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STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
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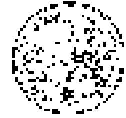

June 8, 2007

Via Electronic Delivery

Kimberly D. Bose, Secretary
Office of the Secretary
Docket Room
Federal Energy Regulatory Commission
888 First Street, N.E., Room 1A, East
Washington, D.C. 20002

Re: Southern California Edison Company, Docket No. EL07-62-000

Dear Ms. Bose:

Enclosed for filing in the above-docketed case, please find an original electronic filing of the attached document entitled **"NOTICE OF INTERVENTION AND PROTEST OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION."**

Thank you for your cooperation in this matter.

Sincerely,

/s/ GREGORY HEIDEN

Gregory Heiden
Attorney for the California Public Utilities Commission

GXH:rar

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Southern California Edison Company	Docket No. EL07-62-000

NOTICE OF INTERVENTION AND PROTESTOF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

I. NOTICE OF INTERVENTION

Pursuant to Rules 212 and 214 (a) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("FERC" or "Commission"), the California Public Utilities Commission ("CPUC") hereby submits its notice of intervention in the above-docketed proceeding and protests SCE's filing, as set forth below.

The CPUC is a constitutionally established agency charged with the responsibility for regulating electric corporations within the State of California. In addition, the CPUC has a statutory mandate to represent the interest of electric consumers throughout California in proceedings before the FERC. This Notice of Intervention serves to make the CPUC a party to this proceeding.

Communications to the CPUC in this proceeding should be addressed to:

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II. PROTEST

A. Introduction

This proceeding concerns the submission by Southern California Edison Company ("SCE") of its Petition for Declaratory Order For Incentive Rate Treatment ("Petition"). These incentive rate treatments are available to non-Transco utilities such as SCE pursuant to the FERC Order No. 679, Promoting Investment through Pricing Reform.[1] SCE seeks the following four incentive rate treatments: 1) Return on Equity ("ROE") adder for new transmission investment; 2) Construction Work in Progress ("CWIP") in rate base; 3) 100 % abandoned plant recovery; and 4) a 50 basis point "ROE adder" for its continued participation in the California ISO. Individually, and in combination, these incentive proposals will have a large impact of SCE's rates. SCE's petition, if granted, will certainly result in large rate increase to California customers. Given the ROE for these projects has not been decided yet it is impossible for CPUC staff to calculate the exact dollar impact of the ROE incentive. However, the CPUC estimates that the ROE incentives alone proposed by this Petition will increase SCE's revenue

[1] Order 679, 116 FERC ¶ 61,057 (2006) ("Order No. 679"), *order on reh'g*, Order No. 679-A, 117 FERC ¶ 61,345 (2006)("Order No. 679-A")

requirements by at least $75 million[2] a year. SCE's customers will be paying higher rates due to these projects going on line as well as the additional burden of the ROE adders if they are granted. Because of this high cost, it is especially important for SCE to properly analyze what its true risks are, and also the interrelationships of the incentives to addressing the true risks.

The CPUC partially protests this filing because SCE has not made the required showing under FERC Order 679-A that these incentives pass the revised nexus test, which requires applicants to show that the total package of incentives addresses the particular risks of the transmission projects. The CPUC believes that the three transmission projects SCE seeks incentive treatment for are important to California's transmission infrastructure. The CPUC has approved DVP2 and part of Tehachapi already, finding that these projects are beneficial to California ratepayers. Additionally, the projects will assist California in its efforts towards its Renewables Portfolio Standard. Therefore, the CPUC does not oppose SCE's proposals for CWIP in rate base and 100% recovery of abandoned plant to the extent that these incentive treatments reduce overall risk and facilitate completion of the projects. However, SCE's filing fails to consider the interrelationships of these incentives, particularly how the two non-ROE incentives will reduce the same risks which the ROE incentive could address. SCE's filing fails to properly analyze its true risks because it does not perform an adequate financial analysis or acknowledge that the California regulatory environment has largely eliminated its risks in building this transmission infrastructure. Finally, SCE's filing does not justify an across the

[2] This calculation, which does not include depreciation, is based on applying the proposed ROE incentives to the estimated capital costs of the three projects: DPV 2- $560 million; Tehachapi-$1.7 billion; Ranch Vista, $200 million. (Petition, pp. 11-19). This calculation does not include the basic dollar impact of a base ROE imputed since at the time of this filing SCE has not provided any factual evidence of its base ROE amount.

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board fifty basis point ROE adder for ISO membership applicable to all of SCE's transmission rate base.

