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Decision 98-10-054 October 22, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

In the Matter of the Application of the Southern California Edison Company (U 339-E) For: (1) Authority to Revise its Energy Cost Adjustment Billing Factor, Its California Alternate Rates for Energy, and its Base Rate Levels Effective January 1, 1997; (2) Authority to Revise the Incremental Energy Rate, the Energy Reliability Index and Avoided Capacity Cost Pricing; and (3) Review of the Reasonableness of Edison's Operations During the Period From April 1, 1995 Through March 31, 1996.	Application 96-05-045 (Filed May 30, 1996)
In the Matter of the Application of the Southern California Edison Company (U 339-E) For: (1) Review of the Reasonableness of Edison's Operations During the Period From April 1, 1996 Through March 31, 1997.	Application 97-05-050 (Filed May 30, 1997)

(See Decision (D.) 96-12-051 for a list of appearances.)

INTERIM OPINION

Summary

Southern California Edison Company (Edison) requests a determination that its operations for the Record Periods April 1, 1995 through March 31, 1996, and April 1, 1996 through March 31, 1997 were reasonable with respect to "non-qualifying facility (QF) matters," also known as the "non-QF reasonableness" phase of these proceedings.[1] The Office of Ratepayer Advocates (ORA) and Edison are in agreement regarding all but one issue, that of the reasonableness of Edison's execution of a natural gas transportation contract with Southwest Gas Corporation (Southwest) on November 29, 1995 to transport natural gas to the Mohave coal generating station.

The Commission finds that Edison has met its burden of proof in providing the necessary cost-benefit analysis justifying the Southwest contract. Accordingly, the Commission concludes that the Southwest contract and Edison's operations, apart from the QF contract administration issues and subject to the disallowances discussed below, for the Record Periods were reasonable.

Background

Southwest delivers natural gas to the Mohave Project, a coal-fired generating facility, in Laughlin, Nevada, via the El Paso and Kern River pipelines. Natural gas is used at the Mohave Project for start-up and flame stabilization purposes.

Edison negotiated a 15-year discounted transportation agreement and associated service agreement (contract) with Southwest that became effective

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[1] The Commission will separately address the QF contract administration issues for these Record Periods.

December 11, 1995. Prior to this date, Edison had been taking transportation service pursuant to Southwest's Southern Nevada Division Tariff Schedule ST-1.

Procedural Summary

On May 30, 1996, Edison filed Application (A.) 96-05-045 seeking a finding that its operations for the Record Period April 1, 1995 through March 31, 1996 were reasonable. On May 30, 1997, Edison filed A.97-05-050 seeking a finding that its operations for the Record Period April 1, 1996 through March 31, 1997 were reasonable. On August 19, 1997, ORA filed its Report on the Reasonableness of Operations in Edison's Energy Cost Adjustment Clause (ECAC) applications, non-QF matters in both the 1996 and 1997 ECAC Reasonableness applications. On October 9, 1997, Edison filed a Motion to Consolidate the above-referenced applications. Edison's Prepared Rebuttal Testimony, Reasonableness Phase was filed on November 18, 1997. An evidentiary hearing was held before the assigned administrative law judge on January 13, 1998. Edison's Motion to Consolidate was granted at that time. Concurrent opening briefs and reply briefs were filed by Edison and ORA on March 13, and April 17, 1998, respectively, and this phase of A.96-05-045 and A.97-05-050 was submitted for decision.

Position of Edison

Edison states that the decision to execute the Southwest contract was made following completion of an exhaustive cost-benefit analysis of the various gas transportation alternatives available to bring gas to Mohave. Prior to the execution of the Southwest contract, Edison took service under Southwest's Tariff Schedule ST-1. In its cost-benefit analysis, Edison evaluated four proposals -- one from Southwest, two from El Paso Gas Company (El Paso) and one from

Southern California Gas Company (SoCalGas) -- to determine which would be the most economic option for Edison and the other owners of Mohave[2] under three different interstate pipeline service scenarios. The proposals were also compared to the projected cost of tariff service.

Edison concluded from the cost-benefit analysis that the Southwest contract would, over the life of the contract, save: (1) a projected $4.8 million compared to tariff service; (2) a projected $2.3 million compared to the most feasible proposal from El Paso; and (3) a projected $2.2 million compared to the SoCalGas proposal.

Also, Edison states that a comparison of the projected cost of tariff service to the projected cost of the Southwest contract on a price per decatherm (dth) basis showed that the Southwest contract would save more than 50% compared to tariff service beginning in contract year three and still offer substantial savings in the first two contract years.

