

Application No: A.15-07-014
Exhibit No.: _____
Witness: Sim-Cheng Fung

Application of Southern California Gas Company
(U 904 G) and San Diego Gas & Electric Company
(U 902 G) for Authority to Revise their Natural Gas
Rates Effective January 1, 2017 in this Triennial
Cost Allocation Proceeding Phase 2

A.15-07-014
(Filed July 8, 2015)

PREPARED REBUTTAL TESTIMONY OF
SIM-CHENG FUNG
SOUTHERN CALIFORNIA GAS COMPANY
SAN DIEGO GAS & ELECTRIC COMPANY

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

April 11, 2016

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1 **I. PURPOSE**

2 The purpose of my prepared rebuttal testimony on behalf of Southern California Gas
3 Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) is to rebut the
4 recommendations by The Utility Reform Network (TURN) regarding SoCalGas' and SDG&E's
5 transmission embedded cost study.

6 **II. SUMMARY**

7 TURN submitted testimony in this proceeding on SoCalGas' and SDG&E's embedded
8 cost study. TURN's testimony makes the following recommendations:

- 9 1) The embedded cost of transmission should be increased by approximately \$110
10 million to:
- 11 a) Reflect higher levels of income taxes including deferred taxes paid by ratepayers.
 - 12 b) Exclude Asset Retirement Obligations (which do not earn a return) from the plant data
 - 13 used to allocate return, income taxes, and property taxes.
 - 14 c) Directly assign, rather than allocate, customer advances for construction.
 - 15 d) Allocate Administrative and General expenses and general plant by labor without the
 - 16 Sempra Utilities' 50% reduction.
 - 17 e) Escalate transmission costs from 2013 to the TCAP period by holding them as a
 - 18 constant percentage of base margin.¹

19 SoCalGas and SDG&E disagree with each of the points raised by TURN except for directly
20 assigning, rather than allocating, customer advances for construction, which has a negligible rate
21 impact on customers.

22 **III. REBUTTAL TO TURN'S PROPOSALS**

23 In this section, SoCalGas and SDG&E address each of TURN's proposals with respect to
24 the embedded cost study.

25 **A. TURN's Argument That Embedded Costs Should Reflect Higher**
26 **Levels Of Income Taxes**

27 TURN claims that SoCalGas "read the wrong number off the wrong page to set
28 SoCalGas' income taxes."² This is not true. TURN erroneously assumes that deferred taxes

¹ Prepared testimony of William Perea Marcus at 1.

1 should be included in SoCalGas' embedded cost study, and then extrapolates its assumption to
2 claim SoCalGas made an error. TURN presents no precedent or authority to support its
3 argument that SoCalGas' treatment of deferred taxes is inaccurate. By definition, an embedded
4 cost study:

- 5 (i) Divides up actual *current* costs of the utility system
- 6 (ii) Is backward-looking, and
- 7 (iii) Requires extreme detail of historical cost.³

8 Deferred taxes are obviously not a current cost incurred by a utility, and therefore it is accurate
9 for SoCalGas to exclude deferred taxes and to include only current taxes in its embedded cost
10 study. In 2013, the current tax amount was a refund of \$31.9 million to SoCalGas. As such, this
11 is the correct number used in SoCalGas' embedded cost study.

12 TURN references SoCalGas' revised response to TURN's data request -03.Q.14 for the
13 proposition that deferred taxes should be included in SoCalGas' embedded costs. However, this
14 data response specifically states that it is provided strictly for informational purposes only.⁴

15 TURN claims that there is a "\$23 million Calculation Error – Using the Wrong Income
16 Tax Figure for SoCalGas."⁵ But TURN is the one using an incorrect income tax figure, not
17 SoCalGas. In SoCalGas' GRC, A.14-11-004, total 2013 SoCalGas GRC base margin taxes
18 (current + deferred taxes) were less than \$40 million, not \$119.4 million.⁶ Based on the

² *Id.* at 4.

³ Introduction to Cost of Service Studies & Rate Design, Jim Lazar, The Regulatory Assistance Project(RAP) Senior Advisor, October 18, 2011, Slide 4.