B. Discussion

1. SCE's Petition Fails Rule 679-A's Nexus Test Because it Does Not Consider the Interrelationships Between the Proposed Incentives

SCE's Petition does not qualify for ROE incentives because the company does not satisfy Order No. 679-A's revised nexus test. In determining whether an applicant has satisfied the nexus test, "the Commission will examine the total package of incentives being sought, the inter-relationship between any incentives, and how any requested incentives address the risks and challenges faced by the project." (Order No. 679-A, at P 21). This test is intended to "protect consumers where an applicant both seeks incentives that reduce the risk of the project and seeks an enhanced rate of return for increased risk." (Id., at P 6). Here, contrary to the mandates of Order 679-A, SCE does not justify why it needs both incentives which reduce risk of its projects, CWIP in rate base and 100% recovery of abandoned plant, and large ROE adders designed to protect against risk. As discussed further below, both recovery of CWIP in Rate Base and the guaranteed recovery of abandoned facilities largely reduce regulatory and economic risk. SCE's Petition argues that the added ROE is needed to compensate for the high financial risks and uncertainties for the three projects; however, in discussing these uncertainties, SCE does not make any linkage to how these uncertainties would be reduced when the company is given the two non-ROE incentives it seeks.

a) *The CWIP in Rate Base Incentive and Recovery of Abandoned Plant Incentive Reduce the Same Risks That the Enhanced ROE is Intended to Compensate For*

SCE's filing states that recovery of CWIP in rate base will assist with cash flow, regulatory certainty and rate stability. (Petition, pp. 38-41). SCE states that the projects are extremely expensive and will greatly increase rate base, and because of this, investors may become concerned about earnings, subsequent rate shock and the ability of the utility to earn a prompt return. (Petition, p. 39). According to SCE, "including CWIP in rate base will assist SCE with its financings" and provide other financial benefits. (Id). SCE also seeks abandoned plant recovery for DPV2 and Tehachapi. For DVP2, SCE states that the need for multiple regulatory approvals increases its risks, and the guarantee of abandoned plant recovery helps compensate for this. (Petition, p. 44). For Tehachapi, there are the same risks of governmental approvals and also risks of generation not being constructed. (Petition, pp. 45-46).

In attempting to justify the ROE incentives, SCE discusses the same financial and regulatory risks. DPV2 and Tehachapi "present an unprecedented financing challenge to SCE." (Petition, p. 34). ROE incentives "will enhance SCE's cash flow, improve SCE's financial metrics, and support SCE's overall credit quality." (Id). SCE states that the same regulatory uncertainties, such as need for government approval and permits, are also relevant in the context of increased ROE. (Petition, pp. 35-36). However, in the ROE discussion SCE does not acknowledge that the abandoned plant and CWIP recovery incentives also will address these concerns. Like ROE incentives, both of these incentives are designed to improve cash flow, assist in financing and account for regulatory uncertainty.

b) SCE's Petition Fails the Nexus Test Due to The Company's Failure to Consider and Weigh the Interrelationships of The Proposed Incentives

As stated above, the Nexus test requires consideration of the interrelationship of the incentives to risk. In Order 679-A, the Commission agreed with the CPUC that where incentives lower risk a higher ROE may be duplicative and unjustified:

> We agree with the California Commission that utilities should consider the effect that certain incentives (e.g. CWIP in rate base, recovery of abandoned plant) may have on risk and that return on equity in the upper end of the zone of reasonableness may not be appropriate when combined with incentive treatments that lower overall risk. (Order 679-A, at P 65).

Similarly, Order 679-A also states that in evaluating a proposal for incentives, "if some of the incentives would reduce the risks of the project, that fact will be taken into account in any request for an enhanced ROE." (Id, at P 27). Despite the fact that these regulatory incentives reduce risk, SCE does not consider this reduction in the context of the enhanced ROE. Typically, when a capital item has a lower risk, the Commission will provide for a lower ROE. Here, SCE is asking for both a lower risk and a higher ROE. In essence, SCE is seeking double recovery for the same risks by seeking an enhanced ROE for risks which are greatly mitigated if not eliminated by the CWIP and abandoned plant incentives. Because SCE has ignored the Commission's Order and not considered the effect that the CWIP and abandoned plant incentives have on risk in the context of its discussion for ROE incentives, SCE fails the Nexus test. Therefore, SCE's request for the ROE adders for the three projects should be denied.

