 and amortized those costs 100 percent to Account 404 in the same month – to mean that SDG&E was precluded from capitalizing a portion of its uninsured wildfire damage claim costs. According to SDG&E, compliance with the Commission's directive required a portion of the total costs in Account 925 to be allocated to capital, because the extent to which SDG&E's labor force works on transmission capital projects is reflected in the labor ratio allocations provided for in SDG&E's current formula.

9. Finally, SDG&E argued that its responses to the deficiency letter demonstrate that the currently effective rates, which are being collected subject to refund, are unaffected by whether or not construction overhead costs associated with the wildfire property losses are capitalized or expensed. SDG&E explained this issue will have rate implications for subsequent rates that will become effective September 1, 2013, subject to refund.⁷

V. Notice of Filing and Responsive Pleadings

10. Notice of SDG&E's compliance filing was published in the *Federal Register*, 76 Fed. Reg. 72,695 (2011), with interventions and protests due on or before December 5, 2011.

11. Timely comments were filed by the Cities of Anaheim, Azusa, Banning, Colton, Pasadena and Riverside, California (collectively, the Six Cities). SDG&E filed an answer on December 13, 2011, and Six Cities filed a motion for leave to respond and response on December 28, 2011.

12. Six Cities asserted that SDG&E's compliance filing does not provide an adequate level of information to allow a full assessment of the impact of the Account 925 treatment. Specifically, Six Cities argued that SDG&E has not provided in its compliance filing a breakdown showing how the \$44.5 million in inverse condemnation

⁷ SDG&E Response at 2.

expenses have been allocated to SDG&E's various corporate functions according to SDG&E's labor ratios. Six Cities also stated that SDG&E failed to provide enough information to show the impact of capitalizing wildfire costs on future rates. Six Cities argued that any proposal by SDG&E to record the inverse condemnation costs in Account 925 and then capitalize them would appear to be inconsistent with the October 14 Order. Six Cities noted that capitalizing the inverse condemnation costs would permit SDG&E to earn a return on the costs while they are reflected in rate base and result in higher costs for customers. Six Cities argued that the Commission should require SDG&E to provide supplemental information.

VI. Discussion

A. Procedural Matters

13. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2012), prohibits an answer to a protest and/or answers unless otherwise ordered by the decisional authority. We are not persuaded to accept SDG&E's answer or Six Cities' response and will, therefore, reject them.

B. Commission Determination

14. We will reject SDG&E's compliance filing, subject to a further compliance filing due within 60 days from the date of this order. We find that SDG&E improperly capitalized wildfire insurance premiums and Wildfire Property Costs. SDG&E failed to demonstrate that these costs were reasonably related to construction as required under the Commission's accounting regulations.

15. Under the Commission's accounting regulations, when a company incurs costs for injuries and damages, it can expense such costs to Account 925 or capitalize these costs as a construction overhead cost in Account 107 (Construction Work in Progress – Electric) under Electric Plant Instruction (EPI) No. 4.⁸ To treat injuries and damages as a construction overhead cost under the Commission accounting regulations, SDG&E must demonstrate that these costs are reasonably related to construction. Absent such demonstration, injuries and damages costs are properly expensed in Account 925 in conformance with the Commission's accounting regulations.

16. In SDG&E's compliance filing, it represented that it recorded wildfire insurance premiums and Wildfire Property Costs in Account 925, and then capitalized 10.9 percent of the balance in Account 925 to construction projects as a construction overhead cost. In

⁸ 18 C.F.R. Part 101, Electric Plant Instruction No. 4.

support of its position that these wildfire costs are properly capitalized as an overhead cost, SDG&E cites EPI No. 4, which states overhead costs includes:

construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto . . .

⁹

17. SDG&E also argued that because the majority of injury and damage costs typically relate to numerous lower dollar incidents, it does not try to evaluate and charge each cost directly to expense or capital. SDG&E asserted that the best correlation to construction activities is the activities of its employees and, therefore, transfers injuries and damages costs to construction work orders from Account 925 on the basis of labor ratios. However, we find SDG&E's arguments to be unpersuasive and contrary to EPI No. 4.