⁴ SoCalGas' original data response showed \$119.4 million which was revised to \$32.1 million based on General Rate Case (GRC) A.14-11-004, Revised Testimony of Mr. Ragan Reeves, p. RGR-16. The \$119.4 million is overstated since it includes current and deferred taxes, and taxes associated with non-GRC base margin items.

⁵ Prepared testimony of William Perea Marcus at 3.

⁶ TURN's data request -03.Q.15 states "...2013 recorded data shown in the Testimony of Ragan Reeves in A. 14-11-003 (Exhibit SCG-28 page RGR-15) of positive \$28,164,000." As an active participant in the

1 definition of embedded costs described above, TURN’s claim of a “\$23 million Calculation
2 Error – Using the Wrong Income Tax Figure for SoCalGas” is not well founded.⁷ TURN also
3 complains that current taxes were not used in calculating SDG&E’s embedded cost. The only
4 reason for that is because SDG&E’s FERC Form 1 does not identify current taxes for gas
5 operations which are available only for electric operations. As such, a simplified tax approach
6 was used for SDG&E’s embedded cost study.

7 The Commission should reject TURN’s income tax-related arguments, and affirm the
8 embedded costs proposed for both SoCalGas and SDG&E.

9 **B. TURN’s Argument That Asset Retirement Obligations (Aros) Should**
10 **Be Excluded From The Plant Data Used To Allocate Return, Income**
11 **Taxes, And Property Taxes**

12 SDG&E and SoCalGas disagree with TURN’s proposal to exclude AROs from the plant
13 data used to allocate return, income taxes, and property taxes. Including AROs in the embedded
14 cost study maintains consistency with the data published in SDG&E’s and SoCalGas’ FERC
15 Form 1 and FERC Form 2, respectively. As stated in SoCalGas and SDG&E’s response to
16 TURN data request -03.Q.10, it is accurate to include AROs in determining functional cost
17 allocation factors because AROs are capitalized costs of the utilities’ legal obligations directly
18 linked to storage, transmission, distribution and general plant. For fiscal years beginning after
19 June 15, 2002, the Financial Accounting Standards Board (FASB) issued Statement 143 (now
20 Accounting Standards Codification ASC 410) to provide a mechanism to improve companies’
21 balance sheets to more clearly reflect the economic realities of the retirement obligations directly
22 associated with each asset category. The changes are particularly significant for capital-intensive

GRC, TURN should also have known that Mr. Reeves updated the original tax of \$28.164MM to \$32.125MM in his Revised testimony.

⁷ If TURN were to update its calculation using \$32.1MM instead of \$119.4MM for SoCalGas’ GRC related taxes, the increase in SoCalGas’ transmission cost would be \$9MM, not \$23MM.

1 companies such as SoCalGas and SDG&E. With the emphasis toward a more balance-sheet-
2 oriented focus in accounting, FASB has fixed its attention on how entities account for
3 obligations associated with the retirement of tangible long-term assets.⁸ SDG&E and SoCalGas
4 have complied with this accounting requirement in their FERC Forms 1 and 2, respectively.
5 Therefore, the allocation factors in SoCalGas and SDG&E's embedded cost study are accurate.
6 TURN has chosen to disregard accounting principles, likely because TURN again dislikes the
7 outcome of these principles. The allocation factors included in SoCalGas and SDG&E's
8 embedded cost study are accurate while TURN's proposal violates accounting principles. The
9 Commission should therefore reject TURN's proposal to exclude AROs in calculating allocation
10 factors for transmission. Once again, SoCalGas' total embedded transmission cost should
11 remain at \$253.1 million and SDG&E's embedded transmission cost should remain at \$38.2
12 million.