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2. SCE fails to Properly Analyze Its Actual Risks in the Context of The California Regulatory Environment That Has Greatly Reduced the Risks Which SCE is Seeking Incentives For

In its filing SCE seeks a number of incentives provided for in Order 679 and 679-A and granted to other utilities under those Rules, but fails to acknowledge many California-specific facts which place SCE in a lower risk category. Therefore, SCE's Petition presents a very incomplete picture of its actual risks. In Order 679-A, FERC states that in future proceedings on the application of the incentives, "the California Commission can raise its concerns regarding … the specific characteristics of California utilities." (Order 679-A, at P 65). Recent actions by the CPUC, the CAISO and FERC demonstrate that California is taking decisive action both to facilitate new transmission, especially to access new renewable energy sources, as well as to reduce the risk that the costs of such projects will not be fully recovered in rates. Below is a discussion of four particular regulatory actions which shows how SCE's risks have been lowered and refutes SCE's need for the ROE adders.

a) CPUC Code Section 399.25 and CPUC Decision D.06-06-034 Provide Backstop Protection to SCE Which Reduces Risk.

SCE's financial and regulatory risks are greatly reduced because of California law and CPUC regulation encouraging the deployment of additional transmission through "backstop" protection. CPUC Decision 06-06-034[3],which implements California Public Utilities Code Section 399.25, helps facilitate utilities' compliance with the state's Renewables Portfolio Standard (RPS) goals. The RPS Program requires each electrical corporation to procure at least

[3] 2006 Cal. PUC LEXIS 220 (Cal. PUC 2006)

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20% of its total retail electricity sales from eligible renewable energy resources by 2010. Section 399.25 provides a "backstop" cost mechanism allowing the utilities to recover through CPUC jurisdictional retail rates any costs of the facilities that are not approved by the Federal Energy Regulatory Commission (FERC) for recovery through transmission rates. The statute broadly applies "to both "network" transmission facilities and high-voltage generation-tie (gen-tie) transmission facilities that are deemed necessary to facilitate the achievement of the RPS goals." (D.06-06-034, June 15, 2006, Ordering Paragraph 2, p.40). The Decision's intention is to assure financial recovery for transmission owners like SCE in projects where rate recovery is uncertain:

> For transmission facilities that are likely to be classified by FERC as gen-tie facilities and for which the most economic build-out involves capacity expansions beyond what is needed for the typical project(s) that may initially interconnect, the CAISO tariff and FERC policy provide no relief. Renewable generation developers are unable or unwilling to finance the costs of these facilities, and utilities have no assurance of cost recovery under the existing CAISO tariff and FERC policy if they choose to finance the facilities themselves. Section 399.25 is intended to cut this Gordian knot, by providing a "backstop" mechanism through which cost recovery for transmission facilities deemed necessary to facilitate achievement of California's renewable energy goals can be assured. (D.06-06-034, pp. 14-15)

This back stop mechanism greatly reduces SCE's risk and should be considered when analyzing whether or not SCE's transmission projects warrant ROE adders. In a footnote in its discussion of abandoned plant recovery, SCE acknowledges that "[w]hile SCE has backstop protection for recovery of costs under California Public Utilities Code Section 399.25 … it is more appropriate for SCE to recover any abandoned plant costs broadly

from all FERC transmission customers rather than solely from CPUC-jurisdictional customers." (Petition, p.36). Either way, SCE is protected from risk here.

b) CPUC Decision 06-11-018 Reduces Regulatory Uncertainty

The CPUC additionally reduced risk for Transmission Owners like SCE in Decision 06-11-018, *Opinion on Methodology for Economic Assessment of Transmission Projects,* (November 9, 2006)[4]. In that Decision, the CPUC held that it would grant a rebuttable presumption to CAISO determinations on whether proposed transmission projects are economically beneficial: "If the California Independent System Operator (CAISO) Board makes the explicit findings regarding an economic evaluation of a proposed transmission project as set forth in this decision, the evaluation shall be granted a rebuttable presumption provided that the CAISO is a party to the CPCN proceeding." (D.06-11-018, Ordering Paragraph 5, p.80). This holding is important to reducing regulatory and economic risk facing SCE because the CPUC agreed to give some deference to a non-regulatory, technical body on the economic needs of new projects. This means SCE and other companies will face a more efficient, streamlined regulatory process.

c) The CPUC-driven Process Facilitating the Tehachapi Renewable Transmission Project Reduces Risk

SCE's proposed Tehachapi Renewable Transmission Project was the result of a coordinated, multi-stakeholder process with CPUC and CAISO input. This project was justified by the CAISO based on over 4500 megawatts of interconnection requests under FERC's Large

[4] 2006 Cal. PUC LEXIS 487 (Cal. PUC 2006)

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Generator Interconnection procedures. The CPUC actively facilitated a "best fit" with a high likelihood of success to accommodate the need for this transmission to connect to proposed wind projects. Therefore, there is very limited risk that the transmission lines that are proposed to be built will not be fully subscribed. In its discussion of Tehachapi, SCE states that the project is risky because it does not have all the approvals needed. (Petition, p. 36). However, SCE did not elaborate on how the level of interaction among the stakeholders on this project reduces risk.

