

Decision 00-04-009 April 6, 2000

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 Sell Its interest in the Mohave Generation Station.

Application 99-10-023
(Filed October 14, 1999)

INTERIM OPINION

Introduction

Southern California Edison Company (SCE) seeks authorization to sell, through an auction process, SCE's share of the Mohave Generating Station, a coal-fired electrical generation facility of which SCE owns a partial, undivided interest. SCE seeks authorization to accomplish this divestiture in order to set the market value of its interest in Mohave pursuant to Section 367(b) of the Public Utilities Code. SCE seeks authorization to conduct this auction and sale in accordance with the terms and conditions contained in the Description of the Auction Process and the Terms and Conditions of Sale, submitted as Exhibit 3 to this application.

Background and Summary of Request

The Mohave Generating Station (referred to as the Plant, Mohave, the Mohave Facility, or the Mohave Plant) is a 1580 megawatt (MW), coal-fired generating station that is located in the community of Laughlin in Clark County, Nevada. SCE is the sole operating agent for Mohave; however, the Plant is jointly owned by SCE, the Department of Water and Power of Los Angeles

(LADWP), Nevada Power Company (NPC)¹ and Salt River Project Agricultural Improvement and Power District (SRP) (collectively, the Participants), as tenants-in-common. The Participants' undivided interests in and to the Mohave Facility are as follows:

Southern California Edison Company	56%
Department of Water and Power of Los Angeles	20%
Nevada Power Company	14%
Salt River project Agricultural Improvement and Power District	10%

In its application, SCE seeks approval of the sale by auction of SCE's undivided 56% interest in Mohave. SCE is continuing the process of market valuation of generation assets under Section 367(b) that began in 1996 with the proposed divestiture (successfully concluded in 1998) of its 12 gas-fired generating plants (the gas plant divestiture). In developing its proposal for divesting its interest in Mohave, SCE states it has drawn heavily upon its previous experience in the gas plant divestiture.

SCE Proposes a Three-Stage Divestiture Process

As in the gas plant divestiture, SCE proposes a three-stage process for accomplishing the regulatory and transactional aspects of the contemplated divestiture. The three-stage process is proposed so as to avoid a drawn-out final approval process that may deter potential bidders from participating in the auction in the first place, or may increase the risk of the executed transaction coming undone, which would greatly delay the valuation of the asset. SCE says

¹ NPC is now a subsidiary of Sierra Pacific Resources.

pre-auction approval of various fundamental aspects of the transaction provides the Commission and interested stakeholders with a full opportunity to consider important aspects of the transaction before the auction is completed and provides potential buyers with assurance that such fundamental issues will not have to be addressed during the final, post-execution, sale approval process.

The three-stage auction process that SCE proposes is substantially the same as the process that was used for SCE's gas plant divestiture. To begin the first stage, SCE has filed this Section 851 application, supporting exhibits, and a Proponent's Environmental Assessment (PEA) that addresses issues relating to the California Environmental Quality Act (CEQA).² In addition to the PEA, this filing includes: SCE's identification and description of the assets that are to be sold; a description of the auction process and SCE's proposed form of asset sale agreement and ancillary agreements; a description of potential workforce impacts and the steps SCE is taking to mitigate them; and a discussion of various ratemaking issues relating to market valuation of the asset. In the first stage, SCE requests that the Commission issue a "First Decision" that authorizes SCE to divest its interest in Mohave in accordance with the auction protocols and procedures, forms of transaction documents, and ratemaking treatment proposed by SCE.

² CEQA requires that the Commission assess the potential environmental impact of the proposed project as part of its decision to grant or deny SCE's application. (Public Resources Code § 21080.) In compliance with CEQA, the Commission is circulating a Draft Mitigated Negative Declaration (MND) for public comment and review.

The Draft MND was completed February 3, 2000 and is available for review on the Commission's website at www.cpuc.ca.gov/divisions/energy/environmental/info/mha/mohave or by calling the Commission (415-703-1446, ex. 31) or at the San Bernardino County Library in Needles, or the city libraries in Bullhead and Laughlin.

