

APR 25 1991

Decision 91-04-070 April 24, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY (U-338-E) for Authority to Increase its Authorized Level of Base Rate Revenue Under the Electric Revenue Adjustment Mechanism for Service Rendered Beginning January 1, 1992 and to Reflect this Increase in Rates.

ORIGINAL

Application 90-12-018 (Filed December 7, 1990)

And Related Matters.

I.89-12-025 (Filed December 18, 1989)

I.91-02-079 (Filed February 21, 1991)

SECOND INTERIM OPINION

Summary of Decision

This decision denies the request of Southern California Edison Company (Edison) that the Commission either establish maximum reasonable costs pursuant to Public Utilities (PU) Code § 1005.5 or adopt estimates of the reasonable costs of the two projects described in this application and authorize their inclusion in rate base. Instead, Edison is authorized ratemaking treatment for the two projects under the Major Additions Adjustment Clause (MAAC) now included in its tariffs. Issues regarding implementation of the MAAC procedure will be litigated in this proceeding.

Background

Small capital projects constructed by electric utilities are usually included in rate base on a forecast basis, either in general rate cases (GRCs) or as part of attrition year allowances.

Large capital projects are most often handled using the MAAC procedure, which allows the Commission the time necessary to review the reasonableness of a project's costs after it is completed and in operation. Edison, San Diego Gas & Electric Company, and Pacific Gas and Electric Company include MAAC procedures in their tariffs.

Timing is crucial to the review of large projects. Without the MAAC procedure a utility would be unable to earn a return on its investment while awaiting a Commission decision on reasonableness. Prior to a project's commercial operation date (COD), the utility accrues an allowance for funds used during construction (AFUDC), which is essentially the capitalization of interest charges on construction costs. At COD, the utility ceases accruing AFUDC and should begin to earn a return on its investment by including reasonable capital costs in rate base. However, Commission review of reasonableness can be lengthy. After a decision is eventually issued, the Commission cannot then allow the retrospective recovery of return on investment, because doing so would be unlawful retroactive ratemaking. The MAAC procedure allows the utility to earn a fair return on its investment while the Commission is deliberating.

The MAAC procedure works by establishing a deferred debit account at COD and setting interim rates subject to refund. On the debit side of the account, the utility books the full investment-related revenue requirement for the new plant, as if all capital costs were prudent. Interim rate revenues go on the credit side of the account. When the Commission issues a reasonableness decision, the revenue requirement debits cease, and prudent capital costs are put into rate base. The prior account debits are adjusted retroactively to reflect any disallowance imposed, and the account balance is amortized in rates over a period determined by the Commission.

The present consolidated proceeding is Edison's test year 1992 GRC. In Application (A.) 90-12-018, Edison requested special ratemaking treatment for the capital costs of two projects described in the application. If Edison's request is granted, MAAC treatment and reasonableness reviews would not be necessary. The two projects are: (1) Edison's share of the California-Oregon Transmission (COT) project, and (2) the installation of selective catalytic reduction (SCR) equipment at Edison's Alamitos Unit No. 6 power plant (Alamitos 6).

At the January 11, 1991 prehearing conference, Toward Utility Rate Normalization (TURN) mentioned Edison's requested ratemaking treatment in discussion of scheduling. TURN suggested that the Administrative Law Judges (ALJs) solicit comments from the parties before deciding whether an evidentiary phase on project costs is necessary.

In a February 1, 1991 ruling following the prehearing conference, the ALJs ordered comments on Edison's request. Timely comments were filed by Edison, the Division of Ratepayer Advocates (DRA), and TURN.

Legal Authority

PU Code § 1005.5(a) deals with major capital projects by energy utilities, requiring in part that:

"Whenever the commission issues to an electrical or gas corporation a certificate authorizing the new construction of any addition or an extension of the corporation's plant estimated to cost greater than fifty million dollars (\$50,000,000), the commission shall specify in the certificate a maximum cost determined to be reasonable and prudent for the facility."

Edison anticipates that if the Commission grants a Certificate of Public Convenience and Necessity (CPCN) for the COT project, the authorizing decision will adopt a maximum cost for Edison's share of the capital costs, based on cost-effectiveness analysis. It is

this amount, yet to be adopted by the Commission, that Edison asks to be included in rate base in the GRC.

PU Code § 463 requires that in setting rates the Commission shall disallow direct and indirect costs resulting from unreasonable errors and omissions in the construction of plant additions costing more than \$50 million. The section explicitly does not prohibit setting rates on a basis other than conventional rate-of-return ratemaking.