d) FERC Decision in Docket EL07-33 Facilities Transmission and Decreases Risk in CAISO territory

In Docket EL07-33, FERC approved the CAISO's proposed Third Stream Transmission proposal, which will allow for cost recovery through the CAISO's TAC of certain elements of transmission that might otherwise be characterized as gen-ties. (*California Indep. Sys. Operator Corp.,* 119 FERC ¶ 61,061, (2007)). SCE's Petition discusses how EL07-33 approved a financing mechanism to facilitate interconnection projects such as Tehachapi as an example of the importance of this and other transmission are to the CPUC, CAISO and FERC. (SCE Petition, p.2). However, the Petition ignores the obvious reduction in regulatory and financial risk that accompanies FERC's action.

In its evaluation of the riskiness of its transmission planning, SCE should have considered how these proceedings reduce risk. Failure to do so is indicative of the company's incomplete and faulty analysis of its risks and its entitlement to ROE adders.

3. SCE's Transmission Projects are Not So Compellingly Challenging that They Warrant the Combination of Incentives Proposed by SCE

SCE's projects should not receive incentive ROE because the projects do not present special risks that differentiate them from routine investments. Order 679-A specifically rejected arguments that routine investments should be treated similarly to others when applying the nexus test, and held that "[t]he most compelling case for incentives are new projects that present special risks or challenges, not routine investments made in the ordinary course of expanding the system to provide safe and reliable transmission service." (Order 679-A, at P 23). Here, SCE's projects do not present special challenges warranting higher ROE because many of the actions of California stakeholders and FERC, as discussed above, have greatly reduced risk.

SCE's Petition can be distinguished from other proceeding where FERC has granted ROE incentives. These include *Allegheny Energy, Inc*., 116 FERC ¶ 61,058 (2006), *order on reh'g* 118 FERC ¶ 61,042 (2007)("*Allegheny*"), *American Electric Power Service Corporation*, 116 FERC ¶ 61,059 (2006), *order on reh'g* 118 FERC ¶ 61,041 (2007) ("*AEP"*), and *Duquesne Light Company*, 118 FERC ¶ 61,087 (2007) ("*Duquesne*"). In arguing for a higher ROE, SCE compares itself to Duquesne Light Company which was granted a 100 basis point ROE by the FERC.[5] (Petition, p. 35). However, the comparison is not convincing. Firstly, there is not evidence that the regulatory environment for Duquesne was as transmission friendly as the one embracing SCE's proposals in California. SCE argues that it is in fact in a more risky situation than Duquesne because "unlike Duquesne, SCE has not completed portions of any of the

[5] Duquesne sought a 150 basis point adder to its base level ROE, but was granted 100 basis points based on the reduction of risk from CWIP and abandoned plant. *Duquesne*, 118 FERC ¶ 61,087, at P 57.

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Projects… SCE's risk in building the Projects is therefore far greater than the risk faced by Duquesne." (Petition, p.37). SCE's risk in building the projects is not "far greater" than that faced by Duquesne or probably by any other transmission owner in the country. In fact, when combined with the steps taken by the CPUC and FERC, and with the inclusion of the two non-ROE incentives which the CPUC does not oppose, SCE's projects are essentially risk free. SCE faces no real risk in its projects despite the fact that it has not completed them, because the CPUC's backstop recovery and the CWIP and abandoned plant in rate base protect the company from risk.

SCE also states that its projects are larger, in absolute terms and compared to overall rate base, than Duquesne's. (Petition, p. 36). However, SCE is a larger utility than Duquesne, and because SCE has a large service territory it is likely that some of its transmission projects will have to be large. The relevant issue under Order 679 and Order 679-A is whether the projects are so unique and unusual that incentive ROE is necessary to accommodate risk. Here, the size of the projects does not justify additional incentives.

SCE's argument that the projects are very expensive, and, therefore, a financing challenge posing risks (Petition, pp. 34-35) is conclusive and unconvincing. SCE does not provide any evidence that it has had difficulty financing its transmission generally or these projects in particular. In asking for an ROE adjustment, Duquesne, like SCE, stated that this would help in financing the project and to preserve credit quality. (*Duquesne*, at P 12). Duquesne substantiated its potential financing by noting it had a credit rating of BBB, "below the average for electric utilities." (Id). Unlike Duquesne, SCE currently

has a Standard & Poor's Rating of BBB+, which is a stable credit rating for a utility company.[6] There is no evidence that SCE's credit rating would suffer or that it would have more difficulty in obtaining financing if it is not granted the package of incentives sought.

