Exhibit Number	:	
Commissioner	:	C.W. Wood
Adm. Law Judge	:	M.S. Wetzel
Witnesses	:	Various

CALIFORNIA PUBLIC UTILITIES COMMISSION

ORA
Office of Ratepayer Advocates

REPORT ON THE RESULTS OF OPERATIONS

FOR

SOUTHERN CALIFORNIA EDISON COMPANY'S

GENERAL RATE CASE

Test Year 2003

VOLUME 2

REDACTED – PUBLIC VERSION

Application No. 02-05-004

San Francisco, California
October 17, 2002

CHAPTER 12

CUSTOMER SERVICE GUARANTEES

I. INTRODUCTION

This chapter contains ORA's analysis of and recommendations for a customer service guarantee program. The purpose of this proposal is to provide an incentive for SCE to meet its stated commitment to providing high-quality service in its interactions with residential customers,[1] and to compensate customers when SCE fails to live up to these commitments. The proposal is based on a voluntary program SCE operated from 1995 until it was cancelled in 2001. It also derives from PG&E's existing shareholder-funded and CPUC-mandated service guarantee program. SCE should work with ORA and other interested parties to implement these guarantees and should report the program's results quarterly, as described below.

II. SUMMARY

ORA proposes the following guarantees and compensatory rebates to customers for failure to meet the guarantees:

Standards	Credits
SCE will:	
1. meet agreed appointment times	$50
2. investigate non-emergency situations and communicate results to customers within 7 days of a customer request	$50
3. decide on a course of action to resolve a complaint and communicate it to the customer within 3 working days, and communicate the complaint's resolution to the customer within 10 working days, or 30 working days when an off-site meter test is required or an on-site home audit is requested.	$50
4. meet the agreed date for installing a new meter and turning on service for a customer	$50
5. respond to service interruptions within 4 hours after receiving a customer report by either restoring service or informing the customer of when they can expect service to be restored	$50

[1] SCE-5, volume 1, page 3.

Standards	Credits
SCE will:	
6. restore service within 24 hours	$50 for each 24 hours without service
7. provide at least three days notice of a planned interruption in service	$50
8. issue an accurate first bill to a new customer account within 60 days of service initiation	$50

The Commission adopted the first six service guarantees (some with slightly reduced rates) for PG&E in their last General Rate Case (GRC) decision, D.00-02-046. SCE had a similar voluntary service guarantee program from September 1995 through January 2001,[2] when it was terminated "as a result of resource limitations imposed by the energy crisis."[3] SCE reported the results of their service guarantee program annually since April 2000 in their Performance Based Ratemaking (PBR) Performance Reports.[4] During the years of their voluntary program, the number of instances in which SCE paid claims for failing to meet its guaranteed voluntary standards decreased fairly consistently.[5]

This proposal is not meant to be punitive, but instead to provide an incentive for SCE to maintain high-quality customer service. Based on SCE's performance under their voluntary service guarantee program, ORA expects that SCE may reduce the number of claims made and the amount of money paid over time. Like the PG&E program and SCE's former voluntary program, these service guarantees should be shareholder funded in order to provide SCE with the incentive to reduce their total claims. It is reasonable to adopt such a program for SCE to ensure that customer treatment does not deteriorate, especially given the higher rates now paid by customers due to surcharges imposed during the energy crisis.

To facilitate tracking of its performance on these guaranteed standards and to allow future evaluation of whether SCE maintains or improves its treatment of customers in the guaranteed areas, SCE should submit quarterly reports showing the number of

[2] SCE response to DR-ORA-055, question 1.
[3] SCE Advice Letter 1537-E, page 26.
[4] SCE Advice Letters 1449-E on performance in 1999, 1537-E on performance in 2000, and 1608-E on performance in 2001.
[5] SCE response to DR-ORA-055, question 5.

claims made, claims paid, and amounts of money paid under each guarantee for each month in the quarter. SCE should work with ORA and other interested parties to define any specific assumptions for the application of these guarantees or exceptions to them, as well as auditable tracking and reporting procedures to ensure that the program is applied consistently. In addition, SCE should provide text along with these tables to explain any material variations in the number of claims over time.

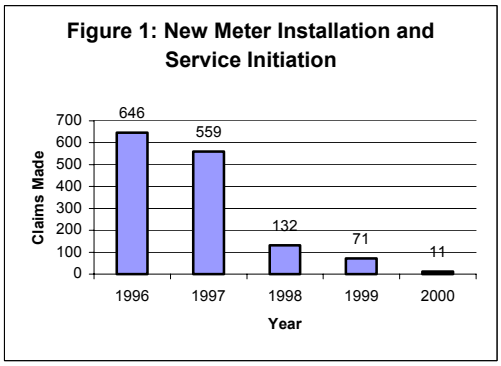
III. DISCUSSION/ANALYSIS

A. BACKGROUND

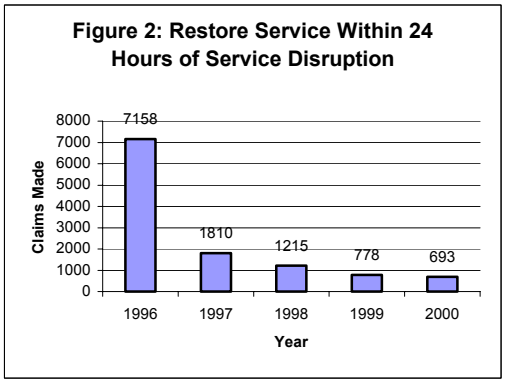
In September 1995, SCE began guaranteeing three services to their customers. Under this program, SCE guaranteed that they would do the following: 1) install new meters and initiate electric service to customers by the agreed date; 2) respond to service disruptions within four hours of customer calls reporting the outage, either by restoring service or by notifying the customer of when service would be restored; and 3) restore service within 24 hours of a reported disruption. This program contained exceptions specifying that the guarantees would not apply in certain emergency situations; under normal circumstances, however, SCE committed to pay customers $50 if they failed to meet any of these guarantees.[6] SCE explains that they set the compensatory credits at $50 "after reviewing similar guarantee programs in place at other utilities." SCE indicates that $50 "was also meaningful to [its] customers in that, at the inception of this program, it approximated the average amount of a monthly residential bill."[7] An SCE marketing brochure describing this program explains its purpose by saying that "[customers] tell us that reliable electric service is important to you…and that makes it important to us." The brochure goes on to say that these guarantees show that SCE is "committed to giving [customers] the kind of service [they] want."[8] SCE maintained their service guarantee program until January 15, 2001, when it was discontinued "due to resource limitations imposed by California's energy crisis."[9]

[6] SCE response to DR-ORA-055, question 1.
[7] Both quotes from SCE response to DR-ORA-055, question 2.
[8] SCE response to DR-ORA-055, question 3: attached brochure titled "Service Guarantee," apparently revised in 1996.
[9] SCE response to DR-ORA-055, question 1.

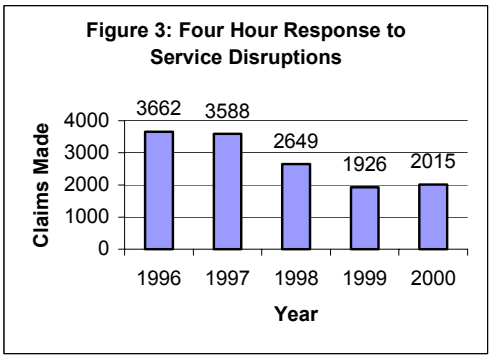
Claims made and paid under SCE's service guarantee program decreased steadily each year for most guaranteed services.



As shown in Figure 1, the number of claims paid under the first guarantee, to install new meters and initiate service on time, decreased from 646 in 1996 (the first full year of the program) to only 11 in 2000 (the program's final full year).



Similarly, claims paid under the guarantee to restore service within 24 hours of a reported outage decreased steadily, from 7,158 in 1996, to 1,810 in 1997, to as few as 693 in 2000 (see Figure 2).



The only area in which claims paid did not decrease every year was in 4-hour response to reported outages, which decreased each year from 3,662 in 1996 to 1,926 in 1999, before rising slightly to 2,015 in 2000 (see Figure 3).[10]

SCE notes two factors that led to these decreases in claims paid. They state that "initially…the yearly decreases in claims were due to SCE's emphasis on meeting the parameters of the guarantee program resulting in continuous improvement." They also acknowledge, however, that due to a change in their customer information system, "SCE lost the ability to automatically identify those instances where [they] were unable to meet [their] agreed upon service turn-on date which led to fewer claims being identified in this

[10] All figures from data in SCE response to DR-ORA-055, question 5.

service area."[11] This means that, though the data show fewer claims paid in this service guarantee category each year, it is not clear whether that change is due to actual improvements in on-time service initiation or to a data collection problem that caused SCE to fail to identify instances in which a payment under this guarantee was appropriate. This highlights the need for the development of consistent criteria and procedures for identifying when a service guarantee payment is due, as well as an auditable reporting system to ensure payments associated with guarantees are applied and reported correctly. Also, because ORA has been unable to get information on the instances in which claims would have been paid if the program had continued since January 2001, it is not clear whether performance in these areas has deteriorated since the program ended.

After SCE instituted its program in 1995, the Commission adopted similar programs for SDG&E and PG&E. SDG&E's program was adopted as part of a settlement in their last PBR proceeding. Decision 99-05-030 adopts this settlement, which requires SDG&E to provide credits to their customers if they miss scheduled appointments or fail to turn on a customer's electric or gas service on the agreed date. Under SDG&E's program as adopted by the Commission, customers receive $50 bill credits for missed appointments, and receive credits of the service establishment charge ($15 for electricity or gas, $30 for both) if SDG&E fails to initiate service on time.

PG&E's current program, adopted in their last GRC decision, D. 00-02-046, requires them to guarantee a variety of services with customer credits of between $25 and $100. The services guaranteed under this program include the services guaranteed under the SCE and SDG&E programs, and several others. Under this program, PG&E must:

Standards	Credit to customer if standard not met
1. Keep scheduled appointments with customers	$25
2. Provide non-emergency services or investigations within an acceptable time period	$25
3. Respond immediately (usually within 2 hours) to a request for emergency service	$100

[11] SCE response to DR-ORA-208, question 11.

Standards	Credit to customer if standard not met
4. Decide on a course of action to resolve a complaint and communicate it to the customer within 3 working days, and communicate the complaint's resolution to the customer within 5 working days	$25
5. Meet the agreed date for installing a new meter and turning on service for a customer	$50
6. Respond within 4 hours after a customer reports a service interruption or inform the customer within 4 hours of when they can expect their service to be restored	$25
7. Restore service within 24 hours	$25 for each full 24 hour period without service

In implementing these guarantees, PG&E worked with ORA, The Utility Reform Network (TURN), and the Coalition of California Utility Employees, as well as the CPUC Energy and Consumer Services Divisions.[12] The final implementation plan, as described in the implementation letter to the Commission's executive director, explains the assumptions about what is being guaranteed and exceptions for certain circumstances beyond PG&E's control. ORA proposes that SCE adopt six of the seven guarantees already in place for PG&E, as well as two other guarantees that would require them to provide customers with at least three days notice of planned outages and to issue accurate bills to customers within 60 days of service initiation.

This proposal omits PG&E's service guarantee on responding within two hours to customer requests for emergency services. SCE considers situations to be emergencies requiring an immediate response if they involve "a threat to public health and safety, and/or to the integrity of the electric system."[13] Because such emergencies generally threaten health and safety, a guarantee on this subject may not be necessary or appropriate. The eight guarantees ORA proposes for SCE are explained in more detail below.

[12] PG&E letter to Wes Franklin dated June 16, 2000, explaining implementation of Quality Assurance Program adopted in D. 00-02-046.
[13] SCE response to DR-ORA-128, question 6.

In adopting service guarantees for PG&E, the Commission recognized that they are "a self-enforcing mechanism that may create a significant incentive for PG&E to meet the standards,"[14] and stated that PG&E's general rate case was the appropriate place to adopt such measures.[15] In PG&E's case, the Commission reduced the credit amounts proposed by ORA for some of the guarantees out of concern "that the levels proposed by ORA may be excessive, and may create perverse incentives for customers."[16] Based on SCE's reported performance under their voluntary guarantee program and on PG&E's reports to Energy Division in its program's two years of operation, these programs do not appear to have had this effect. In fact, while it is difficult to judge the impact of PG&E's program given that it has only been in effect for two years, SCE reduced their claims made and paid fairly consistently throughout their program, which offered standard $50 credits. Based on this experience, it appears that the service guarantee programs may provide the incentive foreseen by the Commission in D. 00-02-046, without creating perverse incentives.

[redacted].[17] [redacted].[18] [REDACTED] Proposed guarantees five, six, and seven address these customer concerns about avoiding outages and receiving accurate information on their

[14] D.00-02-046, page 92.
[15] D.00-02-046, page 89.
[16] D.00-02-046, page 92.
[17] SCE response to DR-ORA-167, question 3.1: IBM study page 32.
[18] SCE response to DR-ORA-167, question 3.1: IBM study page 33.

expected duration when they occur. [redacted][19]

[REDACTED] Proposed guarantee eight, which would require SCE to provide accurate first bills to new customer accounts within 60 days of service initiation, addresses this concern.

Due to the recent energy crisis, electricity rates for SCE's customers have increased, and it is reasonable to attempt to ensure that service does not deteriorate at the same time, especially in areas that are important to customers. Instead, SCE discontinued the voluntary program that they began to "assure continued high-quality service even as prices [were] going down and productivity measures [were] being implemented."[20] The discontinuation of these guarantees when resources were limited shows that these customer services are vulnerable to cuts. Making SCE's program mandatory, like those of SDG&E and PG&E, should help to ensure continued high-quality service.

B. PROPOSED GUARANTEES

ORA proposes the following guarantees, modeled after SCE's original program, as well as the PG&E program. As was the case when PG&E's program was adopted, any exceptions to these guarantees or assumptions needed for their application should be defined, along with reporting requirements, by SCE in consultation with ORA and other interested parties.

Service Guarantee 1: Missed Appointments

Unlike some other utilities in the state, SCE sets appointments for specific times, rather than providing customers with 4-hour appointment windows or all-day appointments. These specific appointments allow customers greater convenience and flexibility than they might receive through other utilities, allowing them to schedule their own activities on the basis of these specific appointment times. Because of this, once SCE agrees to a time to meet a customer, their field representative should be required to meet this commitment, and the customer should be appropriately compensated if SCE fails to arrive on time. Given that SCE schedules exact times, it would be reasonable to provide a

[19] SCE response to DR-ORA-167, question 3.1: IBM study page 34.
[20] SCE response to DR-ORA-055, question 3: attached brochure titled "Service Guarantee," apparently revised in 1996.

grace period after the arranged appointment time to account for minor traffic delays and other circumstances that may cause field representatives to arrive slightly after the agreed time. ORA proposes that SCE compensate their customers with a $50 credit if they miss agreed appointment times by more than 30 minutes.

While this $50 credit amount is more than the credit adopted for PG&E, it is consistent with the standard credit amount SCE offered under their voluntary guarantee program. SCE explains that "[f]or simplicity, [they] offered a standard credit amount for each of [their guaranteed] services,"[21] and as described above, chose $50 as the appropriate amount to provide meaningful compensation to their customers.