Position of ORA

ORA argues that at the time Edison entered into the contract with Southwest, Edison knew of the possibility that such a contract could be considered an "uneconomic asset" contributing to "stranded costs" for which ratepayers are responsible to the extent of the recovery provide in Public Utilities Code Sections 367 and 368. Therefore, ORA recommends that the Commission find the contract unreasonable, as Edison should not have exposed ratepayers to additional stranded costs on the eve of electric restructuring.

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[2] Edison is the operator of Mohave and has a 56% ownership share. The other owners of Mohave are Los Angeles Department of Water & Power, Nevada Power Company and Salt River Project Agricultural Improvement and Power District (Mohave Participants).

ORA posits that Edison knew, at the time it entered into the Southwest contract on November 29, 1995, that: (1) Edison had recommended to the Commission in the Electric Restructuring Rulemaking/Investigation (R.94-04-031/I.94-04-032) that fuel supply contracts such as the one it was entering into with Southwest be considered as part of Edison's "uneconomic assets and obligations"; (2) the Commission had already proposed that all utility uneconomic assets and obligations be recovered from ratepayers, in the two main, alternative proposed policy decisions set forth in D.95-05-045; and (3) the Southwest contract, a 15-year contract with most pricing set on a fixed basis, rather than on a market basis, could contribute to such uneconomic assets. Given this knowledge, ORA contends that it was unreasonable for Edison to have entered into the Southwest contract, for entering into the contract potentially exposed ratepayers to greater costs than had Edison not entered into it – i.e., uneconomic costs to be recovered through the competition transition charge (CTC).

Further, ORA argues that this proceeding presents the Commission with an interesting problem: when a utility knows that its policy suggestions are being considered in effectuating a grand regulatory transformation that it knows is imminent, and that such policy suggestions would increase the burden on ratepayers, does it have an obligation to act in a way to minimize the burden on ratepayers, or should it be allowed to increase that burden? ORA strongly urges that under these circumstances, the utility has an obligation not to increase the burden on the ratepayers. ORA contends that Edison successfully convinced the legislature to include all of Edison's fuel supply contracts entered into prior to December 20, 1995 as part of the calculation of "uneconomic costs" to be recovered from ratepayers, and when Edison entered into the contract with Southwest, Edison knew that it was advocating such a policy before this

Commission. Further, according to ORA, Edison also knew that once restructuring commenced, uneconomic costs would not be recoverable, because generation costs would have to be recovered from the market. Yet Edison entered into a contract that locks ratepayers into a long-term contract that ignores the incipient market and could increase the amounts the ratepayers pay Edison for their "uneconomic" investments. ORA submits that this increased burden on the ratepayers should be the fact the Commission uses to justify a finding that the contract is unreasonable.

Response of Edison

According to Edison, ORA fails to recognize that one purpose of Edison's filing in the transition cost proceeding (A.96-08-001 et al.) was to identify all of Edison's uneconomic fixed fuel costs. Edison proposed to determine its uneconomic fixed fuel costs by calculating all of its unavoidable fuel costs, then applying a credit equal to its revenue received from generation output less variable costs incurred. Edison did not state or suggest, as ORA has contended, that the Southwest contract would contain uneconomic costs. Edison identified the Southwest contract in its transition cost filing for the purpose of calculating Edison's total unavoidable fuel costs.

Addressing ORA's concerns regarding the demand charge contained in the Southwest contract, Edison states that the 75% demand charge and 25% volumetric charge reflect the same rate design embedded in the tariff service. The projected demand charge payments under the tariff service, however, would have been more than double the demand charges under the Southwest contract. Further, Edison points out that the alternatives evaluated in its cost-benefit analysis would have required construction of bypass pipelines, which were more costly than the demand charge within the Southwest contract.

Addressing ORA's concerns that the 15-year term and the demand charge which comprises 75% of the costs within the contract are unreasonable provisions, Edison points out that its cost-benefit analysis also demonstrated that the 15-year term of the Southwest contract was more favorable than the length-of-the-contract term or payment schedule of the other proposals. For instance, the SoCalGas alternative proposed a 20-year agreement. For the first five years, there would be no option to terminate and for the remaining 15 years, the right to terminate could be exercised only upon payment of 90% of the undepreciated balance of the cost to construct the pipeline plus gross-ups for tax purposes. With respect to the El Paso proposal, the Mohave participants would have been required to make an up-front payment of approximately $4.2 million - $4.3 million. This payment would have compensated El Paso for all of the capital costs associated with the proposed bypass pipeline, plus gross-ups.

Further, Edison points out that although the Southwest contract term is for 15 years, there are numerous provisions which permit termination at no cost upon certain conditions. Such conditions include a Commission finding of unreasonableness or the imposition of environmental regulations which would render it cost prohibitive to operate the plant.