In both *Allegheny* and *AEP*, FERC stated that the multi state nature of the Projects presented substantial risks. (*Allegheny*, 116 FERC ¶ 61,058, at P 64; *AEP*, 116 FERC ¶ 61,059, at P 44). Both Rancho Vista and Tehachapi are located entirely within California so they do not face exceptional problems of multiple state and local authority approval. SCE is primarily dealing with authorities, such as the CPUC, with whom the company has already dealt with in its previous projects. The fact that SCE has regular dealings with many of these authorities lessens the challenge compared with dealing with new state and local authorities. Rancho Vista is intended to primarily serve two counties in California. (Petition, p.19). SCE also notes that Rancho Vista is the first substation in 20 years. Nevertheless, SCE needs this project and would have built it in the normal routine with or without ROE adders.

DPV2 will be located in two states, but DPV 2 will be using a similar corridor to the already built DPV 1 line, which reduces complexity and uncertainty in construction. SCE states that the DPV2 project is particularly "complex and risky project" because it requires the approval of California and Arizona as well as federal authorization. (Petition, p.35). As stated above, the CPUC has helped facilitate DPV2, which has reduced the complexity and riskiness of the project on the California side. While the Arizona Corporation Commission denied approval of DPV2 on May 30, SCE's potential higher risks are covered because it should still be able to

[6] Standard and Poor's SCE Credit Ratings, 5/25/2007, McGraw Hill Corporation, New York.

recover 100 percent of its abandoned plant costs and CWIP in case the DVP2 application and/or rehearing process take longer than expected. Furthermore, because DPV2 is part of a US Department of Energy's proposed National Interest Transmission Corridor, there remains a high likelihood the project will be built.

The investments SCE seeks incentives for are not of the type FERC had in mind in promulgating Order 679. In *AEP*, FERC granted ROE and other incentives and stated, "unlike the ordinary transmission project, AEP is under no state obligation to construct the line. We think it is important to recognize that instead of investing capital in another venture, AEP has voluntarily chosen to invest a large amount of capital …" on transmission. (*AEP*, 116 FERC ¶ 61,059, at P 44). SCE is a CPUC-regulated investor-owner public utility. The CPUC has made clear that SCE needs to build the Tehachapi and DPV2 transmission projects. If necessary, the Commission could compel SCE action pursuant to California Public Utilities Code Section 761, which grants the CPUC the broad authority to require SCE and other California utilities to construct facilities necessary to serve its customers.[7] As an investor owned utility, SCE is not in a position to make the variety of non- utility investments available to other companies and even if it was it would have a difficult time finding such low risk and high return as it can through

[7] California Public Utilities Code Section 761: Whenever the commission, after a hearing, finds that the rules, practices, equipment, appliances, facilities, or service of any public utility, or the methods of manufacture, distribution, transmission, storage, or supply employed by it, are unjust, unreasonable, unsafe, improper, inadequate, or insufficient, the commission shall determine and, by order or rule, fix the rules, practices, equipment, appliances, facilities, service, or methods to be observed, furnished, constructed, enforced, or employed. The commission shall prescribe rules for the performance of any service or the furnishing of any commodity of the character furnished or supplied by any public utility, and, on proper demand and tender of rates, such public utility shall furnish such commodity or render such service within the time and upon the conditions provided in such rules.

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transmission investment. For all of these reasons, SCE should not get ROE incentives, even if FERC has granted them to these other companies.

4. SCE's Petition Should Be Denied Because it Does Not Properly Analyze Financial Risks and Return on Equity

SCE has not justified its need for ROE incentives by failing to include a thorough financial analysis considering the real economic relationships among its risks and return. In its petition for rehearing of Order 679, the CPUC argued that the Order did not consider a number of specific facts which lower risk, thereby alleviating the need for any incentives. (Order 679-A, at P 57). FERC did not grant rehearing on this ground, but explained that California's concerns would be valid in individual applications, stating that in future proceedings on the application of the incentives, "the California Commission can raise its concerns regarding comparative returns within the energy industry and the specific characteristics of California utilities." (Id., at P 65). The CPUC discussed some of the specific characteristics of California utilities in Section 2 above. Below is an analysis of the appropriateness of SCE's incentives in the context of its actual financial risk.

Generally, the risks for SCE's transmission infrastructure investment projects are different than the risks for generation or distribution. There are three distinct components to an integrated utility such as SCE: generation, transmission, and distribution. Before the restructuring of California electricity market the rate of return was determined on the basis of the integrated unit, not the sum of its parts. After restructuring, each of the components is now considered separate for regulatory purposes by economic functions.