Service Guarantee 2: Non-Emergency Service Investigations

SCE should investigate non-emergency situations, such as requests to check meters and investigate other customer concerns that do not require the customer to be present, within 7 days of a customer request. Requests that require the customer to be present would be covered under Service Guarantee 1 because an appointment would be needed.

Again, although this $50 credit amount is more than the credit adopted for PG&E, it is consistent with the standard credit amount SCE offered under their voluntary guarantee program.

Service Guarantee 3: Complaint Resolution

SCE should be required to decide on a course of action to resolve each customer complaint and communicate it to the customer within three working days, and should fully resolve the complaint and communicate the resolution to the customer within ten working days. However, if final resolution of the complaint requires a field visit such as an off-site meter test or an on-site home audit, then the time allowed for resolution should be thirty days. This guarantee allows more time before final resolution than PG&E's comparable guarantee, in recognition of the possibility that some complaints may take more than five days to resolve adequately. It retains the three-day limit to communicate the intended action and time until resolution to the customer, to ensure that customers receive prompt and adequate information on the status of their complaints. If the time guarantees relevant

[21] SCE response to DR-ORA-055, question 2.

to a particular complaint are not met, SCE should provide the customer with a $50 credit. Again, although this $50 credit amount is more than the credit adopted for PG&E, it is consistent with the standard credit amount SCE offered under their voluntary guarantee program.

Service Guarantee 4: New Installations

Under SCE's voluntary guarantee program, they provided $50 credits to customers if they failed to install a new meter or initiate a customer's service on the date agreed. Reliable electric service is valuable to customers, and timely service initiation is a basic part of providing this service. SCE should provide the same guarantee with the same credit amount, $50, as they did under their own voluntary service guarantee program.

Service Guarantee 5: Response to Service Disruptions

Under SCE's voluntary guarantee program, SCE provided $50 credits to customers if a service representative failed to respond to a customer call reporting an outage within four hours, either by restoring service or by informing the customer of when service would be restored. Reliable electric service is important to customers, and service interruptions cause inconvenience and disruption that may range from the costs of spoiled food to negative health impacts on customers who require life support equipment. SCE should provide the same guarantee with the same credit amount, $50 per incident, as they did under their own service guarantee program. As in the parallel guarantee implemented for PG&E, exceptions may be made for some circumstances beyond SCE's control, such as widespread emergency situations.

Service Guarantee 6: Restoring Service

Under SCE's voluntary guarantee program, SCE provided $50 credits to customers if they failed to restore a customer's electricity within 24 hours of receiving a customer call reporting an outage. SCE should provide the same guarantee with the same credit amount, $50, as they did under their own service guarantee program. Like PG&E, SCE should provide a new credit of this base amount for every additional 24 hours that the customer is without service. As in the parallel guarantee implemented for PG&E, exceptions may be made for some circumstances beyond SCE's control, such as widespread emergency situations.

Service Guarantee 7: Advance Notice of Planned Interruptions

SCE should be required to provide customers with notice at least three days in advance of planned service interruptions, such as for equipment maintenance or upgrades. In fact, SCE already attempts to provide their customers with notice of approximately 10 days for "outages affecting a large number of residential customers," or "personal contact or a door hanger, a few days prior to an outage" for outages that affect fewer customers.[22] SCE's existing policy recognizes that residential customers depend on electricity for basic needs such as refrigeration and climate control, as well for home offices and other purposes, and some customers may require electricity to sustain life-support equipment. Customers who receive advance notice may be able to make arrangements to minimize the disruption caused by planned outages. SCE should continue to provide as much notice as possible, at least maintaining current practices. Three days is a minimum amount of notice that may allow people to minimize the disruption caused by an outage in most cases, and is consistent with the minimum amount of notice SCE already attempts to provide. Less time could be insufficient in many situations, for example if a customer is not present to receive notice on a daily basis; this may be the case if the customer is away on vacation or traveling for work. If a customer does not receive at least three days notice of a planned interruption, SCE should provide the customer with a $50 credit, consistent with the credit amount provided under SCE's former service guarantee program.

Service Guarantee 8: Issuing First Bill

SCE should be required to issue an accurate bill to every customer within 60 days of establishing service on a new customer account. When moving into a new residence, a customer may not be aware of the amount of electricity used by new or existing appliances; a timely first bill may assist customers in judging and managing their energy usage. For some customers, it may create a hardship to be billed for several months of usage at once. SCE already attempts to bill 99% of their customers, including new customers, every month.[23] If a customer does not receive an SCE bill within 60 days of establishing service, SCE should provide the customer with a $50 credit, consistent with the credit amount provided under SCE's old service guarantee program.

[22] Both quotes from SCE response to DR-ORA-161, question 7.
[23] SCE response to DR-ORA-155, question 5.

C. REPORTING REQUIREMENTS

Decision 00-02-046 requires "PG&E to report monthly on compliance and penalties to the Energy Division."[24] Specifically, PG&E submits monthly tables reporting the number of claims made, claims paid, and amounts of money paid, to facilitate tracking of their performance on these guaranteed standards and allow an evaluation of their performance under these guarantees. ORA recommends that SCE provide the Commission similar monthly data in quarterly reports with tables that include claims made, claims paid, and amounts paid under each of the eight guarantees. These quarterly reports should allow the Commission to evaluate whether SCE maintains or improves its treatment of customers in the guaranteed areas and to assess whether the guarantees provide appropriate incentives.

In addition, SCE should provide text along with these tables to explain the factors leading to significant variations in the number of claims over time. PG&E's tables, while informative, do not provide explanations of such fluctuations, and this makes it difficult to determine whether changes in the claims made over time are due to changes in customer service or are due to unrelated circumstances. For example, in 2001, the number of claims made per month under guarantee 1, that PG&E will meet scheduled appointment times, ranges from 73 to 253, with 73 claims made in August, 78 in May, 229 in December, and 253 in January.[25] The high number of claims in the first and last months of the year does not seem to show any improvement in this category over the course of the year, but it is not clear what caused the differences. They could be due to some particular factor such as weather (with more claims made in winter months) or changes in PG&E staffing levels, or could just reflect random fluctuations. To clarify the meaning of such fluctuations, SCE should be required to provide an explanation of material increases or decreases in claims made in consecutive months or in the same month in consecutive years. ORA recommends the explanations be required for variances exceeding +/- 10 percent.

In addition, SCE should track and report data on the planned outages to help place reports of claims under Service Guarantee 7, above, in context. Currently, "SCE does not

[24] D.00-02-046, page 93.
[25] PG&E report on Customer Service Guarantee Program – 2001, dated January 3, 2002.

track nor retain planned outage data."[26] Collecting information on the number and duration of planned outages and the number of customers they affect would make it possible to determine whether SCE is not only notifying customers in advance of such outages, but also attempting to minimize the inconvenience to affected customers in other ways. SCE should work with ORA and other interested parties to develop auditable tracking and reporting requirements on planned outages, and on the service guarantee program in general, to ensure that the reports contain the information necessary to evaluate SCE's performance in the areas covered by these service guarantees.

IV. CONCLUSIONS

ORA recommends that the Commission adopt a service guarantee program for SCE that includes the eight service guarantees described above. SCE should be required to report on this program to Energy Division each quarter; the reports should include tables for each month comparable to those provided by PG&E under their existing service guarantee program, and should further explain any material fluctuations in claims. SCE should work with ORA and other interested parties to define any specific assumptions for the application of these guarantees or exceptions to them, as well as auditable tracking and reporting procedures to ensure that the program is applied consistently.

This proposal is not meant to be punitive, but could provide an incentive for SCE to maintain high-quality customer service. In fact, based on SCE's performance under their voluntary service guarantee program, ORA expects that SCE may reduce the number of claims made and the amount of money paid in each category over time. Like the PG&E program and SCE's former voluntary program, these service guarantees should be shareholder funded in order to provide SCE with an incentive to reduce their total claims. ORA hopes that eventually SCE would meet these guarantees all or the vast majority of the time, and this high-quality service would allow them to pay little if anything in rebates to their customers.

[26] SCE response to DR-ORA-210, question 2.

CHAPTER 13

CUSTOMER PAYMENT OPTIONS

I. INTRODUCTION

This chapter contains ORA's analysis of SCE's customer bill payment options and recommendations regarding needed improvements. The majority of SCE's customers (72%) pay their bills using the mail payment option. The next largest customer group (20.4%) pay their bills in person. Customers who pay their bills in person have complained about poor service[27]. ORA recommends SCE implement changes needed to improve Authorized Payment Agency services, and to expand the Authorized Payment Agency network where needed. In addition, ORA recommends SCE undertake an education program to migrate customers away from in-person payments to lower cost payment options. Finally, ORA recommends that SCE evaluate the feasibility of replacing or supplementing Authorized Payment Agencies and Local Business Offices with unmanned payment processing stations.

II. SUMMARY

Mailed-in payment is the most widely used payment option, accounting for 33 million payments annually, or 72% of all payments received. Because processing this large volume of payments is mechanized, pay-by-mail is highly efficient and cost-effective. The average cost to process a mail payment in 2000 was $0.09. In-person payment at one of SCE's Authorized Payment Agencies (APAs) or Local Business Offices (LBOs) is the second most popular method of payment. The primary reasons customers pay in person are for customer convenience, personal preference, to make last minute payments to avoid service disconnection or to have service reconnected, and to pay with cash. The average cost to process payments received by an APA in 2000 was $0.46 while the average cost by an LBO was $1.92. Since 1996 SCE has closed all but 10 of its LBOs. The remaining LBOs are all located in existing SCE offices and serve rural customers. Employees in these offices perform duties other than payment processing.

SCE's customers may also pay their bills using the Internet, direct debit, and electronic data interchange.

Although customers indicate a high level of satisfaction with the services provided in both APAs and LBOs, customer complaints and recently completed research identified opportunities for SCE to improve service available from APAs. ORA recommends SCE implement a series of changes designed to improve the level and quality of service provided.

ORA also recommends that SCE revise its criteria for establishing APAs to achieve the objective that APAs be:

1. Located a reasonable distance from the customer's home or office.
2. Located in retail centers that provide parking, access via public transportation, safety and convenience.
3. Located in businesses that are clean and pleasant.
4. Located in businesses that process payments quickly and efficiently.

So long as customers want to pay their bills in person, SCE should make the option available and convenient to use. However, 42.8% of customers who use APAs and 58.4% of customers who use LBOs, pay by check. ORA recommends that SCE undertake an education initiative to encourage these customers to migrate to lower cost, more convenient payment options such as pay by mail or pay by phone.

SCE customer research also indicates willingness on the part of customers who pay in-person, to use automated payment machines. ORA recommends that SCE complete a cost/benefit analysis of this alternative as a means to supplement or replace APAs and LBOs.

III. DISCUSSION AND ANALYSIS

A. SCE PAYMENT OPTIONS

Prior to 1995, SCE customers had only two bill payment options. They could mail their payment with a check or money order, or they could pay in person at one of the company's 63 Local Business Offices (LBOs) or one of the 250 Authorized Payment

[27] SCE response to DR-ORA-016, Q. 12 and SCE Authorized Payment Agency Qualitative Research, July 23, 2002, Flexo Hiner & Partners, Inc.

Agencies (APAs). The primary function of the LBO prior to 1996 was to provide the **only** means for customers who paid their bills just in time to avoid service disconnection or wanted to receive a "same-day reconnect."

In 1996 the development of an automated payment system provided the means for APAs to process these "same-day" payments, thus allowing APAs to offer the same range of services available at the LBOs. The introduction of this technology allowed SCE to increase the convenience of APAs and to close all but 11[28] of its LBOs.

Today, SCE offers its customers a broad array of payment options. These include:

1. PAY BY MAIL

   To pay the bill by U.S. mail, the customer may send a check or money order with the bill payment stub in the envelope provided with the bill.

   Mail payment is by far the most popular payment option with about 72%[29] of the payments in 2000 processed through the SCE mail payment center. The average cost to process a mail payment was $0.09[30].

2. PAY IN PERSON

   To pay the bill in person, the customer may visit the nearest Local Business Office or Authorized Payment Agency. To locate the closest LBO or APA the customer may call the Customer Communication Center or use the Authorized Payment Agency locator provided on SCE's web site. There is no additional charge to the customer for paying at an LBO or APA.

   In-person payments are the second most popular payment option with about 20.4%[31] of the payments in 2000 processed by an LBO or APA. The vast majority of the in-person payments (96%) were received by APAs, while only 4% of in-person payments were received by LBOs. In-person payments are by far the most costly payment option for SCE customers. In 2000, it cost SCE

[28] On February 23, 2001 the 29 Palms LBO was closed, bringing the total number of LBOs to 10. SCE Response to ORA-DR-169, Q. 1, Attachment B-1.
[29] SCE-5, Vol. 2, p. 48, Table III-9.
[30] SCE-5, Vol. 2, p. 131, Table IV-25.
[31] SCE-5, Vol. 2, p. 48, Table III-9.

$1.92 for each payment processed by its LBOs and $0.46 for each payment processed by an APA[32].

3. DIRECT DEBIT BILL PAYMENT

   Direct Payment automatically deducts the total amount due from the customer's bank account each month. Once the customer elects this option, SCE makes the automatic deduction ten days after it mails the customer's bill. There is no additional charge for this option.

   In 2000, approximately 1.6 million payments were made by Direct Debit to customer bank accounts. This represents approximately 3.6% of all payments.[33] SCE did not provide a cost for processing a Direct Debit payment. However, since this is an electronic transaction, once the initial setup costs are incurred, ongoing processing costs should be minimal.

4. PAY ELECTRONICALLY VIA ELECTRONIC DATA INTERCHANGE (EDI)

   Business customers who are able to conduct EDI and have access to a Value Added Network, can receive SCE billing information electronically. These customers can also pay their bill electronically. In addition to reducing paperwork and increasing efficiency and productivity, EDI allows customers to:

   - Quickly access billing and energy-use information.
   - Perform budget and trend analysis in a historical database with no data entry or paperwork required.
   - Facilitate the payment approval process to avoid late payment charges.
   - Upload information directly into accounting systems.
   - Eliminate data entry errors.
   - Standardize electronic communications with all trading partners.
   - Eliminate the risk of bills lost or delayed in the mail.

[32] SCE-5, Vol. 2, p. 131, Table IV-25
[33] SCE-5, Vol. 2, p. 48, Table III-9

In 2000 approximately 246,000 payments were made by EDI. This represents approximately 0.5% of all payments.[34] SCE did not provide a cost for processing EDI payments. However, since this is an electronic transaction, once the initial setup costs are incurred, ongoing processing costs should be minimal.

5. PAY BY PHONE

SCE's Pay-by-Phone option allows customers to pay using their telephone. Customers enrolled in this program provide their bank account information to SCE. When customers are ready to pay their bills, they call SCE to authorize payment.

In 2000 about 106,000[35] (0.2%) payments were made by phone. Customers who exercise the pay-by-phone option are charged 20 cents per payment[36]. The charge is added to the payment and included in the total charged to the customer's bank account.

6. ONLINE BILLING/PAYMENT OPTION

Customers who wish to receive and pay their bills online must register with SCE and then they can enroll for free online billing and payment services. SCE did not provide a cost for processing online payments. However, since this is an electronic transaction, once the initial setup costs are incurred, ongoing processing costs should be minimal.

If the customer elects to access their SCE bill through a bill payment service such as a bank, Internet service portal, or online brokerage service, SCE will facilitate that process. The charges for this option vary according to the provider chosen by the customer.