PU Code § 463.5 allows the Commission further discretion in setting rates for capital projects, stating:

"Section 463 does not require the commission to undertake a reasonableness review of recorded costs to determine the reasonableness of the costs of each item of any electrical or gas corporation's plant which costs, or is estimated to have cost, more than fifty million dollars (\$50,000,000) where the commission either has established a maximum reasonable cost pursuant to Section 1005.5 or has adopted an estimate of the reasonable costs in any proceeding."

PU Code § 463.5 became effective on January 1, 1989 and has not been invoked or even discussed in any Commission decision since then.

Edison's Request

Edison asks the Commission to use the authority granted in PU Code § 463.5 to include the capital costs of the COT project and of the Alamitos 6 air quality improvements in Edison's rate base, without reasonableness reviews.

Edison estimates that its share of COT project capital costs will be about \$100 million. The current estimate of COD for the project is December 1992, near the end of the GRC test year. The COT project is the subject of Edison's A.90-08-067, which seeks a CPCN for the project. That matter is now submitted, and a proposed decision by the assigned ALJ has been recently mailed. Edison cites the pending COT project decision as a source for the

"maximum reasonable cost pursuant to Section 1005.5," thus qualifying the COT project costs for inclusion in rate base at the COD.

Edison requests that the Commission adopt in the GRC an estimate of reasonable costs for the Alamos 6 project, and then include those costs in the rate base adopted for attrition year 1993. Edison has selected the Alamos 6 project in order to comply with South Coast Air Quality Management District (SCAQMD) Rule 1135, which requires installation of SCR technology at a 480 megawatt (MW) Edison power station. In the GRC, Edison estimates Alamos 6 capital costs to be \$56 million, including construction overheads, AFUDC, and a 15% contingency charge on direct costs. Edison's estimate of COD is December 1993, at the end of the first attrition year following the GRC test year.

Finally, Edison requests that if the Commission chooses not to invoke PU Code § 463.5, then Edison should be authorized the same MAAC treatment that was adopted for four capital projects in Edison's last GRC in Decision (D.) 87-12-066 (A.86-12-047). In that proceeding the Commission adopted a joint proposal by Edison and the Public Staff Division (predecessor to the DRA) which covered many ratemaking issues, including MAAC interim rates set at 75% of the estimated initial revenue requirement for the four projects.

Positions of the Parties

Edison

Edison believes that PU Code § 463.5 provides the Commission with administratively efficient alternatives to subsequent reasonableness reviews. The COT project CPCN proceeding will provide a cost-effectiveness cap which would satisfy PU Code requirements, assuming a CPCN is issued. According to Edison, this is administratively efficient because the same issues would not have to be relitigated in a reasonableness review.

Edison believes that many of the considerations typical in reasonableness reviews would not be at issue for the Alamitos 6 project, because it will be undertaken under order from the SCAQMD. No maximum cost has been approved by the Commission, but PU Code § 463.5 allows the utility to forego a reasonableness review if the Commission adopts an estimate of reasonable costs. Edison has provided such an estimate in its GRC application, and asks that it be tested and approved in this proceeding.

If the Commission elects MAAC treatment for the two capital projects, Edison would remove the revenue requirement associated with the projects from the GRC, and follow MAAC procedures. Edison asks that the specific procedures adopted in Appendix A to D.87-12-066 also be adopted in this GRC.

DRA

DRA strongly opposes inclusion of the COT project and Alamitos 6 capital costs in rate base under the terms of PU Code § 463.5. DRA points out that the many uncertainties surrounding the costs of both projects make them unsuitable for treatment under § 463.5.

For the COT project, DRA first cites the uncertainty of project costs: the Commission has not yet signed a CPCN decision; the final power rating for the transmission line has not yet been determined; and the Commission's cost cap may be on a cost per MW basis rather than a total cost basis.

Second, it is unclear when the project will go into operation. The adoption of a COT project rate base amount requires estimation of a COD, and DRA claims there are too many variables to forecast a COD with the necessary accuracy. DRA illustrates this point using two of the MAAC projects authorized in the last GRC: (1) a high voltage, direct current transmission line upgrade, and (2) a transmission line between Edison's Devers switching station and the Palo Verde Nuclear Generating Station in Arizona. The direct current project went into service four months late, and the

Devers-Palo Verde line is still not in service nine months after the predicted COD.