Among the three functions, generation is considered the most risky, while distribution follows next and transmission is considered least risky. An S&P report describing how the rating criteria for electric utilities are determined explains this: "[S&P] analytical groups choose various ways to express these scores [overall financial risk profile]: Some use letter symbols, while other use numerical scoring systems. For example, utilities' scoring is from 1 to 10 – with 1 representing the best. Companies with a strong business profile – typically, transmission/distribution utilities – are scored 1 through 4; those facing greater competitive threats – such as power generators – would wind up with an overall business profile score of 7 to 10."[8] The S&P rating criteria shows that the risks from transmission and distribution are different than the risks for generation. Similarly, the rate of return for an integrated unit is not the same as the rate of return for each individual component.

Currently, the CPUC has approved SCE's overall ROE to be at 11.6 percent[9] where the Standard and Poor's overall credit rating for SCE is currently at BBB+ which is a quite stable credit rating for a utility company.[10] The additional ROE adder that SCE is requesting in this filing will reward its least risky investment capital much higher than its overall company is receiving from its investments. During the California energy crisis of 2000-2001 SCE's overall company business did not suffer due to its risks on

[8] Standard and Poor's Report on Corporate Ratings Criteria: June 2003 , Page 17, The McGraw-Hill Companies, New York.

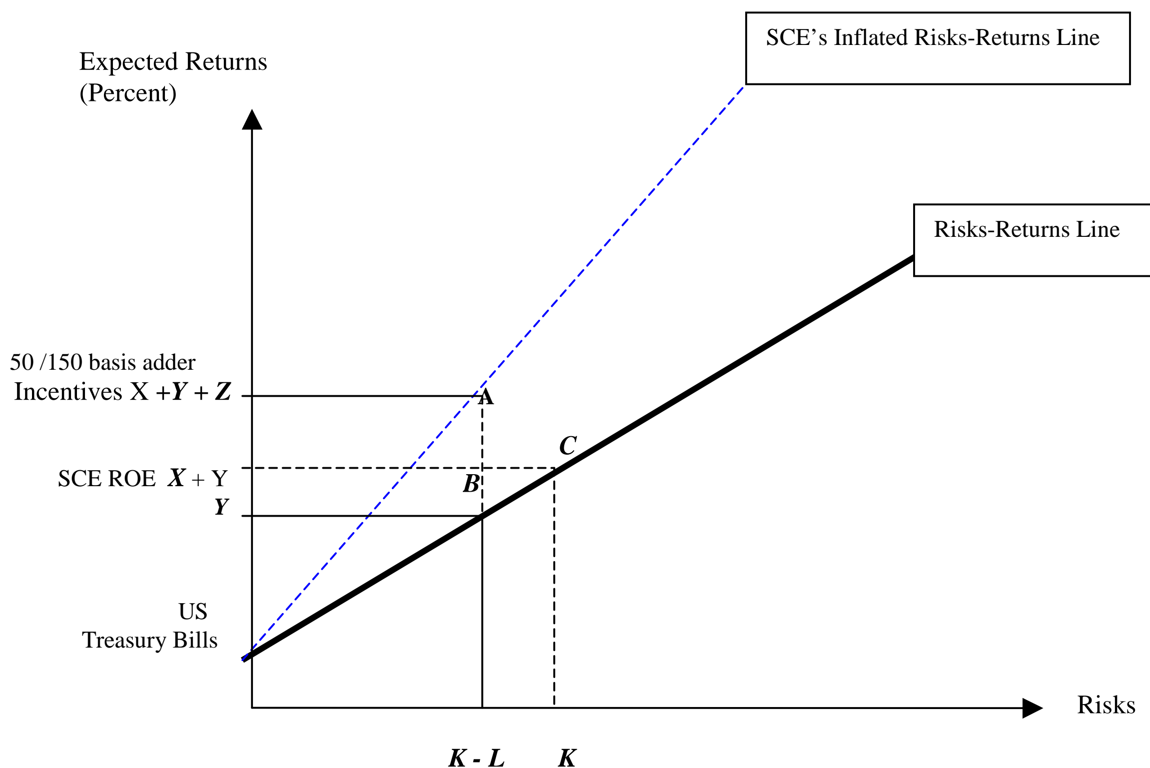
[9] CPUC Decision 05-12-043 , *Application of Southern California Edison Company (U 338-E) for Authorized Capital Structure, Rate of Return on Common Equity, Embedded Cost of Debt and Preferred Stock, and Overall Rate of Return for Utility Operations*, December 16, 2005.