In 2000 approximately 8,000[37] payments (0.0%) were processed via the Internet.

[34] Ibid.
[35] SCE-5, Vol. 2, p. 48, Table III-9.
[36] www.sce.com., Payment Options, Pay-by-Phone.
[37] SCE-5, Vol. 2, p. 48, Table III-9.

7. QUICKCHECK PAYMENT OPTION

This option is available to customers who wish to make a one-time payment by debiting their bank account. This option is particularly attractive to customers who are facing service disconnection and are able to pay the amount owed by providing the bank account information to the Customer Call Center.

In 2000 approximately 473,000[38] payments (1.0%) were processed using QuickCheck. A charge of $5.00[39] is assessed for each QuickCheck transaction.

8. LEVEL PAY PLAN

The Level Pay Plan allows small commercial and lighting customers as well as residential customers to budget electric service costs into equal monthly payments. This feature is particularly useful for customers who want to spread high summer or high winter bills over an entire year based on their electrical usage for the prior 12 months. Under this option, the cost of the electricity the customer used over the past year is calculated at current rates. This dollar amount is divided by 11 to determine the Level Pay Plan amount the customer will pay for the next 11 months.

On the 12th month, the customer receives a bill showing either an amount due or a credit, depending on whether the customer used more or less electricity than the annual Level Pay Plan amount. If the customer used less energy than they paid for during the 11-month Level Pay Plan contract, the difference is credited to the customer's next Level Pay Plan contract and appears on the first statement under that contract.

Regardless of the method of bill payment chosen, customers may elect the Level Pay Plan. There is no added cost to the customer for this option.

[38] SCE-5, Vol. 2, p. 48, Table III-9.
[39] Per phone inquiry to SCE's Customer Communication Center, September 12, 2002.

B. AUTHORIZED PAYMENT AGENCIES & LOCAL BUSINESS OFFICES

Since 1995, SCE has increased the number of APAs and reduced the number of LBOs.

TABLE 1

SCE PAYMENT NETWORK[40]

CATEGORY	**1990**	**1995**	**2000**	**2002**
Local Business Offices	63	63	11	10*
APAs	15	250	370	375*
TOTAL	78	313	381	385*
# Transactions LBOs	N/A	N/A	397,208	387,021**
#Transactions APAs	N/A	N/A	8,952,853	9,371,437**
TOTAL TRANSACTIONS	N/A	N/A	9,350,061	9,758,458**

*Office Numbers as of March 2002.

**Transaction numbers for calendar year 2001.

Between 2000 and 2002, the number of payment processing locations increased by 4 (1%) while the number of transactions increased by 408,397 (or 4.37%). Given the number of APAs compared to LBOs, the APA is the primary option for customers who wish to pay their SCE bill in person.

[REDACTED MATERIAL – PAGES 8-24]

[40] SCE Response to DR-ORA-016, Q. 09 and Q. 11.

IV. CONCLUSIONS

ORA recommends that the Commission require SCE to implement the changes described above to improve the level of service provided customers who use Authorized Payment Agencies and Local Business Offices to pay their SCE bills. In addition, ORA recommends that the Commission encourage SCE to implement creative approaches to educate customers about lower-cost payment options. Migration of these customers to lower cost payment options will further reduce SCE's cost of service without eroding customer satisfaction.

Further, ORA recommends that SCE evaluate the feasibility of replacing or supplementing its APA/LBO network with automated payment processing equipment. If cost effective, this payment option may provide a higher level of customer service and flexibility.

APPENDIX A – REDACTED

APPENDIX B – REDACTED

APPENDIX - REDACTED

CHAPTER 14-A

INTRODUCTION/SUMMARY

I. INTRODUCTION

This chapter presents the estimates and recommendations of the ORA on Administration and General (A&G) Expenses. The category of A&G expenses covers general expenses not chargeable to a specific functional activity in other chapters. SCE has requested a total of $562,878,000 for TY2003 Electric Operations A&G expenses. ORA recommends $476,316,000 for such expenses. The difference between ORA and SCE is the result of ORA's alternative 2003 Test Year estimates of the various A&G activity expenses and program-by-program derived adjustments. The table at the end of this chapter summarizes ORA's and SCE's estimates by Federal Energy Regulatory Commission (FERC) Account. Expenses discussed in this chapter are expressed in constant 2000 dollars, except where otherwise indicated.

A&G expenses involve FERC Accounts 920 through 935 as described in the FERC Uniform System of Accounts. These FERC accounts consist of the following A&G expenses:

- Salaries
- Wages
- Supplies and expenses of officers and general office employees in operation which are not chargeable to a particular operation or maintenance function fees
- Consultant charges for general services
- Expenses of insurance and reserve provisions
- Injury and damage claims
- Employee pensions and benefits
- Franchise requirements
- Trustee, registrar and transfer agent fees and expenses
- Regulatory expenses
- Rents

- Maintenance of general plant

Chapter 14 is divided into Sections A through I. The content and witness of each section is explained below.

A.	Introduction/Summary	J. Tom
B.	Financial Organizations	J. Tom
C.	Legal and Regulatory	J. Tom
D.	Shared Services	T. Godfrey
E.	Information Technologies	J. Tom
F.	Human Resources	T. Godfrey
G.	Pensions and Benefits	M. Loy
H.	Public Affairs/Corporate Communications/Franchise Fees	T. Godfrey
I.	Qualifying Facilities and Energy Supply & Marketing	P. Sabino

SCE forecasted the 2003 Test Year A&G expense levels on both a departmental and a FERC Account basis. SCE's testimony on A&G expenses and related capital expenses were arranged in nine volumes (SCE-6, Vol. 1 through SCE-6, Vol. 9). ORA's testimony on A&G expenses is in Chapter 14. ORA's testimony on the related capital expenses that SCE included in its nine volumes of SCE-6 is found in Chapter 16-D "Shared Services," Chapter 16-E "Information Technology," and Chapter 16-F "Capitalized Software." ORA's testimony explains why ORA has recommended different expenditure levels for each functional areas and quantifies these differences in constant dollars.

II. SUMMARY

ORA provides a summary table of (1) its recommended expense levels, (2) SCE's GRC expense level request, and (3) the differences between the two parties that are recorded to the Federal Energy Regulatory Commission's (FERC) Uniform System of Accounts (USOA) 920 through 935 for Administration & General Expenses.

Table 14-A-1			
Administrative and General Expenses			
Test Year 2003			
(2000 Constant Dollars in thousands)			
	SCE	ORA	Difference
FERC Account	Proposed	Recommended	SCE - ORA
920	$ 162,438	$ 137,731	$ 24,707
921	$ 65,909	$ 52,238	$ 13,671
922	$ (28,414)	$ (25,435)	$ (2,979)
923	$ 39,007	$ 38,189	$ 818
924	$ 7,064	$ 1,014	$ 6,050
925	$ 39,706	$ 39,385	$ 321
926	$ 233,812	$ 199,212	$ 34,600
927	$ 28,268	$ 24,259	$ 4,009
928	$ 5,346	$ 5,346	$ -
930	$ 1,591	$ (3,075)	$ 4,666
931	$ 1,411	$ 1,411	$ -
935	$ 6,740	$ 6,041	$ 699
Total	$ 562,878	$476,316	$ 86,562

CHAPTER 14-B

FINANCIAL ORGANIZATIONS

I. INTRODUCTION

This chapter presents the estimates and recommendations of ORA on A&G Expenses for the following SCE financial organizations: (1) Controllers; (2) Audits; (3) Treasurer's; and (4) Tax Department. SCE has requested a total of $28,833,000 for TY2003 financial organizations' expenses. ORA recommends $24,740,000 for these expenses. The difference between ORA and SCE is the result of ORA's alternative TY2003 estimate of the various A&G activity expenses. The table in the Summary section summarizes ORA's and SCE's estimates by SCE organization. Expenses discussed in this chapter are expressed in constant 2000 dollars, except where otherwise indicated. The A&G expense in these functions involve FERC Accounts 920, 921, 923, 926 and 930.

II. SUMMARY

ORA recommends a $4,093,000 adjustment in the Controller's Organization of FERC Account 930 amount that accounts for miscellaneous general expenses incurred in connection with the general management of the utility and participant credits. ORA's recommendation will result in a $4,093,000 decrease in SCE's TY2003 request.

Table 14-B-1
Administrative and General Expenses
Test Year 2003
(2000 Constant Dollars in thousands)

Organizations	SCE Proposed	ORA Recommended	Difference SCE - ORA
Controller's	$ 14,670	$ 10,577	$ 4,093
Audits	$ 4,568	$ 4,568	$ -
Treasurer's	$ 7,838	$ 7,838	$ -
Tax Department	$ 1,757	$ 1,757	$ -
Total	$ 28,833	$24,740	$ 4,093

III. FERC ACCOUNT 930

A. MISCELLANEOUS GENERAL EXPENSES INCURRED IN CONNECTION WITH THE GENERAL MANAGEMENT OF THE UTILITY AND PARTICIPANT CREDIT AMOUNTS

SCE co-owns the SONGS and Mohave power facilities, but is the sole operator of the facilities. SCE is also a non-operator co-owner in the Palo Verde and Four Corners electric power facilities. SCE, as an operator of a power facility that has co-owners, charges its fellow participant co-owners for the cost of operating the facility. In turn, operators of power facilities charge SCE where SCE is a co-owner but not the facility operator. The portion of total costs for the operation of a power facility that a co-owner is responsible for is called a participant share. The participant share represents the co-owner's calculated amount of the costs of operating a power facility.

SCE (1) as an operator of power facilities receives credits for operating facilities and (2) as a non-operating participant in other power facilities receives charges for its share of costs in the operation of facilities. SCE nets the costs of what it charges other participating co-owners against the costs of what SCE is charged for its participant share as a non-operating participant. This is a credit for overhead service expenditures that SCE provides for other co-owners.

SCE used the year 2000 recorded expense as their estimate of the Non-Labor expenses for TY2003 because SCE believes that the most recent recorded year reflects current participant rates and is therefore the best indicator for test year expenses. (SCE-6, Vol. 2, p. 19) SCE estimates a credit of $8,102,000.

ORA recommends using a five-year average in estimating the TY2003 Non-Labor credit in FERC Account 930 because the historic amounts are variable and the use of an average is just as valid as the use of the last recorded year for a TY2003 estimate.

Table 14-B-2
Account 930
Historic Data
(2000 Constant Dollars in thousands)

Year	Non-Labor Credit
1996	$ (12,687)
1997	$ (15,763)
1998	$ (14,213)
1999	$ (10,208)
2000	$ (8,102)
ORA 5-Yr Average	$ (12,195)
SCE Estimate	$ (8,102)
ORA Adjustment	$ (4,093)

ORA believes that the 1996-2000 five year historic Non-Labor expenses for miscellaneous general expenses incurred in connection with the general management of the utility and participant share credit amounts in FERC Account 930 is historically variable (see Table 14-B-2). (SCE-6, Vol.2, p.18) Given that the credit amounts are historically variable, then the use of historic recorded annual expenses in calculating an average expense level is valid. ORA calculates the five-year average as a credit of $12,195,000 while SCE recommends a lower credit amount of $8,087,000. Therefore, ORA recommends a $4,093,000 higher credit for miscellaneous general expenses, which results in a lower forecast expense for this function.

IV. CONCLUSION

ORA recommends a credit of $12,195,000 to the Controller's Organization FERC Account 930 amount which is credited for miscellaneous general expenses incurred in connection with the general management of the utility and participant credits. This will result in a $4,093,000 credit increase and will reduce SCE's TY2003 request (see Table 14-B-1).

CHAPTER 14-C

LEGAL and REGULATORY

I. INTRODUCTION

This chapter presents the estimates and recommendations of ORA on A&G Expenses for the following SCE organizations: (1) Law; (2) Claims; (3) Insurance Expenses; (4) Worker's Compensation; (5) Regulatory Policy and Affairs; and (6) Environmental Affairs. SCE has requested a total of $92,363,000 for TY2003 Electric Operation's A&G expenses in these functions. ORA recommends $85,992,000 for such expenses. ORA's recommended adjustment of $6,431,000 is the difference between ORA and SCE's estimate of TY2003 expenses. This difference is the result of ORA's alternative 2003 Test Year estimates of the various A&G activity expenses and program-by-program derived adjustments. The tables at the end of this chapter summarize ORA's and SCE's estimates by SCE organization. Expenses discussed in this chapter are expressed in constant 2000 dollars, except where otherwise indicated. A&G expenses in these functions involve FERC Accounts 920, 921, 923, 924, 925, 928, and 930 as described in the FERC Uniform System of Accounts.

II. SUMMARY

ORA recommends that an adjustment credit of $6,371,000 to SCE's TY2003 request in recognition of historically higher nuclear insurance refund amounts than estimated by SCE (see Table 14-C-1). ORA recommends that the $347,690 in adjustments per ORA's Auditors Report be accepted and have been incorporated into ORA's estimates.

Table 14-C-1			
Administrative and General Expenses			
Test Year 2003			
(2000 Constant Dollars in thousands)			
	SCE	ORA	Difference
Organizations	Proposed	Recommended	SCE - ORA
Law	$ 31,343	$ 31,343	$ -
Claims	$ 5,238	$ 5,238	$ -
Insurance Expense	$ 12,638	6,267	$ 6,371
Workers Compensation	$ 30,279	$ 30,279	$ -
Regulatory Policy & Affairs	$ 9,419	$ 9,419	$ -
Environmental Affairs	$ 3,446	$ 3,446	$ -
Total	$ 92,363	$85,992	$ 6,371

III. INSURANCE COSTS

A. NUCLEAR INSURANCE REFUND

SCE states "[n]uclear property insurance is purchased from a mutual insurance company owned by a number of nuclear plant owners/operators called the Nuclear Electric Insurance Limited ("NEIL"). The board of directors of NEIL may approve a [refund] distribution to members. (Generally, the board of directors meets in December to approve a distribution for the current year. The distribution is then paid in March of the following year.) Such distribution would be based on the losses experienced in the year, the estimate of future claims, and the surplus funds and reinsurance available to pay future claims." (SCE-6, Vol. 3, p. 44)

"As a member, SCE receives a distribution from NEIL. These distributions are substantial, as shown in Figure IV-15 [in SCE's testimony]. In 2000 and 2001, the NEIL board of directors approved a supplemental distribution in addition to the normal distribution. Also, during the 1996-2000 period and based on the same factors mentioned above, the NEIL premium expenses decreased significantly." (SCE-6, Vol. 3, p. 44) SCE states that "[t]he NEIL refund is expected to be reduced in 2003 because premiums have decreased in recent years, NEIL has experienced losses this year, and the stock market has performed poorly. Furthermore, reinsurance will be more costly at renewal, availability is uncertain and financial stability of the reinsurers is now in question. Also,

the tragic events of September 11, 2001 have caused NEIL to attach a higher likelihood to having two large losses at one time." (SCE-6, Vol. 3, p. 45) Therefore, as a reason for SCE lowering their nuclear liability refund estimate, SCE used NEIL's position that there is higher likelihood to having two large losses at one time after the tragic September 11, 2001 terrorist incidents.

For ratemaking purposes, ORA does not believe it is appropriate to assume that extraordinary events (having two large losses at one time) will occur. SCE's lowered estimate of nuclear liability refunds is based on the NEIL information. Unless or until two large losses occur at one time, ORA will utilize the past experience and normal conditions in making its estimate. And, if and when the out of the ordinary events occur, then the impact on ratemaking estimates can be addressed in the next GRC.