18. Under EPI No. 4, A&G costs, such as the cost of injuries and damages included in Account 925, may be charged to construction work orders as a construction overhead cost under the basis that the costs are reasonably related to the construction project. Specifically, overhead construction costs are expenditures that have a proven relation to construction activities, but cannot be traced to, or specifically identified with an individual construction project as a direct cost. The relation could be supported by time card distributions or other special studies for labor costs assigned to construction projects as an overhead. However, where A&G costs do not have a definite relation to construction activities, those costs should not be capitalized as a construction overhead cost and must be recorded in the appropriate A&G expense account.

19. We find that the wildfire insurance premiums and Wildfire Property Costs incurred by SDG&E represent A&G expenses necessary to operating its business and should not be capitalized because such costs did not have a relation at all to any past or ongoing construction activities. As discussed above, SDG&E's wildfire costs relate to the increased costs for wildfire insurance policies and the claims it paid to third parties for wildfire property losses not covered by insurance. In addition, SDG&E failed to name or describe a single construction project connected with the wildfire costs in its

⁹ *Id.*

response to the Commission's specific questions in the deficiency letter.¹⁰ Accordingly, SDG&E did not demonstrate that these costs bore any relationship to construction as required by the USofA in order to capitalize these costs. Therefore, we conclude that the methodology used to capitalize the wildfire insurance premiums and the Wildfire Property Costs in Account 925 is not sufficiently supported.

20. We also find that the majority of injuries and damages costs that SDG&E incurred related to costly wildfire expenditures rather than lower dollar incidents as SDG&E indicated. Wildfire costs represented \$112.9 million (which is 88 percent of injury and damage costs) and only \$15.4 million (or the remaining 12 percent) was related to other injuries and damages. SDG&E's capitalization policy for assigning injuries and damages to construction is inconsistent with EPI No. 4 because it is not able to establish that the injuries and damages associated with the wildfires are related to construction. Moreover, SDG&E's tariff does not require it to capitalize amounts recorded in Account 925 based on the allocation labor ratios.

21. We also note that SDG&E stated that the California Public Utility Commission (CPUC) has authorized it to track all wildfire property loss costs not recovered from insurance or transmission customers in a Wildfire Expense Memorandum Account. SDG&E did not specify which account under the Commission's accounting regulations it intends to use for the Wildfire Expense Memorandum Account. Therefore, we clarify that all wildfire costs should be recorded in Account 925 as discussed above. However, to the extent that certain wildfire costs are recoverable in future periods in CPUC-jurisdictional rates, SDG&E may defer the costs, as appropriate, in Account 182.3 (Other Regulatory Assets).¹¹

¹⁰ Deficiency letter Question 1d stated:

Please provide the following information pertaining to the wildfires: a) date wildfire started, b) date wildfire ended, c) cause of the wildfires (e.g. environmental phenomenon, equipment failure, or other), d) cost incurred, e) location of construction projects to which wildfire property losses were assigned, and f) proximity of these construction projects to the damaged property.

¹¹ 18 C.F.R. Part 101, Definition 31:

Regulatory Assets and Liabilities are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains, or losses that would have been included in net income determination in one period under the general

(continued...)

22. Finally, we direct SDG&E to make correcting journal entries that remove improperly capitalized amounts from plant accounts. Additionally, within 60 days from the date of this order SDG&E must resubmit all FERC Form No. 1 filings with the corrected amount recorded in Account 925 and all other accounts affected.

The Commission orders:

(A) SDG&E's compliance filing is hereby rejected, as discussed in the body of this order.

(B) SDG&E is hereby directed to submit a compliance filing related to the wildfire insurance premiums and Wildfire Property Costs within 60 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

requirements of the Uniform System of Accounts but for it being probable: (A) that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or (B) in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required.