Also, Edison points out that the cost-benefit analysis took note of the operational flexibility in the Southwest contract compared to the tariff service. For example, the tariff provides that the customer can burn 3,500 dth or 25%, whichever is greater, in excess of the amount of gas scheduled. Any burn beyond that amount would incur a 150% penalty. The Southwest contract, on the other hand, allows Edison to schedule up to 18,000 dth with no prior notification. Any burn beyond 18,000 dth will then fall under the 25% balancing window that is provided for in the tariff.

Further, Edison states that it negotiated the Southwest contract, not only on its behalf, but also on behalf the other Mohave participants who, with the possible exception of Los Angeles Department of Water and Power, are not presently subject to electric industry restructuring legislation. Edison contends that ORA's argument fails to consider the impact of its recommendations on those other owners. Edison points out that the Southwest contract was approved and executed by all the Mohave participants because it was the most economic choice and would provide more than a 50% savings compared to the Southwest default tariff service.

Discussion

We decline to adopt ORA's recommendation to find the Southwest contract not reasonable because Edison signed the contract on the eve of electric restructuring, thereby, qualifying the contract for the "protection of CTC recovery."

The issue, as stated by ORA, is that given the facts known to Edison at the time it executed the Southwest contract, Edison should have protected its ratepayers from the risk of uneconomic costs resulting from the execution and operation of any new fuel or fuel transportation contract. ORA argues that to the extent that uneconomic costs may result under the term of this contract as suggested by Edison in its filing in the transition cost proceeding, the Commission should not find this contract reasonable.

This issue was previously raised by The Utility Reform Network (TURN) in the transition cost proceeding. We stated: "We do not agree with TURN that the fuel contracts signed after the electric restructuring rulemaking was issued should receive additional scrutiny. As established by law, December 20, 1995, is the cut-off date to which we must adhere." And we stated that reasonableness

must be determined subsequent to execution, before transition cost recovery. (D.97-11-074, pp. 123, 124.)

Public Utilities Code Section 367(c)(2) allows Edison to recover 100% of the uneconomic portion of the fixed costs paid under fuel and fuel transportation contracts that were executed prior to December 20, 1995, and subsequently determined to be reasonable by the Commission. This was affirmed by the Commission in the transition cost decision:

> "Edison's fuel and fuel transportation contracts must first be found reasonable by this Commission. Once that hurdle is cleared, it is the uneconomic fixed costs that may be eligible for transition cost treatment. To the extent Edison cannot receive (recover) these costs from market revenues, including the take-or-pay provisions of fuel contracts, Edison may seek transition costs recovery of the demonstrably uneconomic fixed portion of these costs." (D.97-11-074, p. 124.)

Edison's explanation for inclusion of the Southwest contract in its transition cost filing is that Edison proposed to determine its uneconomic fixed fuel costs by calculating all of its unavoidable fuel costs, then applying a credit equal to its revenue received from generation output less variable costs incurred. Edison did not state or suggest, as ORA has contended, that the Southwest contract would contain uneconomic costs. Edison identified the Southwest contract for the purpose of calculating Edison's total unavoidable fuel costs (Exhibit 20, pp. 9, 10).

We believe the explanation for inclusion of the Southwest contract in Edison's transition cost filing is reasonable and is not an admission by Edison that sometime in the future the contract would become uneconomic.

We should apply the usual reasonableness review standard to the Southwest contract. The Commission has set forth the standard for reasonableness review in several decisions. Essentially, the utility is required to

show that it pursued a reasonable course of action based on the facts known to the utility management at the time the decision was made. (See D.90-09-088, 37 CPUC2d 488, 499; D.94-03-050, 53 CPUC2d 481, 595, Finding of Fact 7.)

As discussed above, Edison's cost-benefit analysis shows a projected saving of $4.8 million over the life of the contract compared to Southwest tariff service. And Southwest tariff service is the only realistic alternative: Service from El Paso or SoCalGas requires construction of several miles of new pipeline and entails significant up-front charges.

Edison's cost-benefit analysis also determined: (1) the 15-year term of the Southwest contract was more favorable than the length-of-contract term or payment schedule of the other proposals; (2) there were provisions within the Southwest contract which permit termination at no cost under certain conditions (such as a Commission's finding of unreasonableness or the enactment of a cost prohibitive environmental regulation which would impact plant operations); and (3) the Southwest contract provided much more operational flexibility than tariff service or the other proposals.

ORA does not dispute Edison's cost-benefit analysis. ORA simply argues that Edison has not met its burden of proof since it failed to assess whether any of the alternatives to tariff service would be economic in the competitive marketplace and not add to ratepayers' burdens.