ORA has compared the annual recorded nuclear insurance refunds in the year recorded (as provided in SCE's GRC workpapers) to the "nuclear insurance refund amounts matched to the respective nuclear insurance expense for that respective year's policy." The amount of refund recorded in the year received as compared to the amount of refund matched to that respective year's policy is similar.

What is critical to estimating the nuclear liability refund received by SCE is the fact that the largest component of the nuclear liability refund does not show up in either: (1) recorded nuclear insurance refunds in the year recorded, nor (2) nuclear insurance refund amounts matched to that respective year's policy data spreadsheets. Concerning the amount of nuclear insurance refunds, SCE states in a data response that when matching the insurance expense and the refunds to the respective year's policy, "the largest component of the nuclear liability refund is received in respect of a policy period 10 years prior. Therefore, that component does not show up on this [the provided] spreadsheet." (Data Request No. ORA-194, Question 10). Thus, ORA finds that the data used in estimating the nuclear liability refund is missing the largest component of the actual and/or potential refund amount. Given this finding, ORA's estimate of the nuclear liability refund may actually be **underestimating** the actual and/or potential refund amount using the data provided by SCE in its GRC workpapers and data request responses. (Data Request No. ORA-209, Question 1)

For TY2003, SCE estimates a refund amount of ($5,451,000) credited in Account 924 and an additional refund amount of ($239,000) credited to Account 925 for a total nuclear insurance refund amount of ($5,690,000). SCE has provided ORA with the last year's 2001 recorded refund amounts of ($15,341,000) credited in Account 924 and an additional recorded refund amount of ($318,000) credited to Account 925 for a total nuclear insurance refund amount of ($15,659,000). (Data Request No. ORA-177, Question 1) ORA recommends using the six years of data provided by SCE in calculating a TY2003 nuclear insurance refund amount. The (1996-2001) six-year average of recorded nuclear refunds provides the best estimate of the TY2003 amount of nuclear insurance refund because of the historic variability of the amount of nuclear insurance refunds (see Table 14-C-2). During the last two years in the six-year period of 1996 – 2001, SCE received a high of $16,865,000 in 2000 and a second high of $15,659,000 in 2001 for nuclear insurance refunds. If ORA uses the six-year average of nuclear insurance refunds as a TY2003 estimate, then the amount is only $12,061,000 when compared to the last two years of recorded refunds.

ORA estimates that there will be a greater nuclear insurance refund in TY2003 than what SCE estimates. There is a credit difference of $6,371,000 (which is calculated by taking ORA's $12,061,000 refund estimate and subtracting SCE's refund estimate of $5,690,000) for nuclear insurance refunds between ORA's estimate and SCE's estimate. This credit difference of $6,371,000 will result in lowering SCE's requested expenses for TY2003. ORA does not take issue with other aspects of SCE's estimates of TY2003 nuclear insurance. Therefore, ORA recommends that SCE's TY2003 request be reduced by the full $6,371,000 difference between ORA's and SCE's estimate of nuclear insurance refund.

Table 14-C-2			
Nuclear Insurance Refund			
Test Year 2003			
(2000 Constant Dollars in thousands)			
Year	Account 924	Account 925	Total Refund
1996	$ (6,989)	$ (569)	$ (7,558)
1997	$ (8,553)	$ (721)	$ (9,274)
1998	$ (10,921)	$ (845)	$ (11,766)
1999	$ (10,877)	$ (366)	$ (11,243)
2000	$ (16,322)	$ (543)	$ (16,865)
2001	$ (15,341)	$ (318)	$ (15,659)
ORA 6-Yr Average	$ (11,501)	$ (560)	$ (12,061)
SCE Estimate	$ (5,451)	$ (239)	$ (5,690)
ORA Adjustment	$ (6,050)	$ (321)	$ (6,371)

B. SCE HAS NO BEST PRACTICES IN THE STANDARD OPERATING PROCEDURES OF PROCURING INSURANCE

The Insurance Procurement Department at SCE does not have an established "best practices" in its Standard Operating Procedures (SOP). (Data Request No. ORA-144, Questions 2 and 3) ORA recommends that SCE institute "best practices" at the operational level. ORA also recommends that SCE has written SOP that holds its management to definite "conflict of interest" restrictions beyond the current reading and acknowledgment of an annual memorandum on this topic.

IV. INCORPORATION OF THE AUDIT REPORT FINDINGS

A. AUDIT REPORT DISALLOWANCES

ORA's Audit Report recommends a $347,690 adjustment for ratemaking purposes. The Audit Report recommends the following adjustments.

- $407,071 for bankruptcy costs causes a downward adjustment of $135,690 due to the use of a three-year average.
- $150,000 for Equal Employment Opportunity Commission settlement costs causes a downward adjustment of $150,000.
- $62,000 for a lawsuit against the CPUC causes a downward adjustment of $62,000.

V. CONCLUSIONS

ORA recommends that a credit of $12,061,000 (an additional credit of $6,371,000 which will reduce SCE's TY2003 request by $6,371,000) be credited to SCE TY2003 request in recognition of historically higher nuclear insurance refund amounts than estimated by SCE for TY 2003. ORA recommends that the $347,690 in adjustments from the Audit Report be accepted and incorporated in the appropriate accounts.

CHAPTER 14-D

SHARED SERVICES

I. INTRODUCTION

SCE forecasted $30,827,000 for its Shared Services expenses for test year 2003. The ORA estimate for Shared Services is $28,222,853. SCE's Shared Services Organization was created in 1996 from independent departments within SCE during its reorganization from a traditional department-based organization to service-delivery business units. SCE's employees that work in its Shared Services Business Units support other SCE units such as Generation, Customer Services, Transmission and Distribution and do not interact directly with SCE customers.

II. SUMMARY

SCE's Shared Services is organized into seven business units: Corporate Real Estate, Business Resources, Corporate Security & Emergency Planning Preparedness, Occupational Health & Safety, Procurement & Material Management, Shared Services Support, and Transportation Services. SCE utilized the Last Recorded Year Method to determine its forecast for all of its Shared Services business units except for its Corporate Security & Emergency Planning Preparedness business unit, which used a Budget Based Method. ORA's Forecast for SCE's Shared Services Department is summarized in Table 14-D-1 below.

Table 14-D-1

ORA's Forecast of SCE's Test Year 2003 Expenses for Shared Services

Account	SCE Forecast	ORA Forecast	Difference
920	$10,976,000	$10,976,000	0
921	12,250,000	10,232,124	$2,017,876
925 Labor	416,000	416,000	0
925 Non-Labor	287,000	287,000	0
931	158,000	158,000	0
935	6,740,000	6,041,000	699,000
Total	$30,827,000	$28,222,853	$2,604,147

III. DISCUSSION/ANALYSIS

ORA did not take issue with SCE's forecasted level of expenses for the following business units: Procurement & Material Management of $1,018,000, Shared Services Support Account 920 of $767,000, Transportation Services of $246,000, and Business Resources Account 920 of $2,803,000, and Corporate Real Estate's Accounts 920 of $4,132,000 and 931 of $158,000 for a total forecast of $9,406,000. The recorded costs in these business units for labor and non-labor appear reasonable and have been declining due in part to its reorganization, workforce reductions/consolidations and in some cases, contracting out certain services to reduce costs and thus are expected to remain flat. ORA does take issue with SCE's expense forecast for its Corporate Real Estate Accounts 921 and 935, Business Resources, Shared Services Support Account 921, Corporate Security & Emergency Planning Preparedness, and Occupational Health & Safety business units. ORA's findings are discussed below.

ORA conducted its analysis by reviewing SCE's testimony and workpapers, issuing data requests and analyzing the responses. ORA also performed variance analyses, conducted phone conferences with various A&G witnesses at SCE to discuss findings and questions pertinent to data requests and responses. ORA also made some normalized adjustments to SCE's historical data for costs it could identify that were

incurred for non-recurring, unusual, or one-time expenditures for ratemaking purposes to reflect what should be SCE's normal and reasonable costs of doing business. ORA also went on a field visit to observe some of the facilities included in SCE's forecast for capital additions.

A. CORPORATE REAL ESTATE

SCE has forecasted 2003 test year expenditures of $17,645,000 for its Corporate Real Estate (CRE) Unit: $4,132,000 in Account 920, $6,615,000 in Account 921, $158,000 in Account 931, and $6,740,000 in Account 935. SCE's CRE is responsible for all activities related to the management of SCE's property and buildings, which includes planning, design, construction and maintenance of all of its non-electric facilities.[41] SCE has utilized the Last Recorded Year Method to forecast CRE expenses for test year 2003.

SCE's historical 1996-2000 data recorded in Account 921 has been declining each year and are expected to remain at 2000 levels, so ORA utilized the Last Recorded Year Method to forecast SCE's test year expenses for this area. ORA made normalized adjustments to SCE's historical 2000 data in Account 921 for market studies performed and increased title and mapping services that were performed in connection with the studies for its Revenue Enhancement section amounting to $210,000 and $113,000 in 2000, and increased landscaping activities (i.e. turf replacement, removal/replacement of ground cover, replacement of dead trees) amounting to $96,000.[42] The purpose of the studies was to determine if SCE's operating properties were producing optimal revenues. ORA considers these costs to be one-time/non- recurring expenditures that should be removed for ratemaking purposes. ORA recommends a forecast of $6,196,000 for CRE Account 921, a difference of $419,000, which is a 6.8% decrease in SCE's forecast of $6,615,000.

ORA utilized a five-year average to forecast SCE's CRE expenses in Account 935 due to fluctuations in historical 1996-2000 data, in particular SCE's Function 2010

[41] SCE's non-electric facilities are not directly used in the generation, transmission or distribution of electricity.
[42] SCE response to ORA-Verbal-08 question 3, 4 and 5.

Maintenance, where the majority of Account 935 activities was recorded. For example, SCE's costs decreased by 15.7% over the 1996 to 1998 period from $5,679,000 to $4,910,000. SCE's costs increased by 18.4% in 1999 over 1998 from $4,910,000 to $5,813,000. SCE's 1999 increased costs were due in part to implementation of its Strategic Facilities Plan construction and remodeling projects.[43] SCE's costs increased by 20.5% in 2000 over 1999 from $5,813,000 to $7,007,000. A five-year average is more consistent with normal test year conditions due to the annual fluctuations associated with this function. Therefore, ORA recommends a forecast of $6,041,000 for Account 935 for non-labor expenses, a difference of $699,000 which is an 11.6% decrease in SCE's forecast of $6,740,000.

B. BUSINESS RESOURCES

SCE has forecasted $5,495,000 for its Business Resources Unit, $2,803,000 for labor and $2,692,000 for Non-Labor expenses. SCE's Business Resources Unit provides document and drawing management, event and travel services (E&TS), mailing services and records management and storage services for departments and sections within SCE. ORA estimates $2,803,000 for Account 920 and $1,275,853 for Account 921 for Business Resources expenses.

ORA made normalized adjustments to SCE's historical 2000 data for Account 921 that incorporate costs identified by SCE as well as other costs ORA identified for non-recurring, unusual, and/or one-time expenditures. ORA also removed costs SCE included in its forecast that were or should have been charged to SCE's shareholders, because they are costs that have no ratepayer benefits. SCE also included costs in this function that were identified by ORA through discovery as expenditures that were funded by other regulatory accounts (i.e. Energy Efficiency funds).

[43] SCE's Strategic Facilities Plan, an infrastructure "bundling" project, was implemented in 1998. SCE had apparently delayed making major infrastructure upgrades for the following reasons: delayed in 1990 due to anticipation of regulatory decisions relating to its proposed merger with San Diego Gas and Electric; delayed in 1996-1997 due to workforce reductions and electric restructuring. SCE's management decided to proceed with the modifications in 1997.

ORA asked SCE in DR-ORA-034 question 4:[44]

> Please provide documentation that explains the purpose of each of the 659 "All Hands Meetings" mentioned on page 11 of Volume 4 Chapter I-VII for 2000. Also provide an itemized list of all the recorded costs incurred for these events and the number of FTE that attended. Likewise provide the same information as mentioned above for any "All Hands Meetings" that were held in 2001.

And in questions 6:

> Please identify all costs incurred for one-time, non-recurring, or unusual events that cannot be attributable to the normal and reasonable costs of doing business.

SCE provided additional information that was not provided in its response to DR-ORA-034 question 4 and ORA's verbal data request, in its response to ORA-183 by stating:

In order to appropriately respond to this latest request, SCE has further analyzed the details of the 659 'All Hands meetings" mentioned on page 11 of Volume 4 Chapters I-VII for 2000, and provided in its original response(s) to DR-ORA-034, Question 4 and ORA's follow-up question DR-ORA-Verbal 10, Question 2. This analysis included the accounting to which each meeting was charged, as well as a second look at whether the meetings were recurring, or non-recurring.

Through this analysis, SCE has determined that:

228 of the meetings listed, for a total of $470,537, were shareholder funded, and are thus not included in this GRC request

32 meetings, for a total of $98,344, had no identifiable ratepayer benefit, and will be removed from this GRC request

52 meetings, for a total of $117,471, were deemed non-recurring, and will thus be removed from this GRC request

14 meetings, for a total of $82,383, were included in other regulatory

ORA discovered that SCE's Business Resources E&TS scheduled approximately 659 "All Hands" meetings (6 of these meetings were cancelled and 58 meetings were in support of EIX) and other activities for its employees amounting to approximately

[44] ORA also issued a verbal data request for additional information on SCE's 659 "All Hands meetings" due to SCE's insufficient responses.

$1,790,207.[45] SCE later identified and removed some of these costs from its test year estimate amounting to $768,734. After its analysis, ORA determined that there were remaining costs amounting to $647,414 for non-recurring, unusual, and/or one-time expenditures that need to be removed for ratemaking purposes.

ORA recommends a forecast of $1,275,853 in Account 921 for test year which is $1,416,147 lower than SCE's forecast. ORA discovered that SCE's E&TS scheduled events for its employees that included several basketball games at the Staples Center and baseball games at Edison Field, music concerts, wrestling matches, employee/executive diners, lunches, recognition/retirement/holiday parties (one such celebration amounted to $265,738 for Y2K festivities, which SCE failed to remove), lobbying and networking events with "key opinion leaders", international visits (i.e. Brazil, Belgium, China) etc. ORA removed all such expenses that are not appropriately recoverable from ratepayers. SCE should only be allowed to recover in rates the amount necessary for reasonably incurred costs to provide reliable service for its ratepayers.

C. SHARED SERVICES SUPPORT

SCE has forecasted $1,049,000 for its Shared Services Support Unit: $767,000 for labor and $282,000 for Non-Labor expenses. SCE's Shared Services Support is staffed with seven employees that provide centralized support for business planning and strategy, business improvements and financial services for the Vice President of Shared Services, and other senior managers of the six Shared Services business units. ORA estimates $767,000 for Account 920 and $169,271 for Account 921. SCE utilized the Last Recorded Year method to determine its forecast of Shared Services Support expenses

ORA made normalized adjustments to SCE's historical 2000 data for account 921 that incorporate costs identified by SCE as well as other costs ORA identified for non-

[45] SCE's ET&S scheduled the 659 "All Hands Meetings" and events in 2000 for employees in the following departments: Shared Services, Information Technology, Corporate Communications, Executive, Equal Opportunity, Corporate Center Finance Controllers, Corporate Finance General Audits, Corporate Center Finance Treasurer, Generation Power Production, Corporate Center Human Resources, Corporate Center Law, Nuclear, Corporate Center Public Affairs, QF Resources General Administration, Corporate Center Regulatory Policy & Affairs, Corporate Center Community Relations, Corporate Center Educational Relations, Customer Service and Transmission and Distribution.

recurring, unusual, and/or one-time expenditures. SCE later identified and removed some of these costs from test year estimate amounting to $20,913,000. After its analysis ORA determined that there were remaining costs amounting to $91,816,000 for non-recurring, unusual, and/or one-time expenditures that need to be removed for ratemaking purposes.