The second stage, which overlaps to a degree with the first, involves the auction itself, which will include two rounds of bidding: (1) an initial round in which bidders will submit non-binding "initial indications of interest," which will be used to develop a list of eligible bidders who may proceed to an intensive due diligence investigation of the Plant in preparation for the next round of bidding; and (2) a second round of bidding that will ultimately result in the selection of a winning bidder and execution of the asset sale agreement.

The final stage of the divestiture process involves SCE's submission of a description of the completed auction process and the executed transaction to the Commission for a "Second Decision" granting final approval for the sale. In the Second Decision, the Commission would: (i) confirm that SCE conducted the auction in accordance with the approved protocols and procedures or that any deviation from the approved process was reasonable; (ii) authorize closing of the sale pursuant to the executed agreements; and (iii) accept the sales price as a determinant of the market value of SCE's interest in Mohave pursuant to the ratemaking treatment adopted in the First Decision. SCE asserts that, in order for the auction to be successful, it is highly important that the Commission limit the scope of this final stage of proceedings. SCE believes that if potential bidders perceive a likelihood that the sale closing will be significantly delayed by regulatory proceedings in which the scope of review is unclear and potentially extensive, or perceive that losing bidders may have an unreasonable opportunity to interfere with the closing of the sale, they may be deterred from participating in the auction.

The Office of Ratepayer Advocates (ORA) has protested the application, citing three grounds:

1. There are serious air pollution issues as Mohave is located in a Class 1 airshed (Grand Canyon National Park);

2. Mohave's permits and agreements to withdraw water from the Colorado River are complex;
3. Mohave's co-owners have rights of first refusal.

ORA is concerned that these three factors could be impediments to SCE's obtaining a reasonable price for its share of Mohave. Therefore, ORA recommends that we approve the proposed auction with the additional provision that in our post-auction review of the sale we review the final bid accepted by SCE to satisfy ourselves that it is not unrealistically low. ORA points out that as operated by SCE, Mohave is a cost effective source of electricity and a hedge against volatile market prices. These ratepayer benefits must be weighed against costs ratepayers might incur given a low bid for the plant.

SCE argues that ORA's proposed restriction will have a negative effect on the bidding process by making it uncertain, thereby causing a low bid, the very problem ORA is concerned with. Further, ORA's restriction is contrary to the procedures approved in SCE's gas plant divestiture. (D.97-09-049.)

We agree with ORA. The complexities of the Mohave divestiture differ significantly from the issues raised in the gas plant divestitures for the reasons stated by ORA. We do not believe that a review of the adequacy of the final bid will dampen the bidding process; rather, it puts the bidders on notice that bargain basement bids will not pass scrutiny. We note that SCE has reserved to itself the right to reject all bids if they are too low to make the sale an attractive option to SCE. (Reply Comments, p. 6 footnote 11.) We merely add strength to SCE's position.

The Coalition of California Utility Employees (CCUE) has also protested this application. CCUE recommends that we should require any new owner to recognize and bargain with the existing union and to offer employment to existing employees on terms equal to or better than those available under the existing collective bargaining agreement. SCE says we should reject CCUE's

proposal. SCE argues that the Commission has approved divestitures by SCE, Pacific Gas and Electric Company, and San Diego Gas & Electric Company that were accompanied by the same kinds of worker protection provisions as are included in SCE's Mohave application, and that we have never imposed the additional requirements that CCUE now suggests. SCE states that CCUE's proposal is inconsistent with the worker protection provisions established by the Legislature and the Commission and unfair to SCE's customers.

SCE argues that in our Policy Decision, we expressly recognized that the transition to a competitive generation market will result in "hardships for employees" who may lose their jobs as a result of the market valuation and/or sale of utility generation assets.³ To address this concern, we authorized the utilities to provide worker benefits, "including early retirement and retraining" to displaced employees and authorized the utilities to recover the costs of those benefits through the competition transition charge.⁴ In Assembly Bill (AB) 1890, the Legislature agreed with the Commission's conclusion that employee job loss may occur as a result of Restructuring⁵ and adopted the same approach to addressing the issue. AB 1890 stipulates that reductions should be "accomplished through offers of voluntary severance, retraining, early retirement, outplacement, and related benefits" and provides that "reasonable costs associated with these sorts of benefits should be included in the competition

³ D.95-12-063, as modified by D.96-01-009, *mimeo.* at 47.

⁴ *Id.* at 47, 75.

⁵ See Pub. Util. Code § 330(u) ("The transition to expanded customer choice, competitive markets, and performance based ratemaking as described in D.95-12-063, as modified by D.96-01-009, of the Public Utilities Commission, can produce hardships for employees" including "reductions in the utility work force.")

transition charge.”⁶ The Legislature also established a two-year transitional period during which facilities that have been sold by a utility owner will continue to be operated by the utility or an affiliate or successor,⁷ and it mandated that the additional “employee related transition costs” incurred pursuant to this arrangement are also recoverable by the utilities as transition costs.⁸

We agree with SCE. Our prior decisions have never required the protection CCUE seeks nor has the Legislature. There is nothing special in this auction that would persuade us to add to worker protection.

In our Restructuring Policy Decision (D.95-12-063 as modified by D.96-01-009), we established the “buy/sell Rule” which provides that during this transitional period utilities must bid all their generation into the Power Exchange. The Policy Decision encouraged utilities to divest their generation facilities and to foster divestiture the Policy Decision said that “any generation unit sold by the utility by way of divestiture to a nonaffiliated new owner will be immediately freed of any obligation to bid into the Exchange.” (D.95-12-063 as modified, p. 53.)

Because the Participants have a three-year right of first refusal (from prior agreements) to purchase SCE’s interest in Mohave it is possible that SCE will not be able to close the sale to the auction winner until three years after notifying the Participants of the proposed sale. This wait is expected to reduce the sales price,

⁶ Pub. Util. Code § 375(a) and (b).

⁷ Pub. Util. Code § 363. Although Section 363 arguably may not be directly applicable insofar as SCE is not the sole owner of the facility, SCE has, as discussed above, incorporated a two-year O&M requirement that is consistent with this provision into the proposed transaction.

⁸ Pub. Util. Code § 375(b).

as uncertainty is built into the process. There is a further uncertainty that during this three-year wait the "bid into the Exchange" provision of our Policy Decision would remain applicable. This uncertainty also may reduce the sales price. To alleviate the "bid into the Exchange" uncertainty SCE seeks to have it waived. SCE argues that granting a waiver will allow this transaction to go forward and will make SCE's interest in the Plant's energy and power available to the buyer without the bid uncertainty. In other words, the buyer will be able to make use of this power any way it wishes, even during the three-year period. The waiver supports the goal of obtaining the highest market value for SCE's interest insofar as it will enable the buyer of SCE's interest to obtain some of the benefits of the transaction without the delay that may occur as a result of the notification period and thus promotes the Commission's broader objective of facilitating the rapid transition to a competitive generation market. We agree with SCE and will grant the waiver.

SCE proposes that the proceeds of the sale, net of transaction costs and tax effects, be compared to the net book value of the divested Mohave assets at the time of divestiture, and that the difference be subtracted from or added to the balance in the Transition Cost Balancing Account (TCBA). At that time, SCE will stop recording the amortization of the net book value of its Mohave assets in the TCBA. SCE will not wait until the right of first refusal expires to properly record this transaction in the TCBA. The costs of the sale (including fees paid to investment bankers, attorneys, and environmental consultants) will be deducted from the sale proceeds in order to determine the net market value of the assets. Similarly, tax liabilities or benefits will be reflected in the net market value of the facility.

The costs of reasonable worker protection benefits for workers who are impacted as a result of electric industry restructuring are recoverable transition

costs, as set forth in SCE's Preliminary Statement, Part JJ, TCBA.⁹ The Employee Related Costs Subaccount of the TCBA was established effective January 1, 1998 in accordance with the Commission's rulings in D.97-06-060, D.97-11-074, and D.97-12-039. SCE proposes to record such workforce management costs arising from the divestiture of SCE's interest in Mohave in the Employee Related Costs Subaccount of the TCBA.

SCE proposes to retain its operating agent status under the existing Mohave Project Operating Agreement and SCE, an affiliate or successor shall thereby continue to operate and maintain the Plant for two years following sale. That agreement was developed as a cost of service agreement, and does not incorporate any profits. Because SCE would be compensated for its costs only and would not be receiving any profit, SCE does not propose to establish any special ratemaking for the costs and revenues associated with the O& M contract.

There have been no objections to the ratemaking treatment proposed by SCE (see, Exhibit 5) for the proceeds from the sale. The ratemaking treatment will be adopted. All ratemaking must be consistent with § 367(b), which requires that market valuation be completed by December 31, 2001.

No party seeks an evidentiary hearing. We have disposed of the legal arguments and find that a public hearing is not necessary.

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. No comments were filed.

⁹ See Pub. Util Code § 375(a) ("In order to mitigate potential negative impacts on utility personnel directly affected by electric industry restructuring ...the commission shall allow the recovery of reasonable employee related transition costs incurred and projected for severance, retraining, early retirement, outplacement, and related expenses for the employees.")

Findings of Fact

1. SCE's ownership of its interest in the Mohave Plant is no longer 'necessary or useful in the performance of [utility] duties to the public' under Pub. Util. Code § 851, in light of the Commission's Restructuring Policy Decision and AB 1890.

2. SCE's divestiture of its interest in the Mohave Plant will not impair the reliability of electric supply.

3. SCE's divestiture of its interest in the Mohave Plant by means of the auction procedures and protocols described in Exhibit 3 is reasonable.

4. SCE's divestiture of its interest in the Mohave Plant pursuant to the asset sale agreement and ancillary agreements described in Exhibit 3, including the optional provisions identified therein, is reasonable, and SCE's proposal that it or an affiliate continue to serve as operator of the Mohave Plant for a two-year period pursuant to the existing Operating Agreement is "reasonable for both the seller and the buyer" within the meaning of Pub. Util. Code § 363.

5. The requirement that SCE sell power only through the Power Exchange during the rate-freeze period¹⁰ is waived for the sole purpose of allowing SCE to offer to enter into an interim power sale agreement with the buyer of SCE's interest in the Mohave Plant, in the event that all of the other Participants do not waive a three-year notice provision contained in the agreement between the Participants, and the closing of the sale is delayed by such three-year notice of a sale of SCE's interest.

¹⁰ D.95-12-063, as modified by, D.96-01-009.

6. SCE's ratemaking proposals with respect to the net sale proceeds, environmental liabilities, market valuation, and other matters described in Exhibit 5 are reasonable and should be approved.

7. In compliance with CEQA, Energy Division Staff prepared an Initial Study for SCE's proposed divestiture of 56% of its ownership in the Mohave Generating Station that identified potentially significant impacts in the area of Cultural Resources.

8. The Commission finished its Draft MND on February 3 and released it for public comments which must be submitted no later than March 13, 2000.

9. The Commission's final approval of SCE's application would be conditioned on SCE's acceptance of any mitigation and monitoring measures adopted by the Final MND.

10. In SCE's post auction filing, we will determine whether to: (i) find that SCE has conducted the auction substantially in accordance with the procedures and protocols approved by this decision (or that SCE has justified any deviation as reasonable); (ii) authorize SCE to close the sale in accordance with the executed agreements; (iii) accept the sale price as an adequate determinant of the market value of the generating station for transition cost purposes; and (iv) make certain appropriate findings relating to the buyer's ability to qualify as an Exempt Wholesale Generator.

Conclusions of Law

1. The application should be granted subject to the conditions set forth in the Interim Order.

2. This order should be effective today so as to allow the auction process to begin expeditiously.

INTERIM ORDER

IT IS ORDERED that:

1. Southern California Edison Company's (SCE) divestiture of its interest in the Mohave Plant by means of auction procedures and protocols described in Exhibit 3 is authorized.
2. SCE's proposal that it or an affiliate continue to serve as operator of the Mohave Plant for a two-year period pursuant to the existing Operating Agreement is approved.
3. SCE's ratemaking proposals with respect to the net sale proceeds, environmental liabilities, market valuation, and other matters described in Exhibit 5 are approved.
4. In SCE's post auction filing, we will determine whether to: (i) find that SCE has conducted the auction substantially in accordance with the procedures and protocols approved by this decision (or that SCE has justified any deviation as reasonable); (ii) authorize SCE to close the sale in accordance with the executed agreements; (iii) accept the sale price as an adequate determinant of the market value of the generating station for transition cost purposes; and (iv) make certain appropriate findings relating to the buyer's ability to qualify as an Exempt Wholesale Generator.

This order is effective today.

Dated April 6, 2000, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
CARL W. WOOD
Commissioners