Decision 87 11 018 NOV 13 1987 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY for Authority to Establish a Major Additions Adjustment Clause, to Implement a Major Additions Adjustment Billing Factor and an Annual Major Additions Rate to Recover the Costs of Owning, Operating, and Maintaining San Onofre Nuclear Generating Station Unit No. 2 and to Adjust Downward Net Energy Equal the Increase in Major Additions Adjustment Clause Rates.	Application 82-02-40 (Filed February 18, 1982; amended December 1, 1982 and October 4, 1983)
And Related Matters.	Applications 82-02-63 83-10-12 83-10-36 83-11-19

ORDER MODIFYING DECISIONS 86-10-069 AND 87-07-097 AND DENYING REHEARING

Applications for rehearing of Decision (D.) 86-10-069, wherein we reviewed the reasonableness of costs incurred by Southern California Edison Company (Edison) and San Diego Gas & Electric Company (SDG&E) for the construction of the San Onofre Nuclear Generating Station Units 2 and 3 (SONGS), were filed by Edison, SDG&E, and the California Coastal Commission (Coastal Commission). The Commission's Public Staff Division, recently renamed the Division of Ratepayer Advocates (DRA), filed a response to these applications. After considerable review and deliberation, we issued D.87-03-042, which granted limited rehearing solely for the purpose of hearing oral argument on two issues: the methodology for determining a disallowance of indirect costs, and the California Coastal Commission's request

that we reconsider our decision to charge ratepayers with all coastal access mitigation costs. D.87-03-042 reserved all issues in the applications for rehearing for our further consideration.

Oral argument was held, en banc, on April 27, 1987 and on July 19, 1987 we issued D.87-07-097. This decision denied rehearing but modified and clarified D.86-10-069 in several substantial respects. The modifications and clarifications most relevant to our discussion today involved the two issues argued in the en banc hearing: coastal access mitigation costs, and the formula used to determine an indirect cost disallowance.

An application for rehearing of D.87-07-097 was filed by the Attorney General of the State of California (AG), to which both our DRA and, jointly, Edison and SDG&E responded. We have considered all of the allegations raised in the application and the responses thereto, and are of the opinion that good cause for granting rehearing has not been shown. However, as we discuss below, we will further clarify and modify both D.86-10-069 and D.87-07-097 in response to the AG's application.

As a preliminary matter, we respond to the AG's argument that by issuing D.87-07-097 in closed executive session, we violated the Bagley-Keene Open Meeting Act, Government Code Sections 11120 et seq. Section 11126(q) of the Act provides that a state agency may hold closed sessions for the purpose of conferring with counsel on pending litigation, which includes the situation where, in the sound opinion of the agency, the threat of litigation is imminent (see Section 11126(r)). At the time we issued D.87-07-097, we had three applications for rehearing still before us, despite the fact that we had already granted limited rehearing to hear oral argument. Such applications are the only procedural vehicle through which parties can perfect their right to judicial review. See Public Utilities Code Sections 1731(b); 1732. Thus whenever an application for rehearing is filed, we are justified in concluding that the threat of litigation may be imminent. Given the sensitive nature of this proceeding, this conclusion was even more justified. Therefore, in good faith, we

discussed and took action on the pending applications for rehearing in closed session under the authority of Section 11126(q).

However, Section 11126(p) of the Act states that any of the Commission's meetings at which "the rates of entities under the commission's jurisdiction are changed shall be open and public." Certainly D.87-07-097 had the effect of changing rates for customers in Edison's and SDG&E's service territories. The question is, which of these sections should prevail in this situation?

We have found no authority reconciling these two sections, and are not persuaded that the issue is as clear as the AG would make it. In short, we do not agree with the AG that we have violated the Act. However, because this proceeding has a substantial impact on the ratepayers of this State, and because of the unusual procedural circumstances it presents, we have determined that the public interest is better served by our rescinding those portions of D.87-07-097 which affect rates and reconsidering the issues involved in public session and in this decision.

A. Indirect Costs.

We first clarify our rationale for our disallowance of indirect costs.

The evidence Edison presented showed that the indirect costs it sought to recover had indeed been incurred, and that Edison had a system in place which would monitor the accrual of such costs and ensure that they stayed at reasonable levels. However, Edison did not develop the record with specificity as to what indirects could be determined reasonable.

The DRA challenged Edison's evidence as not meeting its burden of proof on reasonableness. However, the DRA also did not develop the record on the reasonableness of specific indirects. Rather, it developed a risk sharing methodology through which a certain portion of indirects would be disallowed as part of a

general disallowance of costs exceeding a certain benchmark amount.