ORA recommends a forecast of $169,271 in Account 921 for test year, which is $112,729 lower than SCE's forecast. ORA discovered that SCE incurred such cost for Employee Awards, mentor luncheons, employee contributions, flowers, sports events at the Staple Center and Edison Field. ORA removed all such expenses that are not appropriately recoverable from ratepayers. SCE should only be allowed to recover in rates the amount necessary for reasonable incurred costs to provide reliable service for its ratepayers.

D. CORPORATE SECURITY & EMERGENCY PLANNING PREPAREDNESS

SCE has forecasted $4,671,000 for its Corporate Security & Emergency Planning Preparedness Unit (CS&EPP), $2,445,000 for labor and $2,226,000 for non-labor. SCE's CS&EPP has three divisions: Investigations Division that has special agents that investigate threats of hostile or criminal acts against SCE and its employees; Security Operations Division that is responsible for providing security guard services at SCE locations,[46] and EP&P which is responsible for preparations for and recovery from natural disasters.

SCE utilized the Budget Based method to determine its forecast of CS&EPP expenses. SCE's Budget-Based method and the Last Recorded Year method produced the same results for SCE's labor expenses of $2,445,000. SCE forecasted an additional $70,000 for investigations by its Special Agents, which increased its non-labor expenses. SCE argues, "Non-Labor expenses in 2000 were reduced due to the SCE financial crisis and the need to preserve cash. This increase is related to reinstatement of non-labor

[46] SCE's expenses for its security operations increased by 34.7% or $469,000 between 1996 and 2000 due to the "phasing in" of contracts for security services.

spending to previous levels".[47] SCE utilized a five-year averaging method for its investigations to account for the increase of $70,000 and then utilized the Last Recorded year expenses for its non-labor expenses to arrive at its forecast of $2,226,000 for non-labor expenses.

ORA utilized SCE's last recorded year data to forecast SCE's Corporate Security & Emergency Preparedness labor expenses. SCE's recorded costs have been declining and are expected to remain flat. SCE argues that the cost reductions associated with the reduced non-labor costs in 2000 for investigations were due to a hiring freeze and reduced employee training due to SCE's financial crisis and the need to preserve cash. Although SCE implemented a hiring freeze in 2000, SCE continued to hire employees. In 2000, SCE's Human Resources Department processed 2,234 new hires, a 13.21% increase over 1999 new hires of 1,973. SCE also increased other costs over its 1999 expense levels due to new hires and included costs for various trainings, employee relocation, recruitment, and testing activities.[48] SCE has not provided any documentation to substantiate and/or justify the $70,000 increase in its Corporate Security & Emergency Planning Preparedness expenses for test year nor has SCE provided any documentation to support its assertions that "The three-year average of investigations prior to the California Energy Crisis was just over 3,000. In 2000, there were just over 2,300".[49] ORA recommends a forecast of $2,445,000 for Account 920 and $2,156,000 for Account 921 for test year which is lower than SCE's forecast by $70,000 in Account 921 of $2,226,000.

E. OCCUPATIONAL HEALTH & SAFETY

SCE has forecasted $703,000 for its Occupational Health & Safety (OH&S): $416,000 for labor and $287,000 for Non-Labor expenses recorded in Account 925. ORA did not take issue with SCE's forecasted level of expenses for Account 925. However, ORA did take issue with SCE' Safety Mechanism proposal, which will be discussed below. SCE's forecast for Account 925 is a decrease of 50% since 1996 due to a

[47] SCE workpapers Volume 4, Chapter I-VII, page 26.
[48] SCE response to ORA's verbal data request 09 question 01-d and 01e.

reorganization that transferred several health and safety responsibilities and staff to other SCE business units. SCE's OH&S transferred 22 employees to other business units within a five-year period, and have a current staff count of six in OH&S. SCE utilized the Last Recorded Year method to determine its forecast of Occupational Health & Safety expenses. SCE's OH&S provides training to SCE employees on various SCE safety and health manuals required by Cal-OHSA regulations (i.e. written Injury and Illness Prevention Program, the investigations of serious industrial accidents, employee access to a Material Safety Data Sheet Program, and training and compliance with the California Code of Regulations, Title 8 which is applicable to electric utility operations). SCE also provides consultation to SCE business units and develops, maintains, and distributes various documentation relating to employee safety and health issues.

F. OCCUPATIONAL HEALTH & SAFETY EMPLOYEE SAFETY MECHANISM

SCE has developed an employee safety mechanism, which was incorporated into its current Distribution PBR. SCE's Distribution PBR provides SCE with rewards and penalties that are based on its performance in achieving employee safety. However, SCE's reward and penalty mechanism in its Distribution PBR will expire on January 1, 2003. SCE is proposing to implement a new employee safety mechanism in this GRC from a mechanism based on total injuries and illnesses to one based on OSHA Recordable occupational injuries and illnesses. The purpose of SCE's proposal is to provide a corporate incentive to maintain and improve worker safety. SCE's proposal includes penalties (rewards) of $500,000 for each 0.1 rate above or below the deadband. SCE's proposal has a maximum reward or penalty of $5 million, which would be based on its actual safety performance demonstrated as an OSHA Recordable frequency rate. SCE's proposal includes a deadband of 3.7 to 6.8; at these levels no penalty would occur. SCE has been able to maintain the 3.7 frequency rate for 2000 and 2001 and because of this SCE believes that "This is an indication that we will not be able to continue dramatic decreases in future years and that we may have reached a plateau that is difficult to

[49] SCE response to ORA Verbal-10 question 6.

improve upon, despite our best efforts to prevent occupational injuries and illnesses". [50] SCE's proposed employee Safety Mechanism would include all OSHA "recordable" occupational injuries and illnesses (Recordable Injuries and Illnesses) sustained by its employees, including its Generation employees.

SCE should not be compensated additional rewards from ratepayers in the form of incentives amounting to approximately $5 million to ensure that it maintains an appropriate working environment for its employees because it has previously improved its performance by decreasing occupational injuries, deaths and illnesses. SCE has generated rewards funded in part by ratepayers by improving safety in the workplace. SCE's reward for maintaining a safe and healthy work environment should be the benefits from increased employee moral and worker efficiency, decreased absenteeism rates due to improved working conditions and a decline in sick and injured employees, decreased workers compensation claims and lawsuits, decreased regulatory fines and citations, and lower operating expenses which all serve to increase SCE's shareholder value.

SCE's proposal for safety performance rewards are unwarranted and unnecessary burdens on SCE's ratepayers given the extent of past rewards. Therefore, ORA recommends that the Commission adopt only the penalty portion of SCE's proposed safety mechanism proposal. ORA believes that penalties would be appropriate if SCE were to backslide from the levels established while earning PBR rewards. As an employer, ORA believes that one of SCE's objectives should be to improve and maintain reliable worker safety standards and programs without having to be paid incentives. Furthermore, through utility rates, SCE's captive ratepayers that are required to pay for basic service, already fund SCE's employee safety maintenance programs and should not be forced to pay excessive incentives to ensure that SCE continues to maintain a safe and healthy working environment for its employees.

[50] SCE response to ORA data request DR-ORA-034 question 14.

IV. CONCLUSIONS

ORA recommends a forecast of $28,222,853 for Shared Services expenses. This recommendation is a difference of $2,604,147 in SCE's request of $30,827,000. ORA recommends that the Commission adopt only the penalty portion of SCE's proposed

CHAPTER 14-E

INFORMATION TECHNOLOGIES

I. INTRODUCTION

This chapter presents ORA's recommendations on TY2003 Administration & General (A&G) expenses and Operation & Maintenance (O&M) expenses of SCE's Information Technology (IT) Department. SCE refers to "IT" as "SCE's infrastructure of large processors, storage media, communications links, operating system and application software, and the variety of personal computing and communication devices that enable [its] employees to use the tools of the information revolution in conducting SCE's business." (SCE-6, Vol. 5, p.1) SCE requests a total of $117,890,000 in expenses for TY2003, most of which are charged to A&G FERC Accounts.

II. SUMMARY

SCE spent $42,987,000 in Year 2000 (Y2K) compliance project A&G and O&M expenses over 1998-2000. ORA believes that the Y2K expenditures are abnormal, non-reoccurring expenditures and are not forward on-going expenditures, since the Y2K expenditures will not occur in TY2003. ORA recommends subtracting the Y2K expenditures from the historic expenditure levels. ORA recommends using the historic Information Technology A&G and O&M data without the Y2K expenditures and taking a five-year average as the best TY2003 estimate. This five-year average is $99,324,000. SCE TY2003 estimate is $117,890,000. Therefore, ORA recommends SCE's information technology TY2003 request be adjusted by $18,566,000. ORA's recommended $18,566,000 adjustment is allocated to expense accounts as summarized in Table 14-E-1.

Table 14-E-1			
Information Technology A&G and O&M Expenses			
Test Year 2003			
(2000 Constant Dollars in thousands)			
	SCE	ORA	Difference
FERC Account	Proposed	Recommended	SCE - ORA
920/921	$ 63,841	$ 54,067	$ 9,774
923	$ 16,570	$ 16,570	$ -
926	$ 4,152	3,758	$ 394
931	$ 1,254	$ 1,254	$ -
A&G Accounts	$ 85,817	$ 75,649	$ 10,168
517	$ 3,519	$ 3,519	$ -
561	$ 2,935	$ 2,935	$ -
588	$ 4,907	2,005	$ 2,902
903	$ 20,712	15,216	$ 5,496
Non-A&G Accounts	$ 32,073	$ 23,675	$ 8,398
Grand Total	$ 117,890	$ 99,324	$ 18,566

III. FIVE-YEAR AVERAGE WITHOUT Y2K EXPENDITURES

A. FIVE-YEAR AVERAGE IS THE BEST TY2003 ESTIMATE

SCE requests that Y2K expenditures incurred in 1998-2000 be built into the future TY2003 forecast, as projects expenditures for work that was reprioritized to accommodate the Y2K costs returned or will return during the forecast period. ORA believes that the Y2K expenditures are abnormal, non-reoccurring expenditures and are not forward on-going expenditures, since the Y2K expenditures will not occur in TY2003.

ORA recommends using the historic Information Technology A&G and O&M data **without** the Y2K expenditures and taking a five-year average as the best TY2003 estimate. ORA's TY2003 recommendation of $99.3 million (five-year average without Y2K expenditures) for Information Technology A&G and O&M work is reasonable considering that ORA is recommending a similar amount as the average non-Y2K expenditure for 1998-1999 which is $97.8 million. The 1998 and 1999 A&G and O&M

Information Technology expense levels are consistent with ORA's recommended A&G and O&M expense levels for TY2003 (see Table 14-E-2). ORA believes that SCE is able to function effectively under the 1998 and 1999 funding levels and still get required work done without adversely impacting the quality of service, or compromising reliability, customer service or safety due to the project or work activity deferrals. SCE operated under constraints placed upon them by the Y2K compliance project during 1998 and 1999 (see Appendix 14-E). ORA believes that SCE should be able to function and operate in a similar manner in TY2003.

For non-Y2K A&G and O&M work, SCE spent $89.6 million in 1998 and $106.0 million in 1999. ORA's TY2003 recommendation of $99.3 million (five-year average without Y2K expenditures) for Information Technology A&G and O&M work is reasonable considering that ORA is recommending a similar amount as the average non-Y2K expenditure for 1998-1999 which is $97.8 million. ORA believes that SCE has an incentive and it is in their best interest to operate as efficiently as possible. SCE operated efficiently from 1998 –1999 when the Y2K compliance project was incurred and imposed on their operations. In addition, ORA believes that SCE can operate as efficiently in TY2003 as SCE did in 1998-1999 when the bulk of the Y2K costs occurred. Thus, what ORA is recommending is reasonable under the above circumstances.

SCE did not incur negative incidents of adverse quality of service, reliability, customer service or safety due to the project or work activity deferrals that occurred for Y2K. SCE states that though: "There is no analysis that identifies the positive and negative impact of deferring each project listed in response to 1.c. However, as noted in response to 1.a. and 1.b. above [in Data Request No. ORA-113], there are no recorded incidents of adverse quality of service, reliability, customer service or safety due to the project or work activity deferrals that occurred for Y2K". (Data Request No. ORA-113, Question 1.d. i.)

The information provided by SCE indicates that the $68.1 million spent ($42,987,000 in A&G and O&M expenses and $25,107,000 in capital expenditures) for the Y2K compliance project during 1998 and 1999 was absorbed by the budgets of the affected business units. SCE did not record incidents of adverse quality of service,

reliability, customer service or safety due to the project or work activity deferrals that occurred for Y2K.

ORA recommends using the historic Information Technology A&G and O&M data without the Y2K expenditures and taking a five-year average as the best TY2003 estimate. ORA's TY2003 recommendation of $99.3 million (five-year average without Y2K expenditures) for Information Technology A&G and O&M work is reasonable considering that ORA is recommending a similar amount as the average non-Y2K expenditure for 1998-1999 which is $97.8 million. At 1998 and 1999 A&G and O&M recorded expenditure levels, SCE did not incur negative impacts on service, reliability, customer service or safety due to the project or work activity deferrals caused by the Y2K project.

Table 14-E-2
Information Technology A&G and O&M Expenses
Historic Data
(2000 Constant Dollars in thousands)

Year	Recorded Expenditure	Y2K Expense	Difference Recorded - Y2K
1996	$ 90,405	$ -	$ 90,405
1997	$ 100,723	$ -	$ 100,723
1998	$ 113,920	$ 24,306	$ 89,614
1999	$ 122,723	$ 16,674	$ 106,049
2000	$ 111,835	$ 2,007	$ 109,828
Total For 5 Years	$ 539,606	$ 42,987	$ 496,619
Five-Year Average			$ 99,324

IV. CONCLUSIONS

SCE spent $42,987,000 in Year 2000 (Y2K) compliance project A&G and O&M expenses over 1998-2000. ORA believes that the Y2K expenditures are abnormal, non-reoccurring expenditures and are not forward on-going expenditures, since the Y2K expenditures will not occur in TY2003. ORA recommends subtracting the Y2K

expenditures from the historic expenditure levels. ORA recommends using the historic Information Technology A&G and O&M data without the Y2K expenditures and taking a five-year average as the best TY2003 estimate. This five-year average is $99,324,000. SCE TY2003 estimate is $117,890,000. Therefore, ORA recommends SCE's information technology TY2003 request be adjusted by $18,566,000.

APPENDIX 14-E

On May 7, 1998, the President and Chief Operating Officer of SCE sent a memorandum to Vice Presidents, Department Heads, and Finance Managers discussing the expenses related to the Year 2000 (Y2K) compliance costs and efforts. The memorandum documents SCE's estimate of the cost for Y2K compliance and how SCE intended to pay for the expenditures. The memorandum states:

"As a result of the scope of this issue, we estimate a total cost of $85 million to repair existing code and replace physical assets. Given the magnitude of the estimated expenditures, I want to share with you my plans for covering these expenses. First, I expect all business units to absorb the O&M expenses related to Year 2000 by utilizing existing budgets." (SCE-6, Vol. 5, Chapter III, part 2 of 3, p. 3) From this memorandum, ORA discovered that SCE intended to absorb the entire $85 million of estimated expenditures for the additional Y2K compliance project into its existing budget.

ORA discovered that the Y2K project did not cost $85 million, but it did cost $68.1 million. SCE testifies that "SCE's initial estimate to bring all systems into Y2K compliance was approximately $85 million, approximately $17 million more than the $68.1 million we spent on this effort." (SCE-6, Vol.5, p. 33)

ORA discovered that "[t]o support the expenses related to the Y2K effort, all business units absorbed Y2K expenses into existing budgets by reprioritizing workloads, projects, and resources." (SCE-6, Vol.5, p. 33)

SCE states that the "2003 test year request for O&M is (for the most part) based on [their] 2000 recorded expenses, which includes a minor amount of Y2K related costs that were not accrued in 1999 due to deferral of labor payouts in 2000 and some residual costs incurred to finalize testing through the February 2000 leap year milestone. … For purposes of comparing our 2003 forecast to the five-year recorded base, Y2K related costs should not be removed from those recorded years, because other work was reprioritized in order to fund the Y2K remediation, and the reprioritized work has returned or will return in the forecast period." (SCE-6, Vol. 5, p. 35) For a two-year period, SCE spent $42,987,000 in Y2K O&M expenses and $25,107,000 in Y2K Capital expenditures. (SCE-6, Vol. 5, p. 34)

What happened to SCE's 1998 and 1999 workloads and projects that SCE planned to do if not for the additional Y2K compliance project is that "[a]ll deferred or reprioritized work identified in the response to 1.c. has either already been performed or is in the process of being performed." (Data Request No. ORA-113, Question 1.d. ii.) SCE does state that "[w]ith respect to IT capital projects, we are unable to match the description and eventual cost of work performed to the original description and budgeted cost of the deferred work because the amounts were budgeted in blanket work orders where specific projects are not identified in advance. (Data Request No. 113, Question 1 d. i.) Even though SCE states that it cannot provide information of the Y2K effort on Information Technology capital projects, SCE can say that for all identified O&M IT workloads and deferred or reprioritized has either been performed or is in the process of being performed.

CHAPTER 14-F

HUMAN RESOURCES (EXCLUDING PENSIONS AND BENEFITS) AND RESULTS SHARING INCENTIVE PROGRAM

I. INTRODUCTION

SCE forecasted $33,874,000 of A& G expenses for its Human Resources (HR) Department, which includes $15,900,000 for its Executive Officer Compensation activities for test year 2003. The corresponding ORA estimate is $31,105,569. SCE requests $80,884,000 in the test year for expenses associated with its Results Sharing program. The corresponding ORA forecast of $29,085,800 is based on an estimated funding that is shared 50/50 between SCE shareholders and ratepayers as explained in this chapter. The 50/50 sharing of the incentives between ratepayers and shareholders is based on the Commission's policy stated in D.00-02-046.

II. SUMMARY OF HUMAN RESOURCES

SCE has approximately 12,000 employees. SCE's HR forecasted $33,874,000 (excluding HR Departmental expenses for Account 926 for Pensions and Benefits amounting to $11,229,000) for test year and is organized into eight operating divisions: Total Compensation, HR Service Center, Employee & Organization Development, Staffing and Assessment Services, HR Client Services, Labor Relations, Equal Opportunity, and Executive Officer Compensation. SCE utilized the Last Recorded Year, Budget Based, and three to five year Averaging methods to forecast test year expenses for its HR business units. ORA's Forecast for SCE's Human Resources Department is summarized in Table 14-F-1 below.

Table 14-F-1

ORA's Forecast of SCE's Test Year 2003 Expenses for Human Resources

Account	SCE Forecast	ORA Forecast	Difference
920	$22,438,000	$20,079,569	$2,358,431
921	8,076,000	8,030,000	46,000
923	3,360,000	2,996,000	364,000
Total	$33,874,000	$31,105,569	$2,768,431

III. DISCUSSION/ANALYSIS

ORA did not take issue with SCE's forecasted level of expenses totaling $16,837,000 for the following HR business units: Employee & Organization Development of $2,428,000, Staffing and Assessment Services of $3,412,000, HR Client Services of $4,888,000, Labor Relations of $1,409,000, Total Compensation' Account 920 of $1,069,000 and Account 923 of $589,000, and Equal Opportunity of $2,700,000. The recorded costs in these business units appear to be reasonable and have been declining due in part to its reorganization, workforce reductions and in some cases, contracting out certain services to reduce costs. SCE estimates these expenses will remain flat from 2000 levels through test year. However, ORA does take issue with SCE's expense forecast for Total Compensation Account 921, HR Service Center, and Executive Officer Compensation. ORA's recommendations are discussed below.

ORA conducted its analysis by reviewing SCE's testimony and workpapers, issuing data requests and analyzing the responses. ORA also performed variance analyses, conducted phone conferences with various A&G witnesses at SCE to discuss findings and questions pertinent to data requests and responses. ORA also made some normalized adjustments to SCE's historical data for costs that were for non-recurring, unusual, or one-time expenditures to reflect what should be SCE's normal and reasonable costs of doing business. ORA also went on a field visit to observe some of SCE's facilities.

A. HUMAN RESOURCES TOTAL COMPENSATION

SCE forecasted $1,721,000 for its HR's Total Compensation business unit: $1,069,000 for Account 920 and $63,000 for Account 921, which utilized a Budget Based methodology that combined its Last Recorded Year expenses for labor and a three-year Average for non-labor expenses. SCE forecasted $589,000 for Account 923, which utilized a three-year averaging Method. SCE's forecasted labor and non-labor expenses seem reasonable and ORA does not take issue with SCE's forecast. SCE's Total Compensation business unit develops its compensation policy and packages for its employees. SCE expects its labor costs to remain flat at 2000 recorded levels in the test year. However, SCE forecasted an additional $33,000 for activities it anticipates for employee benefit surveys and total compensation statements, which increased its non-labor expenses from $30,000 in 2000 to $63,000 in the test year.

ORA utilized a Last Recorded Year methodology to forecast SCE's test year expenses. SCE's staffing level seems to be reasonable for test year and is expected to remain at those levels. SCE's costs for account 921 have been declining every year over the five-year period from $735,000 in 1996 to $30,000 in 2000. SCE stated in its response to an ORA data request (DR-ORA-182 question 2) that it plans to create total compensation statements for its employees to "clearly communicate the value delivered to each employee through compensation and benefit programs". SCE has not provided documentation to demonstrate how it calculated this increase of $33,000, although SCE argues that is has already started the process of preparing these total compensation statements. SCE also claims that these statements satisfy a federal requirement to make available pension benefit estimates. It is not clear if SCE has been in violation of the federal requirement in the past by not providing these statements to its employees that explained their pension benefit options, or if this is a project to revise or enhance the look of the statements that SCE already provides to its employees. Therefore, ORA has excluded the additional $33,000 request from its forecast for Account 921. ORA recommends a forecast of $30,000 for Account 921 for the test year.

B. HUMAN RESOURCES SERVICE CENTER

SCE forecasted $971,000 in its HR Service Center unit: $491,000 for Account 920 and $480,000 for Account 921 and utilized a four-year average methodology due to fluctuations from 1997 through 2000. SCE's HR Service Center is responsible for payroll functions such as employee timesheet adjustments. SCE's costs have been declining due to reorganizations, workforce reductions, and implemented costs control measures and are expected to remain flat in the test year. SCE's forecast for Account 920 amounting to $491,000 seems reasonable and ORA does not take issue with the forecast. However, ORA does take issue with SCE's forecast for Account 921. ORA made a normalized adjustment to remove costs of $53,000 in Account 921 incurred for memberships and dues that did not relate to the utility business. ORA then utilized a four-year averaging due to the fluctuations in Account 921 for 1996 through 2000. ORA's adjustments were for costs incurred for memberships and dues in such organizations as Corporate Executive Leadership Board, Academy of Business Leadership, The Human Resource Planning Society, American Statistical Association, and contributions to Inroads, a trade and technical associations. ORA recommends a forecast of $958,000: $491,000 for Account 920 and $467,000 for Account 921, a decrease of $13,000 from SCE's forecast of $971,000 for test year.

SCE forecasted $427,000 for Account 923 in its HR Service Center business unit and utilized a four-year average methodology due to fluctuations from 1997 through 2000. SCE's recorded costs for outside consultants have fluctuated significantly over the last five years and therefore, ORA has utilized a five-year average. For example, SCE's costs were $2,000 in 1996 and increased to $347,000 in 1997, and in 1998 the costs decreased to $98,000. In 1999 SCE's costs increased to $676,000 due to implementation of its Strategic Change Initiative, which assisted SCE with centralizing its HR activity. In 2000 the recorded costs decreased again to $587,000 and are expected to decline further. ORA recommends a forecast of $342,000 for Account 923 for test year, which is a decrease of $85,000 or 24.9% to SCE's forecast.

C. HUMAN RESOURCES EXECUTIVE OFFICER COMPENSATION

SCE forecasted $14,852,000 in Executive Officer Compensation: $12,558,000 for Account 920 and $2,294,000 for Account 921. SCE transferred its executive officer's to its holding company Edison International (EIX) in 2000 and promoted four of its senior managers to executives to oversee its Transmission & Distribution and Customer Service, which increased its executive count to 26 in 2000.[51] SCE also made a one-time adjustment to its 2000 recorded costs amounting to $9,290,000 for incentive bonus accruals SCE claims it incurred but did not pay out in 2000 due to the "energy crisis". Similarly, SCE argues that its executives had to forego one weeks' pay due to its financial conditions in 2000. SCE has utilized a five-year averaging methodology to forecast its test year expenses for accounts 920 and 921.

ORA utilized a five-year averaging methodology to forecast SCE's Account 920 and Account 921. However, ORA made normalized adjustments to SCE's recorded costs in Account 920 for costs incurred for 50% of its Executive Incentive Plan (EIP) for 1996 through 2000 for $11,784,500. The total EIP incentives for 1996-2000 amounted to $23,570,000. ORA's auditors discovered that SCE had incurred costs for political activities of $7,351 and flowers of $306.00. These costs should be funded by its shareholders. ORA made another normalized adjust to SCE's 2000 recorded expenses of $7,657.00 for Account 920. This adjustment is addressed in more detail in ORA's audit report.

ORA did not take issue with SCE's forecasted expenses for Account 921 of $2,294,000, the expenses have been relatively flat and are expected to remain so in the test year. ORA used the five-year averaging methodology to account for fluctuations in SCE's data for 1996 through 2000. ORA made adjustments to reduce SCE's recorded data for its EIP by 50% or $11,784,500. SCE's shareholders should fund 50% of SCE's EIP since both shareholders and ratepayers could benefit from SCE's productivity goals.

[51] In SCE's response to ORA data request ORA-091 question 14, SCE stated that its transfer of its executive officer in 2000 is a "Class B or "non-covered" affiliate of SCE and as such, movement of employees form SCE to EIX is not subject to Commission's Affiliate Transaction Rules"…Consequently, the movement of Mr. Bryson from SCE to EIX did not require the recording of the so-called "transfer fee" discussed in Affiliate Transaction Rule V.G.2.c.".

In regards to the 50/50 sharing of incentives, in D.96-01-011 page 247-248 the Commission stated:

> In PG&E's test year 1987 general rate case, even though we noted that PG&E's executive compensation (including its proposed incentive plan) is commensurate with levels paid by utilities of comparable size, we concluded that a 50/50 sharing of the cost of its incentive plan was reasonable, stating that "we find merit in the staff argument that if PG&E's executives perform well enough to justify the 'bonus' then there should be enough savings to pay for the incentive plan." (D.86-12-095, 23 CPUC2d 149, 187.)

ORA discovered that although SCE claimed that its executive officers had to forego one weeks' pay and did not receive cash incentives in 2000 due to the "energy crisis", this was not exactly the case, instead SCE's executive officers took paid vacation time off. Further, SCE's executives received "Performance Shares" which were payable at 50% cash and 50% in EIX common stock. However because SCE paid out these awards in December of 2000, SCE did not record the costs of these awards in its books for 2000.[52] SCE's executives also received stock options in 2000.[53] In regards to SCE's executives foregoing pay, in response to ORA's data request DR-ORA-091 question 17 SCE stated:

> a) Attached is an email dated 12/21/2000 from John Bryson, Chairman, President and CEO of EIX and Steve Frank, Chairman, President and CEO of SCE that explains the cost reduction measures SCE was taking in response to the financial crisis caused by the dysfunctional electricity market. One of the measures called for SCE executives to take one week off without pay or in lieu of foregoing pay, use vacation. All the executive officers elected to use their vacation in lieu of foregoing pay.
>
> b) The amount of the one-time adjustment SCE made to 2000 recorded costs to reflect the 2000 accrual for Executive Incentive Plan bonuses was $9,290,000. Of this amount, $4,552,000 was transferred to our Results Sharing exhibit for non-officer executives, resulting in $4,738,000 remaining in the executive officer activity group.

ORA recommends a forecast for SCE's Account 920 of $10,199,569 and Account 921 of $2,294,000 for a total forecast of $12,494,000 for test year which is an adjustment of $2,358,000 or18.87% to SCE's forecast of $14,852,000.

[52] SCE did not provide ORA with any documentation on the amount it paid out to its executives in 2000 for its "Performance Shares" awards.

SCE forecasted $1,066,000 for Account 923 for test year by utilizing a three-year averaging methodology. SCE expects costs for its outside services to continue at the 1998 through 2000 levels in the test year, but asserts that its 2000 recorded costs are not representative of its anticipated increase in Account 923. SCE claims that its increased reliance on outside consultants is partly due to the "increased number and complexity of executive compensation issues we have had to deal with". [54] SCE also transferred its most senior officer in 2000 to its holding company EIX as the Chairman and CEO for EIX

ORA utilized a five-year averaging methodology to forecast SCE's Executive expenses in Account 923 due to fluctuations in historical 1996-2000. ORA discovered that SCE's costs for outside services started to increase in 1998 through 2000 due in part to custom surveys and special studies for benchmarking its executive compensation, and communication projects that produced executive total compensation statements to "increase executives' understanding and appreciation of the compensation and benefits they receive from Edison and thus help to retain them".[55]

SCE had expenses recorded in Account 923 for costs incurred in 2000 by its executive officer who was transferred to EIX amounting to $312,063 for a portion of their salary and administrative expenses for support staff. SCE's recorded costs in Account 923 decreased in 1997 by 44.5% over 1996 from $435,000 to $301,000. SCE's recorded costs increased by 61.5% in 1998 over 1997 recorded from $301,000 to $781,000. In 1999 SCE's costs increased by 90.7% over 1998 recorded costs from $781,000 to $1,489,000 and then decreased in 2000 by 60.3% to $929,000. Further, SCE has provided no supporting documentation to demonstrate how the increases in its outside services for its executive studies and compensation statements, that are produced to "increase executives understanding and appreciation of the compensation benefits they receive from Edison", benefit its ratepayers. ORA has used a five-year average to

[53] SCE's response to ORA data request DR-ORA-091 question 9.
[54] Ibid.
[55] SCE's response to ORA data request DR-ORA-091 question 19.

develop its test year forecast because of the fluctuations in recorded expenses from 1996-2000. ORA recommends a forecast of $787,000, which is an adjustment of $279,000 or 35.5% compared to SCE's forecast of $1,066,000.