According to DRA, there are also significant uncertainties surrounding the Alamos 6 project. There are no completed projects which use SCR technology on the scale anticipated at Alamos 6, and DRA is concerned that cost estimates in scaling the technology up to 480 MW could be inaccurate. The project completion date is also uncertain. Edison's work papers in this proceeding show a project COD of February 1994, past the December 1993 date in Edison's application. In either event, the construction period is too long to predict when project costs would go into rate base. DRA states that if the costs of the Alamos 6 project were left in the GRC, more time would be required for DRA analysis than is presently scheduled for the revenue requirement phase of the GRC.

DRA supports MAAC treatment for the projects, but not under the terms adopted for other projects in Edison's last GRC.

TURN

TURN believes that Edison's recommended approach would deprive the parties and the Commission of any real opportunity to review the prudence of the construction costs of the two projects.

According to TURN, in the COT project proceeding (A.90-08-067) no evidence was presented on the reasonableness of the construction cost estimates because the project is being constructed not by regulated utilities, but by a consortium of municipal utilities known as the Transmission Agency of Northern California (TANC). The litigation of a maximum construction cost will not establish that the expenditure of this maximum amount or any lesser amount is reasonable. That can be determined only through a review of actual costs after the project is completed. TURN argues that Edison's proposal would simply assume that actual expenditures will equal the adopted cost cap, and that this amount should be recovered in rates. Such an assumption is unwarranted.

With regard to the Alamitos 6 project, no review of construction costs has taken place to date. TURN believes that review of cost estimates in this proceeding would not be an efficient use of GRC hearing time.

TURN argues that MAAC treatment is appropriate for the two projects, to protect both Edison and its ratepayers. The Commission should adopt estimates of costs in the GRC only for the purpose of implementing MAAC procedures.

Discussion

We will deny Edison's request to include capital costs in rate base under the provisions of PU Code § 463.5, for the following reasons: (1) inclusion of capital costs in rate base at their maximum cost-effective level is unreasonable in these circumstances, (2) uncertainties concerning the issuance of a CPCN for the COT project and the CODs for both projects are substantial, (3) the administrative efficiencies claimed by Edison are minimal, and (4) MAAC procedures will adequately protect both Edison and its ratepayers.

The main issue is the policy decision whether to add capital costs to rate base without reasonableness reviews. Although PU Code § 463.5 would allow the Commission to enter reasonable maximum costs for the COT project into rate base, that choice is unappealing when a planned project is likely to be the best resource option available to a utility. Unless the resource planning decision turns out to be wrong, specifically because an alternative resource could have been built less expensively, the inclusion of maximum costs in rate base guarantees that ratepayers will support more rate base than is necessary. Inclusion of the COT project costs in rate base at their approved maximum level is unreasonable.

If it seemed likely that actual construction costs would be nearly equal to the reasonable maximum costs developed by cost-effectiveness analysis, then reliance on PU Code § 463.5 might make

more sense. We leave the remaining possibility, that § 463.5 should be invoked because actual costs exceed cost-effectiveness limits, for another time.

We are convinced by DRA's arguments that the uncertainties of approving Edison's request are substantial. It would be premature to authorize inclusion of COT project costs in rate base before the Commission has granted a CPCN, and before the reasonable maximum costs are actually known. In addition, the uncertainties in estimation of CODs for both the COT and Alamitos 6 projects unreasonably favor Edison. In the real world, construction delays are more likely than schedule improvements. Early adoption of rate base amounts would also give Edison a perverse incentive to delay capital spending.

In one sense the inclusion of capital costs in rate base without review would be administratively efficient, because no Commission effort would be required. However, that approach ignores the Commission's duty to ensure that utility rates are reasonable. The issue is whether the risk that utility rates might not be cost-based is justified by the reduced administrative effort. In this instance, the answer is no. The CPCN proceeding for the COT project might resolve some issues that would later appear in a reasonableness review, but the purposes of that proceeding and the GRC are markedly different. As TURN points out, the CPCN proceeding concentrates on estimates of costs for the COT project and its alternatives as prepared by TANC, not by Edison. The eventual CPCN decision, if a certificate is issued, need find only that the cost estimates for the least expensive alternate to the COT project are reasonable maximum costs for the COT project. The Commission's reasonableness reviews are typically more thorough than prospective cost-effectiveness reviews of the type found in the COT project certification proceeding. A reasonableness review would relitigate very few issues from A.90-08-067.