Faced with a situation where the record did not provide a basis for explicit review of the reasonableness of specific indirect costs, we turned to the record as a whole in order to develop an equitable solution to this problem.

We found that when taken as a whole, the record supported the general conclusion that because the plant had been built and had become operational despite some delays, many of the indirect costs could be considered reasonable because they would have occurred even under completely prudent management. Under these circumstances, it would be unjust to Edison's shareholders to approve total disallowance of indirects. By the same token, it would be equally unjust to make Edison's ratepayers shoulder the entire burden of all of these costs, given our findings of some imprudence and resulting delays.

Our first approach, set forth in D.86-10-069, determined the ratio of disallowed direct costs plus disallowed AFUDC to total project direct costs plus AFUDC, and applied this ratio to the net of total project indirect costs minus indirects already disallowed as elements of delay and quality assurance/quality control. This approach assumed a logical and direct relationship between direct and indirect costs. It also assumed that reasonable indirect costs would be incurred in proportion to other reasonably incurred costs, i.e., direct costs and AFUDC.

Edison and SDG&E applied for rehearing. We granted limited rehearing to hear oral argument on the issue of our methodology. At oral argument, neither the DRA nor the utilities provided us with a well developed alternative methodology.

During the en banc, Edison quoted portions of D.86-10-069 to support its argument that we intended to disallow only "catch-all" indirect costs amounting to about 5.5 percent of total indirects. We did not agree. Edison also argued that we should rely exclusively on the stipulated agreement between

itself and the DRA on time-variable indirect costs, because it was the only item on the record which could legitimately be used to disallow indirect costs. We disagreed with this argument also. While the stipulation covered fixed cost indirects and indirects related to quality assurance and quality control pursuant to the parties' stipulated formula, it did not cover all indirects, or the reasonableness of specific indirects themselves. It was this latter issue that our methodology sought to address.

Thus the en banc did not provide any substantial assistance to us in assessing whether our original methodology or some other alternative would better represent the appropriate disallowance for indirects.

After further review of the record, we issued D.87-07-097, wherein we modified our original methodology by eliminating the AFUDC component from both the numerator and denominator of the ratio to be applied to the net project indirects. The AG applied for rehearing of that decision, requesting that the entire $1.3 billion of indirect costs be placed at issue once again. The DRA concurred with the AG that rehearing should be granted, while Edison and SDG&E supported our determination.

We hereby affirm the methodology for the disallowance we adopted in D.87-07-097. As stated above, the solution we have reached is based on equitable considerations. While the record on expenditures in this case is voluminous, we do not have specific evidence which supports a disallowance of discrete indirect expenditures as unreasonable.[1] The record was not developed in this fashion, for either direct or indirect costs,

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1 However, a staff consultant did make a preliminary estimate of $20-$80 million in possible unreasonable indirect expenditures.

by either Edison or the DRA.[2] Nor do we have evidence that the relationship between direct and indirect costs is a direct, one-to-one relationship. But when we look to the record as a whole, we remain convinced that we are not justified in imposing a larger or smaller indirect cost disallowance than we adopted in D.87-07-097.

We can conclude from the record that many of the indirect costs were reasonable. Notwithstanding the lack of strong evidence of a one-to-one relationship, we can also conclude that there is some logical and direct relationship between direct and indirect costs, although this relationship is not specifically defined. We further conclude, however, that the relationship between AFUDC and indirect costs, as evidenced in this proceeding, does not warrant disallowance of indirects based on their association with AFUDC disallowances. There is no evidence to show that imprudent delay, as quantified by the AFUDC disallowance, caused an incremental increase in indirect expenditures in proportion to the delay. Thus the ratio that we adopt should be based solely on the connection between direct and indirect costs.

Because we find that the record as a whole justifies our treatment of indirect costs, we reject the alternative of granting rehearing and once again placing the full $1.3 billion of those costs at issue.

B. Coastal Commission.

We affirm our decision in D.87-07-097 to allow only $1.4 million of coastal access mitigation costs in Edison's and SDG&E's rate bases. However, it has come to our attention that the $2 million plus associated AFUDC not allowed in rate base

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2 The AG did not actively participate in the reasonableness review.

should be disallowed from the actual date the utilities made the payment to the commercial operating date of each unit, not from August 1, 1978. This is because until the actual payment date, no disallowed funds had been booked to the plant account. We make that change in today's order.