[10] Standard and Poor's SCE Credit Ratings, 5/25/2007, McGraw Hill Corporation, New York.

transmission business but, rather, on the utility's procurement uncertainty that exposed the utility's retail ratepayers to high energy prices.

Why the ROE adder that SCE is requesting is excessive based on its investment risks can be illustrated by the Return and Risk graph below.

Relationship between Expected Returns and Risks



In the above graph (not to scale) the vertical line shows expected investment returns and the horizontal line shows corresponding risks. Finance literature points out that there is a reward for bearing risk which is called a *risk premium*. Secondly, this *risk premium* is larger for riskier investments. The directions of the arrows show the direction

of the increased value of the axes from lower to higher. The percentage of expected investment returns is represented on the vertical axis showing returns from the least risky US Treasury Bill (risks are practically zero) shown near the bottom of the Returns axis to SCE's transmission only ROE at Y to the inflated ROE at X+Y+Z.

The upwardly sloped solid line shows the relationship between investment risks and risk premium or returns. The upwardly sloped solid line starts at the level of US Treasury Bills that are minimum positive returns without much risk. If SCE did not have any CWIP or abandoned plant cost recovery incentives adder, then based on SCE's risks level K its just and reasonable return should be X+Y. From the intersection point C, ROE level at X+Y is higher even though SCE's just transmission incentive should be Y since transmission risk level is denoted by K-L. This is shown by the intersection point B. With CWIP and abandoned plant cost recovery SCE's risks are reduced to K-L, but as an incentive adder SCE is allowed to keep its ROE at X + Y, and not Y. However, if SCE is allowed to keep the adders as requested, the risk-returns line is forced drawn to be steeper as shown by the dotted upwardly sloped line that intersects at A. At point A SCE's incentive adders will substantially increase SCE's returns to level X+Y+Z. This is much higher than what SCE needs to make the appropriate investment. At point A while SCE's risk is significantly reduced to K-L, SCE still will receive incentive by receiving an ROE of X + Y. However the additional incentive adders will result in a much higher percentage level of return to X+ Y+Z while the risk appropriate ROE is at Y.

Financial theory instructs us that companies with higher risks should earn a higher rate of return. However, transmission companies (merchant or not), which will operate

on a cost-of-service basis are, in effect, regulated monopolies. Once a transmission line is approved (for the reason either that it is needed for system reliability or that it is in the economic interest of ratepayers), the company building and operating that transmission line will have a guaranteed revenue requirement as well as guaranteed profits. Such projects are low-risk projects, and accordingly should not be entitled to high rates of return on equity. SCE's application argues superficially that its projects are high risk and need ROE incentives, but the company never really analyzes risk in any meaningful way.

SCE's transmission business can be appropriately described as a regulated monopoly. In all probability, SCE's transmission business will continue to generate a steady revenue stream and does not require an above-average incentive adder to its return on equity. Any excessive revenue FERC grants to SCE based on this filing that is above and beyond a just and reasonable return will not only directly impact the utility consumers of SCE immediately, but will also set a precedent for future transmission rate increases. California has two other large Transmission Owner Utilities, Pacific Gas and Electric (PG&E) and San Diego Gas & Electric (SDG&E). PG&E, the largest transmission utility in California, has significantly upgraded its transmission system and has already had nine Transmission Owner (TO) rate cases at FERC. PG&E did not need incentive adders in its ROE to finance its transmission. SDG&E, the other large California utility also has not needed any ROE adders. As stated below, in its last TO case it settled for an ROE and agreed not to seek ROE adders.

SCE's proposed measures are ultimately adopted, investments in the proposed transmission projects will be compensated at levels that are artificially high, dramatically

surpassing the returns that would be available for almost any other category of investment, at inflated and unjustified cost to ratepayers.

5. SCE Should Not Be Granted the 50 Basis Point RTO Membership Adder

FERC should deny SCE's request for a 50 basis point ROE adder to its entire rate base for being a Participating Transmission Owner in the CAISO. SCE states it is entitled to this adder because the Commission granted this adder to San Diego Gas and Electric in its most recent TO case. (Petition, p.33) SCE's citation to the SDG&E case is misleading. While the FERC granted SDG&E a 50 basis point ROE adder in its initial suspension order, this order became moot after an all party settlement in that proceeding. The settlement specifically states, "all parties agree that SDG&E's requests for a 50 basis point ROE incentive for CAISO participation … and the Suspension Order's ruling on [this] issue [is] rendered moot for purposes of this Settlement."[11] In fact, the SDG&E settlement order states that SDG&E's ROE was reduced from 12.5 percent to 11.35 percent in that settlement.[12] The settlement also states that SDG&E will not file for any transmission incentives, including but not limited to those identified in Order Nos. 679. *et seq,* for any transmission projects that go into service either under Section 205 of the Federal Power Act or pursuant to any other FERC or CPUC rule or regulation or court, FERC or CPUC order.[13]

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[11] San Diego Gas and Electric Company, Offer of Settlement ER07-284-000 submitted to Federal Energy Regulatory Commission, March 27, 2007, pp. 14-15, Article XI -incentives.