13 **C. TURN's Proposal Regarding Allocation Of Administrative And**
14 **General Expenses And General Plant**

15 TURN claims that "(t)he effect of the Sempra Utilities' inappropriate treatment of A&G
16 is to assign approximately \$27.5 million of transmission-related costs to distribution customers
17 (\$21.6 million for SoCalGas and \$5.9 million for SDG&E). Over \$11 million of this amount are
18 expenses for employee benefits, workers compensation, and other insurance directly related to
19 the transmission system."⁹ TURN's approach and results are wrong. The 50% allocation of
20 A&G expenses to transmission has been adopted in both the 2009 BCAP decision, D.09-11-006,
21 and the 2013 TCAP decision, D.14-06-007. TURN claims its new proposal is consistent with the
22 PG&E Gas Accord, but TURN is being selective in which aspects of the Gas Accord it wants to
23 copy. In Phase 1 of this current SoCalGas and SDG&E TCAP proceeding, TURN adamantly

⁸ <http://www.journalofaccountancy.com/issues/2001/dec/accountingforassetretirementobligations.html>

⁹ Direct testimony of William Perea Marcus at 8.

1 | opposed consistency with the PG&E method of allocating the embedded costs of storage among
2 | the core, balancing, and unbundled storage functions. TURN's selective use of PG&E
3 | precedents should not be permitted.

4 | Not only is TURN's proposal inconsistent with prior Commission decisions on the
5 | treatment of A&G costs in SoCalGas' and SDG&E's embedded cost analysis, its results are
6 | overstated. The numbers should be corrected to \$19.6 million (\$15.2 million for SoCalGas and
7 | \$4.4 million for SDG&E) instead of \$27.5 million-- a 29% difference. The \$11 million that
8 | TURN claims to be directly related to the transmission system should be corrected to \$7.4
9 | million—a 33% difference.

10 | The Commission should reject TURN's proposal for full allocation of A&G to
11 | transmission cost since it will cause unnecessarily disruptive price spikes to the SoCalGas and
12 | SDG&E's transmission rates. SoCalGas' total embedded transmission cost should remain at
13 | \$253.1 million and SDG&E's embedded transmission cost should remain at \$38.2 million.

14 | **D. TURN's Proposal To Escalate Transmission Costs From 2013 To The**
15 | **TCAP Period By Holding Them As A Constant Percentage Of Base**
16 | **Margin**

17 | SoCalGas and SDG&E oppose TURN's proposal to escalate transmission costs from
18 | 2013 to the TCAP period by holding them as a constant percentage of base margin.

19 | In A.11-11-002, SoCalGas and SDG&E stated that "This 2010 actual cost of \$198
20 | million is below the 2010 allocated cost of \$210 million, which indicates that the escalation
21 | based on Phase 2 BCAP D.09-11-006 overstated actual embedded transmission costs.¹⁰

22 | Similarly, SoCalGas and SDG&E stated that " The \$80.3 million (represents recorded 2010
23 | storage embedded cost) is below the 2011 allocation of existing storage cost of \$90 million,
24 | which indicates that the escalation based on Phase 2 BCAP D.09-11-006 significantly overstated

¹⁰ A.11-11-002, Revised Updated Prepared Direct Testimony of Sim-Cheng Fung at 12, lines 9-11.

1 actual embedded storage costs.¹¹ These past attrition adjustments described above resulted in
2 overstating allocated costs to SoCalGas and SDG&E's transmission functions. Instead, the
3 transmission cost should be maintained at \$253.1 million and \$38.2 million, respectively, until
4 another embedded cost study is performed for the next TCAP.

5 **IV. ONLY 2013 RECORDED DATA SHOULD BE USED IN TRANSMISSION**
6 **EMBEDDED COST STUDY**

7 TURN suggests using 2014 recorded data to develop embedded transmission cost.
8 SoCalGas and SDG&E oppose this suggestion because all analyses performed by the witnesses
9 in this proceeding are based on 2013 recorded data.¹² Consistency is essential among the studies
10 performed by SoCalGas and SDG&E's witnesses. As such, the Commission should reject
11 TURN's suggestion to use 2014 data to develop SoCalGas' and SDG&E's embedded cost. The
12 Commission should adopt \$253.1 million and \$38.2 million as SoCalGas' and SDG&E's
13 embedded transmission cost, respectively, for this proceeding.

14 This concludes my prepared Rebuttal Testimony.

¹¹ *Id.* at 19, lines 2-7.

¹² Direct testimony of William Perea Marcus at 12-13.