THEREFORE,

IT IS ORDERED that D.86-10-069 is modified as follows:

1. Finding 120 is modified to read:

"Because indirect costs are incurred as an adjunct to direct expenditures, it is logically appropriate to relate recovery of indirect costs to the recovery of direct costs."

2. Finding 122 is modified to read:

"The record does not contain specific evidence which would enable a precise calculation of the reasonableness of indirect costs, or of the specific relationships between direct costs and associated indirect costs."

3. New Finding 122a is added to read:

"The record as a whole supports the conclusions that a) many of the indirect costs incurred by Edison were reasonable, and b) a logical and direct relationship exists between direct and indirect costs."

4. Finding 123 is modified to read:

"The record as a whole does not contain evidence that imprudent delays, as quantified by the AFUDC disallowance, caused an incremental increase in indirect expenditures in proportion to the delay."

5. New Finding 123a is added to read:

"The record as a whole supports imputing the reasonableness of indirect costs by calculating the ratio of disallowed direct costs to total project directs and

multiplying the ratio by the total plant indirects available for disallowance."

6. Finding 124 is modified to read:

"The ratio of disallowed directs to total plant direct costs is .013. The amount of total plant indirects available for non-specific disallowance is $1311.1 million. The resultant indirect disallowance is $17.0 million."

7. New Finding 127 is added to read:

"Pursuant to Public Utilities Code Section 463, the Commission finds that all costs reflecting any unreasonable errors or omissions of Applicants relating to the planning or construction of SONGS 2 and 3 have been disallowed, to the extent the record in this proceeding warrants."

8. Conclusion of Law 33 is modified to read:

"If we determine that a utility's imprudent acts require the disallowance of specific direct costs related to those acts, then the utility's imprudence also requires the disallowance of indirect costs associated with those specific direct costs."

9. Conclusion of Law 34 is modified to read:

"Under the circumstances of this case, where the record was not developed in such a way as to allow discrete calculation of the reasonableness of specific indirect costs, it is within the Commission's discretion to adopt an equitable solution to this problem."

10. Conclusion of Law 39 is modified to read:

"$2 million of the coastal access mitigation costs plus associated AFUDC from the actual date of payment to each unit's commercial operating date, should be disallowed from rate base. $1.4 million of the access mitigation costs plus associated AFUDC from

August 1, 1978 to each unit's commercial operating date should be allowed into rate base."

IT IS FURTHER ORDERED that to the extent the discussion of indirect costs on pages 272-276 of D.86-10-069 is inconsistent with the discussion in today's decision, D.86-10-069 is overruled and today's decision controls.

IT IS FURTHER ORDERED that D.87-07-097 is modified as follows:

1. The discussion entitled Indirect Costs, beginning on page 10 and ending on page 12, is rescinded.

2. Ordering Paragraphs 3, 5, 6, 7, 8, 10, and 11 are rescinded.

3. All references to the disallowance of $2 million in coastal access mitigation costs and associated AFUDC are deemed modified consistent with the relevant discussion and Ordering Paragraphs set forth above.

4. The modifications to Appendix B as shown in Ordering Paragraph 3 of D.87-07-097 are reaffirmed, with the following additional modification to Table B-6 (App. B, p. 7):

Table B-6. Summary of Disallowance.

($ millions)

Unit 2	Unit 3	Total	Issue
$ 10.0	$ 10.3	$ 20.3	QA/QC
8.0	2.0	10.0	Productivity
114.2	101.5	215.7	Delay Days
11.2	5.8	17.0	Indirects
+ 1.0	+ 1.0	+ 2.0*	Beach Mit.
$144.4	$120.6	$265.0*	Total

* Less imputed AFUDC on $1.4 million of prudent mitigation costs.

IT IS FURTHER ORDERED that rehearing of D.86-10-069 and D.87-07-097 as modified above is hereby denied.

This order is effective today.

Dated NOV 13 1987 at San Francisco, California.

I will file a written dissent.

FREDERICK R. DUDA
Commissioner

STANLEY W. HULETT
President
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

Commissioner Donald Vial, being necessarily absent, did not participate.

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Victor Weisser, Executive Director

A.82-02-40
D.87-11-018

FREDERICK R. DUDA, Commissioner, dissenting.

I would grant rehearing in this case for the reasons I previously stated in my dissenting opinions of October 26, 1986 and July 29, 1987; and therefore, I cannot support this decision to deny rehearing because it is inconsistent with the views and opinions that I have previously expressed.

Frederick R. Duda, Commissioner

November 13, 1987
San Francisco, California