[12] 119 FERC ¶ 63,005, at P 19

[13] San Diego Gas and Electric Company, Offer of Settlement ER07-284-000 submitted to Federal Energy Regulatory Commission, March 27, 2007, page 4, section C. Article III - incentives.

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SCE's proposed additional 50 basis point ROE adder to reward its continued membership in CAISO simply provides windfall profits to a utility that already belongs to a transmission organization. By continuing its membership in CAISO, SCE will not incur any additional risks as the nature of transmission business will still remain monopoly. In fact, in California the transmission companies will receive higher incentives in the form of higher opportunity to participate in a broader CAISO market while benefiting from the system-wide reliability criteria and other economies of scale benefits that result. SCE may also benefit from California's Market Redesign and Technology Upgrade that will offer opportunities for locational marginal pricing-related congestion revenue rights and a guaranteed transmission access charge.

Additionally, California investor owned utility transmission owners like SCE are legally obliged to stay in the California Independent System Operator control area. The CPUC's Decision on California restructuring required all three California Investor Owned Utilities, including SCE, to transfer the operational control of the utilities' transmission facilities to the CAISO.[14] Under California Public Utilities Code Section

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[14] California Public Utilities Commission Decision 95-12-063, December 20, 1995, Ordering Paragraph 1:

IT IS ORDERED that:

> 1. Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), and San Diego Gas & Electric Company (SDG&E) shall work together and with other parties to develop a detailed proposal for submission to the Federal Energy Regulatory Commission (FERC) to establish the independent system operator (ISO) and its protocols and transfer operational control of the utilities' transmission facilities to the ISO. This proposal shall be filed at FERC and simultaneously filed and served in this docket within 130 days after the effective date of this decision. The proposal shall comply with the principles and guidelines for operational issues outlined in Chapter III of this decision and shall include recommendations for ownership, financing, and corporate structure of the ISO. …

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851, any utility transfer to or out of the CAISO requires CPUC approval.[15] The 50 basis point incentive adder may have been appropriate if SCE were to join the CAISO control area as a new transmission owner, who otherwise could choose to be outside the CAISO control area. However, SCE has already transferred its transmission facilities to CAISO and does not need this "ROE incentive" adder to continue its participation in CAISO.

The across the board incentive adder to the SCE transmission rate base will also award SCE's existing transmission infrastructure, which SCE already built and from which it has recovered sufficient fixed costs and fair returns. For those projects, an additional 50 basis points cannot incentivize conduct that has already occurred.

6. SCE's ROE Proposals Should be Denied Because They are Not Just and Reasonable

SCE's proposed ROE incentives should be denied because its proposals do not result in just and reasonable rates. Section 205 and 206 of the Federal Power Act require that rates approved by FERC be just and reasonable.[16] SCE's petition, if granted, would improperly result in an increase in rates and profits to the utility without balancing consumer harm.

C. Conclusion

While the CPUC does not oppose SCE's proposal for the two risk-reducing incentives, the CPUC finds no support in SCE's Petition for the proposed large ROE

[15] In relevant part, California Public Utilities Code Section 851, states "No public utility … shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its railroad, street railroad, line, plant, system, or other property necessary or useful in the performance of its duties to the public … without first having either secured an order from the commission authorizing it to do so. …"

[16] 16 U.S.C. §§ 824 d, 824e

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incentives. The CPUC is concerned that if FERC grants SCE these ROE incentive adders this will set a harmful precedent and may result in preapproval for transmission investments without an appropriate analysis of the actual risks facing the applicant. This process may also discourage project competitiveness, transparency and cost reduction that was part of FERC's restructuring effort and the spirit of the Energy Policy Act of 2005. For the reasons discussed above, the CPUC opposes SCE's proposed ROE adders.

Dated: June 8, 2007

Respectfully submitted,

RANDOLPH L. WU
HARVEY Y. MORRIS
GREGORY HEIDEN

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____
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Commission of the State of California

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CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served electronically according to Rule 385.2010(f) of the Commission's Rules of Practice and Procedure.

Dated at San Francisco, California, this **8th** day of **June, 2007**.

/s/ Gregory Heiden

Gregory Heiden

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