According to Edison, there is no market benchmark to which it can compare the Southwest contract to identify if any uneconomic costs exist. No market benchmark exists because the only other gas transportation service option available, without construction of additional pipelines, is tariff service from Southwest. Edison believes that, contrary to ORA's assertions, the Southwest contract will more likely reduce Edison's stranded costs.

In summary, we conclude that Edison has met its burden of proof and provided the necessary cost-benefit analysis to support its decision to shift from tariff service to a contract with Southwest. Accordingly, we find the Southwest contract is reasonable.

Operations for the 1995-96 and 1996-97 Record Periods

In its Reasonableness Report (Exhibit 35), ORA reviewed Edison's operations and expenses for: (1) gas and oil generation, (2) gas purchases subject to the ORA/Edison Gas Cost Incentive Program (GCIP) agreement, (3) coal generation, (4) hydro generation, (5) nuclear generation, fuel management and incentives, (6) long-term firm power purchase and sales agreements, (7) fuel oil management, and (8) recorded operation of balancing accounts.

Aside from the Southwest contract discussed above, ORA recommended: (1) a $0.36 million disallowance relating to an outage caused by a reheater tube leak at the Four Corners Coal plant during the 1995-96 Record Period; (2) a $0.2 million, plus interest, adjustment to the Catastrophic Event Memorandum Account (CEMA); (3) that the heat rate performance and operation of Edison's gas-fired power plants during both Record Periods be found reasonable and that reasonableness review of the operation of Edison's gas-fired power plants be continued so long as Edison receives any ratepayer funding for such operation; (4) that the cost of its gas purchase subject to the GCIP benchmark method be found reasonable; (5) that the Nuclear Unit Incentive Procedure (NUIP) rewards should not be amortized for collection after the rate freeze ends; and (6) that issues relating to purchases from QFs during the Record Periods should remain open and be investigated by ORA in the QF reasonableness phase of A.96-05-045 and A.97-05-050. ORA does not contest any non-QF related issues other than those identified above and specifically does not contest any issues relating to Edison's hydro and nuclear generation, including

hydro and nuclear plant outages, and nuclear fuel management activities during the Record Periods. Also, ORA does not contest Edison's administration of its long-term power purchase, sales and exchange agreements, and the new power sales agreements that Edison signed during the Record Periods. Additionally, ORA does not contest Edison's fuel oil management activities during the Record Periods or Edison's NUIP reward calculations.

Edison did not contest either ORA's recommended disallowance (adjusted to exclude base rate costs) for the reheater tube leak outage at the Four Corners coal plant or its recommended adjustment of $0.2 million plus interest to Edison's CEMA. With respect to its gas-fired plants, Edison believes that the continuance of an ECAC reasonableness review is contingent upon the continued incurrence of ECAC-includable costs. Edison also agreed with ORA's recommendation to book Edison's NUIP award amounts to the ECAC balancing account. However, these amounts should now be presented for recovery as part of Edison's Revenue Adjustment Proceeding (RAP), since the ECAC balancing account no longer exists. (See Coordinating Commissioner's Ruling of May 14, 1998 in R.94-04-031/I.94-04-032; D.97-10-057, p. 25 (Ordering Paragraph 2).

Accordingly, subject to the disallowances discussed above, we find Edison's non-QF operations for the 1995-96 and 1996-97 Record Periods to be reasonable.

Senate Bill 960

On January 14, 1997, the Commission issued Resolution ALJ-170 adopting experimental rules to gain experience with Senate Bill (SB) 960. The non-QF non-gas reasonableness phase of this proceeding was designated for inclusion in the experiment and categorized as ratesetting pursuant to an Assigned Commissioner's ruling dated March 31, 1997.

Section 311 Comments

The proposed decision of the administrative law judge was mailed for comments on September 10, 1998. Comments were timely filed by Edison and ORA. Reply comments were timely filed by Edison. We have reviewed the comments and made changes to the proposed decision where appropriate.

Findings of Fact

1. Edison's nuclear generation and expenses for the San Onofre Nuclear Generating Station (SONGS) and Palo Verde Nuclear Generation Station (PVNGS) were reasonable during the Record Periods.

2. Edison's cost of generation and expenses for the Mohave Generating Station were reasonable during the Record Periods.

3. Edison's coal generation and expenses for the Four Corners Generating Station were reasonable except for a reheater tube leak outage at Unit 5 for which ORA recommended a $0.36 million disallowance.

4. Edison does not contest ORA's recommendations except that the $0.36 million disallowance should be reduced to exclude $10,000 of operations and maintenance (O&M) costs improperly included by ORA in its calculation.