IV. SUMMARY OF RESULTS SHARING INCENTIVE PROGRAM

All of SCE's full time employees became eligible to earn a cash bonus, effective 1999, which is based on team (business unit or department) and SCE performance.[56] SCE's employees and business units that only achieve half of the established goals, earn partial Results Sharing awards. SCE is requesting that ratepayers fund the full cost of its Results Sharing program of $80,884,000. ORA calculated $58,171,600 for SCE's Results Sharing Incentive Program for the test year, and recommends that the funding for this program be shared 50/50 between SCE's ratepayers and shareholders. ORA recommends that the Commission adopt $29,085,800 for SCE's Results Sharing Incentive Program to be funded in rates for SCE's test year as summarized in Table14-F-2.

Table 14-F-2

ORA's Forecast of SCE's Test Year 2003 Expenses for Results Sharing

Department	Payout % Based on Total (A)	SCE's Forecast (B)	ORA's Forecast to be Shared 50/50 (C)	Difference (D)=(B)-(C) (D)	Results Sharing to be funded by Ratepayers (E)=(C/2)
500 Generation	19.16%	$15,494,000	$11,143,252	$ 4,350,748	
588 T&D	30.56%	24,720,000	17,778,571	6,941,429	
905 Customer Serv	15.88%	12,846,000	9,238,816	3,607,184	
920/921 A&G	34.40%	27,824,000	20,010,961	7,813,039	
Total	100%	$80,884,000	$58,171,600	$22,712,400	$29,085,800

[56] Approximately 5% of SCE's employees that are senior managers are eligible for either Tier 1 or Tier 2 of SCE's Management Incentive Program (MIP) and are included in the $80,884,000 forecast which is based on the same targets as the Results Sharing program, but with higher payouts of 30% for Tier 1 and 22.5% for Tier 2. SCE executives that are not officers are eligible for the Executive Incentive Program (EIP), which is based on a set of measurable Company performance goals approved by the Board of Directors. SCE's EIP is included in its Human Resources forecast for Executive Compensation of $15.9 million.

V. DISCUSSION/ANALYSIS

ORA utilized a five-year averaging methodology due to fluctuations in SCE's recorded costs for 1996 through 2000 and adjusted for SCE's actual payout of $64,900,000 for SCE's recorded 2000 Results Sharing Incentive program (i.e. $20,500,000 payment made in 2001 for 2000 performance and a $44,400,000 supplemental payment made on June, 3, 2002 also for 2000 performance).[57] SCE claims that its Results Sharing incentive program encourages good performance from its employees that will benefit ratepayers.

SCE records its Results Sharing in FERC Accounts 500 (Generation), 588 (Miscellaneous Distribution Expenses), 905 (Miscellaneous Customer Accounts Expenses), 920 (A&G Salaries) and 921 (Office Supplies and Expenses). SCE created its Results Sharing Incentive Program in 1995, and argues that it "focuses on the achievement of short-and long-term goals, that benefit ratepayers and make SCE successful – customer service, employee safety, costs savings, new ideas, teamwork, and innovation"[58], and therefore links employee compensation to annual job performance, business unit, and Company performance.[59]

SCE utilized a Budget Based Method and a three-year averaging method for its Results Sharing payout for 1997 through 1999, on a unit cost per labor dollar, to forecast its test your estimate of $80,884,000. SCE argues that its forecast of $80,884,00 is 90% of its maximum available for its Results Sharing. SCE's target level awards for salaried exempt employees is 6 to 12% and for non-exempt and bargaining unit employees it is 0 to 6% of their annual pay based on how well the business unit that the employee works

[57] SCE's workpapers Volume 7 Chapter IV listed $75,965,000 as the Results Sharing payout amount for 2000 performance and this amount was used by SCE to forecast 2003 test year.
[58] SCE workpapers Volume 7 Chapter IV page 2.
[59] SCE also has a "Spot Bonus" program for its employees. This award program is informal and SCE has not established any criteria for how often an employee can be selected for a spot bonus award nor has SCE established a minimum or maximum bonus amount. This program is "designed to immediately recognize individual or team performance. The program is informal as such, the basis for spot bonus program does not have a specific formula to calculate awards". SCE's response to ORA data request DR-ORA-182 question 3.

in, performs in relation to the goals established for that business unit. After SCE determines the target percent for payout, that percent is then multiplied by the corporate modifier of 0.5 to 2.0, which is based on the level of SCE's operating income achieved each year compared to that year's operating income goal.[60] SCE then compares its recorded operating income to its goal for the year to determine the amount available for its Results Sharing program. SCE claims that because of its "outstanding performance" in 1999, the 2.0 multiplier was applied in that year. SCE used the minimum corporate multiplier of 0.5 for 2000 because of its financial crisis caused by the "dysfunctional California market" and therefore did not use 2000 payouts in its forecast estimate.

ORA discovered that although SCE's workpapers showed that its Results Sharing payout for Recorded/Adjusted expenses for 2000 was $75,965,000, SCE only accrued $67,623,000 in Results Sharing for 2000. SCE actually only paid out $20,500,000 to its employees for 2000 Results Sharing incentives in 2001 of the total accrued amount of $67,623,000. ORA also learned that although SCE argued in its testimony that it utilized its lowest multiplier of 0.5 in 2000 to determine its payout for Results Sharing incentives due to the "dysfunctional" market, SCE actually increased its corporate multiplier from the reported 0.5 to 1.5 for the year 2000 and made supplemental Results Sharing payments to its employees on June 3, 2002 amounting to $44,400,000, for a total payout of $64,900,000 for 2000 Results Sharing incentive payments. SCE had the $47,122,000 that was not paid out to its employees for 2000 (the accrual amount of $67,623,000 less the original payout amount of $20,501,000) listed on its books as an accrued expense and liability.

In SCE's response to DR-ORA-026 question 2, SCE states:

> "Originally, SCE paid out $20.5 million to its employees for Results Sharing performance during 2000. This was based on the minimum corporate multiplier of 0.5. SCE recently announced to its employees that it has revised its evaluation of 2000 performance now that a large portion of the write-off SCE took in 2000 due to the unrecovered power procurement costs has been reversed, and that the

[60] Effective in 2001, SCE utilizes a year end assessment of its financial performance instead of its operating income when determining the amount available for its Results Sharing program due to the dysfunctional electricity market and the effect of the energy crisis.

corporate multiplier will be adjusted to 1.5. Eligible employees will receive a supplemental payment later this year".

Similarly, SCE's workpapers showed $77,698,000 in Results Sharing payout for 2001 performance made in 2002. However SCE actually paid out $17,600,000 in Results Sharing incentives to its employees for 2001 performance, a difference of $60,089,000. SCE's statements seem to conflict in regards to how the amount of the Results Sharing that is not paid out to employees is accrued and booked. On one hand SCE argues that the $60,089,000 for 2001 that was not paid out to its employees "was not a recorded expense and therefore SCE is unable to provide documentation to support this amount".[61] And on the other hand, SCE states that the $47,122,000 of Results Sharing that was not paid out for 2000 performance was booked as an accrued expense and liability. SCE needs to reconcile these statements. SCE has accrued approximately $44,000,000 in Results Sharing as of July 31, 2002 to be paid out to employees in 2003.

ORA does not take issue with SCE paying its employees incentives for good job performance, however ratepayers should not be burdened with paying 100% of the costs incurred for sizable bonuses in rates. Likewise, ORA has concerns with the fact that SCE would overcollect from its ratepayers for its Results Sharing incentive program in the event that its employees and business units do not achieve its established objectives. SCE's employees and business units that only achieve half of the established goals, earn partial Results Sharing awards, yet SCE is requesting that its ratepayers fund the full cost of its Results Sharing program of $80,884,000.

ORA asked SCE.[62]

> In SCE's response to Question 6, SCE states "The variable nature of the Results Sharing program ensures that it would be paid only when specific objectives were achieved". SCE is requesting that its ratepayers fund 100% of the $80.9 million. Please provide documentation that explains in detail how the amount that is not paid out to employees due to objectives not being achieved, is handled.

SCE's response:

[61] SCE response to question 3 of DR-ORA-168.
[62] ORA data request DR-ORA168 question 7.

> Because SCE has only developed forecasts based on meeting specific objectives, SCE is unable to provide documentation explaining how any amount of Results Sharing costs recovered in 2003 less than or greater than the $80.9 million forecast will be handled. Notwithstanding this, the following is an example of what might happen if in 2003, specific objectives are not achieved by SCE's employees, and 2003 recorded Results Sharing costs are lower than forecasts. If a business unit overspends its budget, and thus did not meet its Results Sharing objectives, it would have a reduced Results Sharing payout, however, the money previously "earmarked" for Results Sharing would be used to offset the costs related to the budget over-run.

The Commission should not authorize SCE's ratepayers to fund excessive incentive programs in order for SCE to be able to "offset the costs related to the budget over-run" of departments that fall short of their productivity objectives. Budget over-runs should be a risk that SCE's shareholders absorb. With this in mind, the Commission has stressed its concern with overcollection from ratepayers for incentive programs. In D.00-02-046 page 259, the Commission stated that:

> "We find no compelling evidence for a change in our current practice of allowing 50% recovery of targeted incentives from ratepayers. As we have held, shareholders and ratepayers alike benefit from the good performance that incentive programs such as PIP seek to encourage. We continue to believe that equal sharing of costs is fair, and that it provides appropriate incentives to the utility to perform in ways that benefit ratepayers and shareholder alike. Moreover, since the actual payout is less than the target payout in any year when employees do not perform well enough to earn targeted payouts, there is an unacceptable risk of overcollection of costs in the test year if we allow the inclusion of 100% of the targeted payout in rates". Continuing our policy of allowing 50% of targeted payouts mitigates this concern".

ORA calculated its test year estimated of $ 58,171,600 for SCE's Results Sharing Incentive Program by utilizing a five-year averaging methodology due to fluctuations in SCE's recorded costs for 1996 through 2000, and adjusted for SCE's actual payout $,64,900,000 for 2000. ORA followed Commission policy on incentive programs as mentioned in D.00-02-046 and recommends that the $58,171,600 be shared 50/50 between SCE shareholders and ratepayers and that only 50% or $29,085,800 be adopted for SCE's Results Sharing Incentive Program to be funded in rates for test year. ORA's forecast of $29,085,800 that is to be funded by SCE's ratepayers is actually more than SCE's initial Results Sharing payout for 2000 of $20,500,000 and in 2001 of

$17,600,000. ORA discovered that the amount of SCE's Results Sharing incentives that have been paid out to its employees has been less than the amount that SCE has accrued on its books for the Results Sharing program. Further SCE's corporate multiplier utilized to determine its payout for Results Sharing incentives appears to be based on SCE's management discretion and can be adjusted at any time based on the company's performance.

VI. CONCLUSIONS

ORA recommends a forecast of $31,105,569 for Human Resources expenses. This recommendation is a difference of $2,768,431 in SCE's request of $33,874,000. ORA recommends a forecast of $29,085,800 for SCE's Results Sharing program, which is based on a 50/50 sharing of incentives between SCE shareholders and ratepayers.

CHAPTER 14-G

EMPLOYEE PENSIONS AND BENEFITS EXPENSES

Account No. 926
Federal Energy Regulatory Commission, Form 1

I. INTRODUCTION

This chapter sets forth ORA's analyses and recommendations as to value of the "labor loadings" factor the Commission should authorize for SCE's employee pensions and benefits for test year 2003. Employee pensions and benefits is defined, for the purposes of this regulatory proceeding, as all employer provided employee benefit plans and programs, comprising Federal Energy Regulatory Commission, Form No. 1 [FERC], Account No. 926. This includes pensions, postretirement benefits other than pensions [PBOPs], healthcare, relocation reimbursements, school tuition, leaves, etc. These benefits would not include legally mandated benefits, such as unemployment insurance and workers' compensation, and would include executives' and board of directors' retirement plans.

As a matter of formatting and presentation for rate-setting purposes, SCE's pensions and benefit plans are administered on a total company basis, adjusted (e.g., inflation rates, employee participation, and regulatory accounting) and then are allocated to various categories (e.g., capital, affiliates, and jurisdictional) before allocating a revenue requirement to a particular jurisdiction. Correspondingly, this testimony focuses on total company activity before any allocations. These allocations are covered in other parts of SCE's and ORA's showings. By concentrating on total company activity, instead of expenditures net of all allocations and adjustments, we avoid confusing the assignments of different witnesses and ensure that accurate, unbiased recommendations and comparisons are made.

II. SUMMARY OF RECOMMENDATIONS

ORA has examined SCE's request for 2003 rate recovery for F.E.R.C. Account No. 926 and has conducted independent analyses of SCE's supporting workpapers,

responses to data requests, and other discovery. As a result ORA recommends, on a **total company basis:**

1. A one-time refund of $117,915,000 to ratepayers for over-collections of Postretirment Benefits Other than Pensions ["PBOPs"] costs from 1995 through 2000. ORA recommends that this amount be refunded to customers via a one-time credit to the monthly bill or as a surcredit for one-year.

2. Eliminate SCE's request of $31,450,000 for contributions to SCE's pension plan because SCE is using an asset valuation method that chronically undervalues the market value of plan assets. ORA recommends using a five-year average of the market value of plan assets. ORA also recommends using the minimum limit for ratemaking purposes because, unlike Normal Cost, it is a measure of legal funding requirements and is a more accurate and reliable measure of actual funding obligations.

3. Reduce SCE's request for 401(k) Account Savings Plan by approximately $2,005,000 because 1) SCE underestimated the drop in participation and 2) incorrectly assumes that its Matching Contribution Ratio will increase.

4. Eliminate $2,100,000 in supererogatory benefits from SCE's request. These would include social events, employee gym operations, service recognition awards from management, and performance awards from management.

5. Reduce executive managements' supplemental retirement pay by $3,642,000 or 21.76% because supplemental retirement income is based on bonuses and incentive pay that the Commission ruled must be shared between ratepayers and shareholders. (D.86-12-095, 23 CPUC2d 149, 187; D.95-12-055, 63 CPUC2d 570, 592; D.96-01-011, pp. 247-248 *mimeo* and 00-02-046, pp. 259-260 *mimeo*.)

OTHER ISSUES:

In addition to the recommendations above, ORA reserves the opportunity to revise or otherwise amend its showing as a result of the following on-going discovery:

1. SCE's sponsorship of Edison International's PBOPs plans and the merger of SCE's PBOP plan into Edison International's medical plan. Of particular concern is a) the existence of a "firewall" to preclude ratepayers from funding the medical benefits of the non-regulated affiliates and b) proper disclosure of affiliate transactions.

2. Obtaining 2001 recorded and adjusted recorded expenditure data by type of benefit.

3. The impact of an unfavorable ruling by the State Supreme Court or the Federal Appeals Court on the Settlement Agreement between SCE and the Commission on a bailout plan for SCE for its power purchases during the Transition Period to deregulated markets. Of particular concern is the status of the PBOP revenue requirement because it is not a legal obligation; therefore, SCE eliminated or dramatically reduced its PBOP contributions during 2000 and 2001 because of the collapse of SCE's financial creditability. SCE may divert these funds to unregulated affiliates or lock them up in bankruptcy proceedings.