The Commission has never reviewed the costs of the proposed Alamos 6 modifications. Any efficiencies that might be gained by litigating costs in the GRC, rather than in a reasonableness review, would be at the expense of a thorough review of actual costs. Edison's claimed administrative efficiencies would be due to reducing the scope of review, not to eliminating duplication. In any case, such efficiencies would be minimal.

With no administrative efficiencies found, our choice of the best proceeding to review Alamos 6 costs is one of convenience. We choose to authorize conventional MAAC treatment, rather than add Alamos issues to an already ambitious GRC schedule.

With regulatory treatment under PU Code § 463.5 now precluded, Edison requests MAAC treatment under the terms approved in its last GRC. We will authorize MAAC treatment in principle, but we cannot order the specific terms approved in D.87-12-066. Details of the projects in the last GRC do not match the details of the COT and Alamos 6 projects.

Instead, we will reserve a block of GRC hearing time to litigate the details of MAAC treatment of the COT and Alamos 6 projects. For each project the parties should address the issues resolved by Appendix A in D.87-12-066: (1) in-service criteria to determine COD, (2) estimated COD, (3) estimated capital costs, (4) estimated investment-related revenue requirement, (5) interim rate level, (6) effective date of interim rates, (7) tariff language, and (8) treatment of noninvestment-related expenses. If hearings are necessary, the assigned ALJ shall ensure that these issues are incorporated into the GRC hearing schedule.

Findings of Fact

1. In A.90-12-018 Edison requests that the Commission either establish maximum reasonable costs pursuant to PU Code § 1005.5 or adopt estimates of the reasonable costs of the COT and Alamitos 6 projects, and authorize their inclusion in rate base pursuant to PU Code § 463.5.

2. DRA and TURN oppose Edison's request and recommend MAAC treatment of the two projects.

3. The administrative efficiencies of the requested rate treatment of the two projects under PU Code § 463.5 are minimal.

4. For the COT project, the COD, reasonable maximum costs, and granting of a CPCN are uncertain.

5. For the Alamitos 6 project, the COD and costs of scaling SCR technology up to 480 MW are uncertain.

6. Allowing major capital projects into rate base using estimates of future CODs would give Edison a perverse incentive to delay capital spending.

7. It is unreasonable to allow COT project capital costs into rate base at reasonable maximum costs.

8. It is unreasonable to allow Alamitos 6 project capital costs into rate base by review of estimated capital costs in this proceeding.

9. Edison's request for inclusion of the capital costs of the two projects in rate base pursuant to PU Code § 463.5 should be denied.

10. MAAC procedures will adequately protect both Edison and its ratepayers against unreasonable rates related to the two projects.

11. The COT and Alamitos 6 projects should be treated under Edison's existing MAAC procedure.

12. This proceeding should address the eight MAAC implementation issues listed in this decision and any other issues necessary to implement MAAC treatment of the two projects.

Conclusions of Law

1. Edison's request to include the costs of the COT and Alamitos 6 projects in rate base at this time should be denied.
2. Edison should be authorized to include the two projects under the MAAC in its tariffs.
3. This order should become effective on the date signed because scheduling of MAAC issues in the GRC should begin promptly.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. The request of Southern California Edison Company (Edison) that the Commission either establish maximum reasonable costs pursuant to Public Utilities (PU) Code § 1005.5 or adopt estimates of reasonable costs of two projects (Edison's share of the California Oregon Transmission project, and installation of selective catalytic reduction equipment at Edison's Alamitos Unit No. 6 power plant) and include those costs in rate base pursuant to PU Code § 463.5, is denied.
2. Edison shall remove the investment-related revenue requirements associated with the two projects from this proceeding.
3. Edison is authorized to include the two projects under the Major Additions Adjustment Clause (MAAC) in its tariffs.

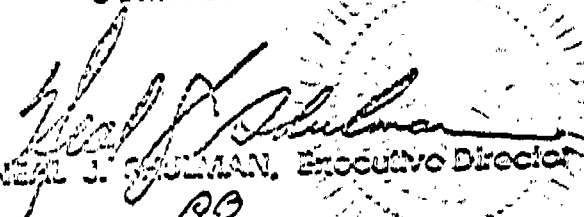
4. Issues necessary to implement MAAC treatment of the two projects shall be considered in this proceeding.

This order is effective today.

Dated April 24, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
G. MITCHELL WILK
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

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


NEAL J. SCHULMAN, Executive Director
PS