5. $0.35 million should be disallowed as a result of the reheater tube leak outage at Four Corners Unit 5. The $10,000 of the O&M costs were not ECAC-includable.

6. Edison's gas and oil generation and expenses were reasonable during the Record Periods.

7. The operation of Edison's gas and oil units will remain subject to reasonableness review as long as ECAC-includable expenses continue to be incurred by Edison on these units.

8. Edison's hydro generation and operations during the Record Periods were reasonable.

9. Edison's planning, procurement and scheduling of nuclear fuel materials and services during the Record Periods were reasonable.

10. Edison's nuclear fuel expenses incurred during the Record Periods were reasonable.

11. Edison's natural gas procurement and gas supply management during the Record Periods were reasonable.

12. Edison's costs of gas purchases subject to the GCIP benchmark evaluation during the Record Periods were reasonable.

13. The execution and administration of Edison's gas transportation contract with Southwest is reasonable.

14. Edison's fuel oil inventory management during the Record Periods was reasonable.

15. Edison's sales of low sulfur fuel oil (LSFO) during the Record Periods and the associated costs and revenues were reasonable.

16. Edison's coal procurement and delivered coal prices for Mohave and Four Corners coal plants during the Record Periods were reasonable.

17. Edison's administration of its long-term power purchase, exchange and sales agreements during the Record Periods was reasonable.

18. Edison's costs and revenues associated with transactions pursuant to its long-term purchase, exchange and sales agreements during the Record Periods were reasonable.

19. Edison's economy energy transactions during the Record Periods were reasonable.

20. ORA agrees with Edison's calculation of its NUIP amounts. Edison is authorized to seek recovery of NUIP rewards, associated with the operation of the nuclear units as follows:

UNIT	FUEL CYCLE	GCF (%)	REWARD
SONGS 2	6,7	84.0	$6,895,368
SONGS 3	6,7	84.4	7,460,958
PVNGS 1	4,5	80.2	75,178
PVNGS 1	6	83.8	465,573
PVNGS 2	6	86.1	461,701

21. Edison shall present the NUIP amounts above, plus applicable interest, and seek their recovery in the Revenue Allocation Proceeding (RAP).

22. Edison's emission allowances trading transactions during the Record Periods were reasonable.

23. Edison's execution and administration of its Special Rate contracts with Dow Chemical, Eisenhower Medical Center, Mobil and UNOCAL during the Record Periods were reasonable.

24. An adjustment of $205,718 plus interest to the CEMA upon which Edison and ORA agree is reasonable and is adopted.

25. With the above adjustment the amounts recorded in the CEMA are reasonable, and Edison is authorized to request recovery the recorded balance in Edison's RAP pursuant to D.97-08-056 issued in Application 96-12-009 et al. and the May 12, 1998 Coordinating Commissioner's Ruling issued in R.94-04-031/ I.94-04-032.

26. Edison's electric vehicle (EV) programs comply with relevant Commission discussions and have been reasonably implemented.

27. Edison's EV program costs incurred during the Record Periods were reasonable.

28. Except for any adjustments ordered herein, the amounts recorded in the ECAC balancing account during the Record Periods are reasonable.

29. The amounts recorded in the Electric Revenue Adjustment Mechanism balancing account during the Record Periods were reasonable.

30. The amounts recorded in the Interim Transition Cost Balancing Account during the Record Periods will be reviewed in Edison's RAP.

31. The amounts recorded in the SONGS 2 & 3 Incremental Cost Incentive Procedure (ICIP) balancing account during the Record Periods were reasonable.

32. Issues relating to purchases from QFs during the Record Periods have yet to be fully adjudicated.

33. Pursuant to Resolution ALJ-170, the non-QF non-gas reasonableness phase of this proceeding was designated for inclusion in the SB 960 experiment.

Conclusions of Law

1. For purposes of the SB 960 experiment, this proceeding was categorized as ratesetting.

2. Subject to the adjustments discussed above, Edison's non-QF operations for the Record Periods 1995-96 and 1996-97 are reasonable.

INTERIM ORDER

IT IS ORDERED that:

1. For the record periods April 1, 1995 through March 31, 1996, and April 1, 1996 through March 31, 1997, the operations of Southern California Edison Company (Edison) are reasonable to the extent set forth in this decision.

2. Edison shall transfer $0.35 million to its Electric Deferred Refund Account associated with the disallowance resulting from the reheater tube leak outage at Four Corners Units described in this decision.

3. This proceeding shall remain open to address the reasonableness of Edison's purchases from QFs.

This order is effective today.

Dated October 22, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners