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

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| Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies. | Rulemaking 06-04-009 (Filed April 13, 2006) |

# COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL ON THE PROPOSED "DECISION GRANTING IN PART PETITION OF SOUTHERN CALIFORNIA EDISON COMPANY TO MODIFY D.07-01-039" BY COMMISSIONER PEEVEY

June 16, 2010

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## 1. INTRODUCTION AND SUMMARY

The Natural Resources Defense Council (NRDC) respectfully submit these comments, in accordance with Rules 14.3, 1.9, and 1.10 of the California Public Utilities Commission's (CPUC or Commission) Rules of Practice and Procedure, on the May 27, 2010 proposed decision of President Peevey, "Decision Granting In Part Petition Of Southern California Edison Company To Modify D.07-01-039" (Proposed Decision or PD).

NRDC shares the Commission's commitment to ensure effective implementation of SB 1368 in a way that does not compromise reliability. While we recognize that investments in retained generation provides a unique problem for the Commission under SB 1368, it is imperative that the Commission protect customers by subjecting investments in retained generation at power plants that do not not meet the emissions performance standard (EPS) to a higher degree of certainty. We recommend the PD be modified with the following critical amendments, summarized here and discussed in detail below, to clarify the Commission's intent to address the Petition of Southern California Edison (SCE) in a more narrow and limited manner than requested:

- The PD should be modified to avoid conflation of the legal requirements of SB 1368 with AB 32 since SB 1368 is in effect and enforceable now, while limits on power plant emissions from AB 32 will begin in 2012;

- The PD should be modified to eliminate the individual size-based investment rule, which would encourage gaming and provide a loophole that could render it meaningless;
- The PD should be modified to specify standards or criteria to avoid setting an unnecessarily low "reasonableness" bar for investments made before January 1, 2012 and should require SCE to submit further information on its investments before considering allowing recovery;
- The PD rightly requires SCE to analyze customer impacts of continued ownership in Four Corners Generating Station Units 4 and 5 after January 1, 2012;
- The PD should be modified to avoid leaving open the possibility of further ownership investment in Four Corners beyond the current ownership/co-tenancy agreement.

## 2. THE PROPOSED DECISION CONFLATES THE LEGAL REQUIREMENTS OF SB 1368 WITH AB 32: SB 1368 IS IN EFFECT AND MUST BE ENFORCED NOW.

By permitting SCE to make any investment under $5,000,000 based only on a showing of reasonableness, regardless of its life-extension impacts before January 1, 2012, the PD conflates the requirements of AB 32 and SB 1368. Similarly, the Commission should not approve investments over $5,000,000 based purely on an indication of how long the investment will extend the life of the plant/unit and why it is "warranted nonetheless." (PD, p. 17, Ordering Paragraph 1(a) and (b)). SB 1368 has separate and independent legal requirements from AB 32: prohibiting new long-term financial commitments in base load power plants not in compliance with the EPS set by the Commission. The appropriate date for enforcement of the prohibition on new investment is the effective date of SB 1368, not AB 32.

SCE should not benefit from its decision to ask forgiveness rather than permission by notifying the Commission of its investments only after agreeing to invest nearly $200,000,000 in units 4 and 5 of Four Corners—a power plant not in compliance with the EPS. While we do not advocate for a blanket exclusion of these investments and recognize that some may be necessary, we strongly recommend the Commission establish criteria in this proceeding that will require a more detailed factual examination in the rate case to determine that the investments were immediately necessary and justified to customers given the short remaining term of SCE's ownership/co-tenancy agreement before any of these very significant investments are allowed to be recovered.

### 3. A SIZE-BASED INVESTMENT RULE WOULD ENCOURAGE GAMING AND OPEN UP A LOOPHOLE THAT COULD RENDER THE STANDARD MEANINGLESS.

The Commission must not lose sight of the fact that SCE committed $178,593,000 in investments broken into nearly 150 discrete "projects," without informing the Commission, despite clear knowledge of SB 1368. Setting a size of investment threshold for investments encourages gaming for investments made after September 29, 2006[1] and before January 1, 2012. Load serving entities (LSEs) complying with this Decision will be encouraged to characterize even very significant investments, that may substantially extend the life of a plant, as a series of smaller "reasonable" investments. The investments made by SCE in Four Corners are a perfect example. The Commission should look at the total effect of these investments and their cumulative impact on the units in question.

The Commission applied this same principle in D.07-01-039 when it prohibited repetitive short term ownership investments though "linking."[2] The Commission should recognize this principle applies equally well to this situation and apply a single evaluation protocol to all investments, regardless of size, and require an evaluation of the cumulative impacts of multiple investments. The Commission should not approve a long list of small sub-projects that, when taken together, substantially refurbish a power plant not in compliance with the EPS.

### 4. THE PD SHOULD BE MODIFIED TO ESTABLISH MORE DETAILED EVALUATION CRITERIA AND REQUIRE SCE TO SUBMIT FURTHER INFORMATION ON ITS INVESTMENTS BEFORE CONSIDERING ALLOWING RECOVERY.

We support the Commission's decision to deal with policy issues in this proceeding and leave factual questions to the rate case. However, more detailed criteria must be established in this proceeding to ensure implementation consistent with Commission policy and the intent of SB 1368.[3] D.07-01-039 disallowed any investment in retained generation that would extend the life of the plant beyond for five years or more.[4] The PD errs in requiring only a finding of "reasonableness" for investments below $5,000,000 and only a slightly higher threshold of justification for investments over $5,000,000 before permitting life-extending investments in base-load power plants not in compliance with the EPS.

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[1] The date SB 1368 was signed into law.
[2] D.07-01-039, "Interim Opinion On Phase 1 Issues: Greenhouse Gas Emissions Performance Standard," p.181.
[3] D.07-01-039, p. 51.
[4] D.07-01-039, p. 5.

The PD must be amended to make more clear how investments made before January 1, 2012 will be considered in the rate case under this policy. As discussed above, NRDC opposes use of a size based threshold. Instead, we recommend the Commission make a two part inquiry.

First, the Commission should examine the totality of the impact of investments in a power plant not in compliance with the EPS. If the total impact is a likely to extend the life of the plant beyond the period of the ownership/operation agreement and/or beyond the period that the original investment in the plant had fully depreciated, the Commission should subject each investment to the highest degree of scrutiny, and allow only those life extending investments that are immediately necessary or provide net benefits to ratepayers within the remaining period of the ownership/co-tenancy agreement.

Second, NRDC recommends the Commission examine the investment under the following four categories. Under any category, the Commission should disallow investments if divestment in the plant and investment in alternatives would provide net benefits to customers sooner.

- **Safety:** Investments should be allowed if justified to prevent the risk of an imminent safety hazard. LSEs making such investments should be required to demonstrate that the investment is immediately necessary based on a credible threat to worker safety or to the environment.

- **Environmental Compliance:** Investments should be allowed when immediately necessary to comply with state or federal environmental standards, and the cost can be prudently justified to customers when compared to alternatives. LSE's seeking approval for investments to meet a state or federal environmental mandate should have to justify the costs as prudent given and the term remaining in their ownership/co-tenancy agreement and available alternative supply options. Where investments are not found to be prudent, the owner should be required to divest rather than make the required investments in environmental controls to avoid imprudent costs.

- **Continued Basic Operation:** Investments can be justified if they are absolutely necessary for the continued operation of the unit. LSE's should also have to justify investments to maintain basic operation of the unit based on the amount of time remaining in the ownership agreement and the alternatives available. Where the

investment would be imprudent based on the time remaining in the joint ownership/co-tenancy agreement, the investment should not be allowed.

- **Improved Operation:** Investments made to improve the operation of a unit that do not fit into one of the above categories should subject to the highest level of scrutiny. Many discretionary investments are made to improve power plant operations to reduce maintenance requirements, improve efficiency, or otherwise optimize plant performance. Power plant owners typically decide which investments to make based on analysis of costs and benefits and payback periods. These investments should only be allowed if justifiable to customers based on a payback period less than the number of years remaining in the existing ownership agreement. In other words, discretionary plant improvement investments should only be allowed when the cost, including the cost of operation after upcoming environmental regulations like AB 32, is outweighed by the benefits that will accrue to customers from the improvement before the end of the contractual obligation of the LSE to the power plant.

In order to assist the Commission in determining whether SCE's investments fall into any of the above categories, the Commission should require SCE to provide further information about the nature and reasons behind the investment made at Four Corners. The Commission should require SCE to justify the investments based on safety, environmental compliance, basic operation or improved operation. SCE should also provide all the cost/benefit and pay-back period analysis already created or reviewed by SCE and any further analysis it wishes to share with the Commission for the purpose of categorization.

## 5. THE REQUIREMENT THAT SCE ANALYZE IMPACTS OF CONTINUED OWNERSHIP IN FOUR CORNERS AFTER JANUARY 1, 2012 IS APPROPRIATE.

The effect on customers of SCE's ownership interest in Four Corners will be significantly shaped by forthcoming regulations under AB 32. Given the substantial cost of greenhouse gas emissions from a conventional coal plant, the Commission is correct to require SCE to analyze the customer impacts of continued investment in Four Corners.. We therefore fully support the PD's requirement that SCE provide a study on the financial feasibility of continued investment in Four Corners. (PD, p. 18; Ordering Paragraph 3).

## 6. THE PD SHOULD BE MODIFIED TO CLARIFY THE PROHIBITION ON NEW LONG TERM FINANCIAL COMMITMENT TO POWER PLANTS NOT MEETING THE EPS.

SB 1368 prevents new long-term financial commitments in base-load power plants that do not comply with the EPS. The PD should be modified to clarify that SCE cannot make such investments. In order to enforce this requirement, the PD states that "SCE should not extend any of its existing co-tenancy agreements or enter into any new agreements concerning its ownership in Four Corners without first obtaining Commission approval." (PD, p. 18; Finding of Fact 11; Ordering Paragraph 4) Under the clear requirements of SB 1368 it would be contrary to law for SCE to "extend existing co-tenancy agreements or enter into new agreements concerning ownership in Four Corners" without bringing it in to compliance with the EPS. SB 1368 leaves some room for necessary continued investment in plants already under ownership by LSEs, but expressly prohibits new ownership investment. The PD should indicate that any new commitment or extension of agreements with regard to Four Corners would only be allowed if SCE were seeking to repower or install pollution controls to bring it into EPS compliance. The PD should also require SCE provide advance notice to the Commission and seek pre-approval for any further investment in Four Corners.

## 7. CONCLUSION

NRDC appreciates the opportunity to submit these comments on the Proposed Decision. We recommend the Commission modify the Proposed Decision's Finding of Fact, Conclusions of Law and Order as follows:

### Findings of Fact

6. Given the important role Four Corners Units 4 and 5 have played and currently play in SCE's energy supply portfolio, the long-term contractual commitments SCE has made to its co-tenants, and the limited time remaining under the contracts, it is prudent to allow certain limited investments in Four Corners ~~a partial exemption from the EPS~~ for capital expenditures made prior to January 1, 2012, subject to review to ensure their necessity and benefits to customers. ~~for reasonableness~~.

8. For capital projects ~~of $5 million or more,~~ where costs are incurred prior to January 1, 2012, SCE's ~~reasonableness~~ showing should identify whether, based on industry standards, the project likely will extend the life of Unit 4 or Unit 5 beyond five years or some additional, five-year increment. Where a life extension by one or more five-year increments is likely, the ~~reasonableness~~ showing ~~for capital projects of $5 million or more also~~ should explain why the capital project is ~~warranted~~ immediately necessary ~~nonetheless.~~ because of immediate

safety hazard, necessity for environmental compliance or basic operation. Where the investment is not justified based on immediate necessity, it should only be allowed if it provides net benefits to customers within the remaining term of the ownership/co-tenancy agreement.

NEW FINDING OF FACT:
SCE should submit to the Commission any and all information it has on the rationale for investments and the cost/benefit and payback analysis of any investments for which it seeks rate recovery.

9. SCE has certain legal obligations to its co-tenants but does not appear to lack all recourse to modify those obligations in order to avoid conflict with AB 32 and SB 1368.

11. Since the financial risks have yet to be determined, SCE should not extend any of its existing co-tenancy agreements or enter into any new agreements concerning its ownership in Four Corners without first obtaining Commission approval and must request pre-approval for any future investments in Four Corners. Extension approval would only be warranted if the plant is repowered or pollution control equipment is installed to bring the plant into EPS compliance.

**Conclusions of Law**

1. ~~After January 1, 2012, SCE's ratepayers would be exposed to potential financial risks to bring Four Corners into compliance with the pollution control requirements established by CARB pursuant to AB 32; therefore,~~ Approving a wholesale EPS exemption for Four Corners would be unsound~~, as would approving an EPS exemption for capital expenditures made after January 1, 2012~~.

~~2. Approving an EPS exemption for Four Corners for the period prior to January 1, 2012 is not subject to the financial risks identified in Conclusion of Law 1.~~

3. Any recovery in rates of capital expenditures for Four Corners made ~~prior to January 1, 2012~~ after September 29, 2006, should be subject to review ~~for reasonableness,~~ as further detailed in the Ordering Paragraphs.

**Order**

1. Decision 07-01-039 is modified to grant a partial exemption from the Adopted Interim Emission Performance Standard Rules for the period prior to January 1, 2012, for Units 4 and 5 of the Four Corners Generating Station (Four Corners) such that Southern California Edison Company (SCE) may recover a yet to be determined portion of the $178,593,000 capital expenditures for Four Corners subject to the following qualifications:

a. Recovery in rates is subject to a showing of ~~reasonableness~~ necessity or customer net benefit prior to termination of the ownership/co-tenancy agreement in the general rate case for test year 2012 that SCE will file later in 2010;

b. For each capital project ~~of $5 million or more,~~ SCE's ~~reasonableness~~ showing must identify whether, based on industry standards, the project likely will extend the life of Unit 4 or Unit 5 beyond five years or some additional five year increment. If life extension ~~by one or more five-year increments~~ is likely, the ~~reasonableness~~ showing for a capital project ~~of $5 million or more also~~ must explain why the project is warranted ~~nonetheless~~ for one of the following purposes: imminent safety hazard, environmental compliance basic operation or improved operation with net benefits to customers prior to the termination of the existing ownership/co-tenancy agreement. Investments should not be allowed where investments in alternative sources of energy would yield lower risk or higher benefits to customers given the short period remaining in the ownership/co-tenancy agreement.

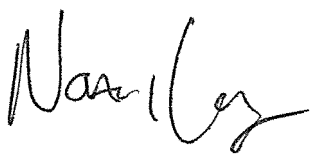
NEW ORDERING PARAGRAPH
SCE must provide to the Commission any and all information on the rationale and cost/benefit or payback period analysis of any investments for which it seeks recovery at Four Corners.

4. Southern California Edison Company must not extend any of its existing co-tenancy agreements, make any further investments in or enter into any new agreements concerning its ownership in Four Corners without first obtaining approval from this Commission.

6. The petition to modify Decision 07-01-039 filed by Southern California Edison on January 28, 2008, as subsequently amended, is granted to the extent consistent with this Order ~~Ordering Paragraphs 1 and 2~~ and is otherwise denied.

Dated: June 16, 2010

Respectfully submitted,



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## CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"Comments Of The Natural Resources Defense Council On The Proposed "Decision Granting In Part Petition Of Southern California Edison Company To Modify D.07-01-039" By Commissioner Peevey" in the matter of R.06-04-009** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on June 16, 2010 at San Francisco, California.

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