Table 14-G-1

Comparison

Total Company Basis

($'s in 000's)

Benefit	**ORA**	**SCE**	**SCE Exceeds ORA**	
Pension	$ 0	$ 31,450	$ 31,450	Na
PBOP	118,337	118,337		-
401(k) Savings	30,615	32,620	2,005	6.55 %
Medical	63,857	64,411	554	0.87
Dental	11,859	11,859	-	-
Vision	2,094	2,094	-	-
LTD	18,312	18,312	-	-
Life Insurance	795	795	-	-
Misc.	5,665	7,765	2,100	37.06
SERP	6,455	10,097	3,642	56.43
TOTAL	**$ 257,990**	**$ 297,740**	**$ 39,750**	**15.41 %**

Table 14-G-2

PBOPs Overcollections 1994-2001

Total Company Basis

Authorized Revenues	$582,648,000
Contributions to SFAS 106	464,733,000
Total Not Contributed	**$117,915,000**

III. DISCUSSION/ANALYSIS

A. ONE-TIME REFUND FOR 1995-2000 PBOPS RATE RECOVERY EXCEEDING CONTRIBUTIONS TO A QUALIFIED TRUST.

ORA recommends a one-time refund to ratepayers of $ 117,915,000 (total company basis[63]), pursuant to Ordering Paragraph No. 3, Decision 92-12-015, because SCE has not used all rate recovery dollars to make contributions to a qualified trust or to pay current benefit claims. Generally, ORA found that SCE did not use all of its annual PBOPs rate recovery dollars to fund PBOPs obligations. In particular, in 2000 SCE did not make a contribution to any of its qualified PBOPs trusts or 401(h) Account and in 2001 may have dramatically reduced its contributions towards incremental accruals, above (pay-as-you-go) claims. ORA has concluded that this shortfall between PBOPs rate recovery and PBOPs payments constitutes diversion of PBOPs assets to nonPBOPs uses. Such diversions of PBOPs assets are prohibited and must be refunded back to ratepayers pursuant to Ordering Paragraph Nos. 2 and 3, Decision 92-12-015:

> 2. Regulated utilities under traditional cost-of-service ratemaking … shall be authorized to recover their PBOP costs associated with the adoption of the Statement [of Financial Accounting Standards No. 106] and actually paid to independent trusts …
>
> 3. … Utility rates are hereafter made subject to refund, but only to the extent necessary to allow such a return to ratepayers of any PBOP assets that cannot be used for PBOP expenses or that have been used for other purposes.

[63] ORA includes the Stranded Cost allocation for generation's transition to competitive markets. SCE apparently excludes it. Discovery is on going to reconcile this and other inconsistencies and insufficient information.

Table 14-G-3

PBOPs Over-Collections by Calendar Year

1995-2000[64]

Total Company Basis Dollars in 000's	1995	1996	1997	1998	1999	2000	Total
Authorized	$97,108	$97,108	$97,108	$97,108	$97,108	$97,108	$582,648
Contributions	90,784	91,591	91,146	103,369	87,843	0	464,733
Over-Collection	6,324	5,517	5,962	(6,261)	9,265	97,108	**117,915**

SCE did provide a "reconciliation" of authorized revenues with "tax-deductible PBOP costs". (Table III-1 in SCE Exhibit SCE 6, Vol. 7, Chapter III, Part 1 of 7, pg. 35.) Unfortunately, SCE did not reconcile authorized revenues with actual contributions; therefore, SCE's tabulation is biased and inaccurate. For example, for 1999, the source for SCE's value is a letter from the PBOP plans actuary, Jonathan Nemeth, containing "the recommended contributions to the PBOP Trusts" … "that will best achieve our understanding of SCE's funding goals". (DR-ORA-044.) It includes a "recommendation" to contribute $17,282,000 to the pension plan's 401(h) Account (*ibid*) that was, in fact, not made. (SCE 2000 Actuarial Certification for Employee Benefit Trusts, pg. 62, Exhibit 3, "Development of Market Value of Assets as of January 1, 2000", line B) 1)).

B. ELIMINATE SCE'S REQUEST OF $31,450,000 FOR CONTRIBUTIONS TO SCE'S PENSION PLAN BECAUSE SCE IS USING AN ASSET VALUATION METHOD THAT CHRONICALLY UNDERVALUES THE MARKET VALUE OF PLAN ASSETS.

For ratemaking purposes, ORA recommends replacing SCE's four-year moving average of the actuarial value of plan assets with a four-year moving average of the

[64] D.96-01-011 covered PBOPs compliance prior to Test Year 1995 and actual funding activities for 2001 are under discovery.

actual fair market value. ORA compared SCE's asset valuation method to actual market value from 1990 through 2001 and found that SCE's method consistently undervalues pension plan assets. Over the most recent twelve-year period, SCE's actuarial value was always less than the actual market value and averaged 87.7% of the actual fair market value. (DR-ORA-195.) Over the last five-years, the asset under-valuation has increased to an average of 82.2%. (*ibid.*) This chronic under-valuation of plan assets is unfair to ratepayers and is biased from a funding standpoint because one would expect the actuarial method to produce at least one asset valuation above the fair market value. Furthermore, ORA is concerned about the volatility introduced by SCE's method. For example, in 1997, when the fair market value dropped approximately 21%, SCE's actuarial value drops 26%. (*ibid.*) For these reasons, ORA has concluded that SCE's pension asset valuation method is not accurate or fair and should not be used for ratemaking purposes. ORA recommends using a conservative[65] four-year moving average of fair market values. For the Test Year, this method produces a funding requirement of zero as the Full Funding Limitation restricts contributions to zero because Expected Plan Assets of $2,935,953 end-of-year 2003 (ORA Workpapers) exceed the Expected Accrued Liability of $2,752,087 end-of-year 2003 (DR-ORA-196).

C. REDUCE SCE'S REQUEST FOR 401(K) ACCOUNT SAVINGS PLAN BY APPROXIMATELY $2,005,000 BECAUSE SCE'S METHOD CONTAINS TWO FLAWS.

ORA recommends a reduction to reflect expected reduction in participation and ORA's labor inflation factor. The Savings plan, unlike other benefit plans, has three cost drivers:

1. Employee participation,
2. Payroll increases, and
3. Changes in the ratio of the company-match contribution.

[65] ORA oversimplifies this actuarial valuation method by excluding retirement income payments and interest (return) on plan assets. This is a conservative approach because returns-on-assets exceeds benefit payments. (DR-ORA-196 Q.1,Table 3, Item B. Assets.)

ORA has examined the most recent payroll data, employee data, and company match provisions in the Labor Agreements. ORA arrived at two key findings. First, the payroll (FERC Form No. 1, pg. 355) and number of employees (FERC Form No. 1, pg. 323) data shows that SCE underestimated the anticipated drop in participation and total payroll. Second, SCE's testimony and the Labor Agreements reveal that SCE does not anticipate any increase in the company match ratio (SCE Exhibit SCE 6, Vol. 7, part 1 of 7, pg. 10). Therefore, ORA concluded that SCE has not justified and is not justified escalating this ratio by the labor inflation factor (*ibid*). As a result of these findings and conclusions, ORA corrected SCE's forecast by a) using the actual recorded 401(k) expense for 2001 and b) not escalating the company match ratio by the labor escalation factor.

D. ELIMINATE $2,654,000 IN SUPEREROGATORY BENEFITS FROM SCE'S APPLICATION.

For "miscellaneous" and medical benefits, SCE is including the costs of restructuring, employee recognition, and fitness facilities. ORA concludes that the restructuring costs – 0348 redeployment events and 0349 redeployment severance - are handled in other proceedings, not GRCs. The recognition awards and fitness facilities costs are employee social, cultural, and charitable activities. It is unfair to use ratepayers to fund recognition, fitness, and other awards that are not determined by ratepayers, ratepayers may disapprove of them, and these programs do not provide a clear benefit to ratepayers. Furthermore, the process of measuring the benefits of these programs is plagued with conflicts of interest and subjectivity. The Commission has consistently ruled that such rate recovery is unreasonable and unfair (D.67369, pp. 851-854; D.89-12-057, pp. 265-266; and D.93-12-043, pp. 34-35, and 75, *mimeo*). These rulings' fundamental justness is evidenced by Pacific Gas & Electric Company eliminating these items from its application (A.97-12-020, "Exhibits (PG&E-6 and PG&E-7)"). For these reasons, ORA recommends that the Commission stay the course and continue to deny rate recovery for these supererogatory benefits. ORA is recommending an adjustment downward of $2,654,000.

E. REDUCE EXECUTIVE MANAGEMENTS' SUPPLEMENTAL RETIREMENT PAY BY $3,642,000 OR 21.76% BECAUSE SUPPLEMENTAL RETIREMENT INCOME IS BASED ON BONUSES AND INCENTIVE PAY THAT THE COMMISSION RULED MUST BE SHARED BETWEEN RATEPAYERS AND SHAREHOLDERS.

ORA recommends that the Commission extend its policy of a "50/50 sharing" of the cost of incentive pay plans between ratepayers and shareholders to retirement plans. This would make the policy consistent across plans. In establishing the 50/50 sharing, the Commission reasoned that if "executives perform well enough to justify the 'bonus' then there should be enough savings to pay for the incentive plan". (D.86-12-0-5, 23 CPUC2d 149, 187.) ORA strongly believes that this makes good sense and for these reasons recommends that SCE's request for Supplemental Executive Retirement Plans be reduced by $3,642,000.

IV. CONCLUSION

ORA recommends that SCE's total request for employee pensions and benefits expense be reduce by $ 39,750,000 or 15.41% (total company basis). This results in an ORA recommended ratemaking expense level of $257,990,000 for Test Year 2003.

ORA reserves the right to amend or otherwise change its testimony pursuant to on-going discovery of the following:

1. SCE's sponsorship of Edison International's PBOPs plans and the merger of SCE's PBOP plan into Edison International's medical plan. Of particular concern is a) the existence of a "firewall" to preclude ratepayers from funding the medical benefits of the non-regulated affiliates and b) proper disclosure of affiliate transactions.

2. Obtaining 2001 recorded and adjusted recorded expenditure data by type of benefit.

3. The impact of an unfavorable ruling by the State Supreme Court or the Federal Appeals Court on the Settlement Agreement between SCE and the Commission on a bailout plan for SCE for its power purchases during the Transition Period to deregulated markets. Of particular concern is the status of the PBOP revenue

requirement because it is not a legal obligation; therefore, SCE eliminated or dramatically reduced its PBOP contributions during 2000 and 2001 because of the collapse of SCE's financial creditability. SCE may divert these funds to unregulated affiliates or lock them up in bankruptcy proceedings.

CHAPTER 14-H

PUBLIC AFFAIRS/CORPORATE COMMUNICATION AND FRANCHISE FEE REQUIREMENTS

I. INTRODUCTION

SCE forecasted $9,489,000 of A&G expenses for its Public Affairs (PA) Department. The corresponding ORA estimate is $3,767,500. SCE forecasted $5,503,000 of A&G expenses for its Corporate Communication Department. The corresponding ORA estimate is $4,907,000. SCE forecasted $69,359,858 of A&G expenses for franchise fee expenses with a franchise fee factor of 0.8470% for test year 2003. The corresponding ORA .estimate is $68,789,858 with a franchise fee factor of 0.8401%.

ORA conducted its analysis by reviewing SCE's testimony and workpapers, issuing data requests and analyzing the responses. ORA also performed variance analyses, conducted phone conferences with various A&G witnesses at SCE to discuss findings and questions pertinent to data requests and responses. ORA also made some normalized adjustments to SCE's historical data for costs it could identify that were incurred for non-recurring, unusual, or one-time expenditures for ratemaking purposes to reflect what should be SCE's normal and reasonable costs of doing business. ORA also went on a field visit to observe some of SCE's facilities.

II. SUMMARY OF PUBLIC AFFAIRS

SCE forecasted $9,489,000 for its Public Affairs (PA) Department: $7,535,000 for Account 920 and $1,954,000 for Account 921. SCE utilized the Last Recorded Year Method to determine its test year forecast for its Public Affairs Department. SCE's PA activities at the state level include conducting legislative policy research, monitoring all proposed legislation, reporting to the legislative and executive branches on present and proposed utility operations, and representing SCE's ratepayers. On average, ORA

calculated that SCE charges its ratepayers 82.86% for the activities performed by its PA functional groups. SCE's PA has seven Areas of Responsibility (AORs) or functional groups:

- Regions (Four): activities are charged at 100% to Ratepayers;
- Legislative & Local Government Affairs: activities are charged at 80% for Legislative Affairs and 100% for other activities of this group to ratepayers;
- Government Education & Resource Team: activities are charged at 100% to ratepayers;
- Coalitions: activities are charged at 80% to ratepayers;
- Sacramento Office: activities are charged at 55% to ratepayers;
- Washington Office: SCE has not forecasted any costs for it Washington Office in the test year; and
- Management and Administrative Support: activities are charged at 65% to ratepayers.

Table14-H-1

ORA's Forecast of SCE's Test Year 2003 Expenses for Public Affairs

Account	SCE Forecast	ORA Forecast	Difference
920	$7,535,000	$3,767,500	$3,767,500
921	1,954,000	0	1,954,000
Total	$9,489,000	$3,767,500	$5,721,500

SCE's Public Affairs (PA) Department represents SCE and its operational departments before federal, state, regional and local governments. SCE claims that the vast majority of its PA activity, which includes but is not limited to system operations and maintenance, system construction, replacement, maintenance, and undergrounding, property and land use, emergency planning, response and recovery and generation, is focused on supporting the utility at the local government level. In 2000 SCE claims that its Sacramento office lobbied in 44 pieces of primary legislation and that 80% of that activity was spent on legislation that was on behalf of its ratepayers interest. And in

2001 SCE claims that it lobbied in 223 primary pieces of legislation and the majority of the time was spent on legislation that was on behalf of its ratepayers. SCE's Legislative Affairs subsection located within AOR Legislative & Local Government Affairs, "monitored on an in-depth basis" in 2000, 37 pieces of primary federal legislation and 95% of the time spent on these activities were in the interest of its ratepayers. In 2001 this group "monitored" 66 primary pieces of federal legislation.

III. DISCUSSION/ANALYSIS

SCE seeks a change in Commission policy to allow costs incurred for lobbying to be included in rates. Several of SCE employees in its PA departments perform specific duties that fall under existing Federal Energy Regulatory Commission (FERC) and Commission definitions of "lobbying". SCE apparently conducted an in-house survey of its employees that hold positions as Corporate Representatives/Regional Managers, the employees that are responsible for and engage in lobbying activities on behalf of SCE, and they responded that no more than 10% of their time in 2000 was spent on lobbing activities. ORA believes that this in-house survey of the individuals that engage in lobbying activities is suspect. SCE did not provide ORA with copies of this survey or details on how it was conducted. ORA recommends that prior Commission policy related to lobbying be continued, as is.

The Commission stated in D.96-01-011 (SCE) page 129:

> "Account 426.4 describes lobbying expenses as activities conducted for the purpose of influencing public officials' decisions. It does not limit lobbying expenses to those activities occurring directly with public officials…We do not believe that influencing the decisions of public officials through staff members of regulatory agencies should be funded by ratepayers any more than direct contact with these public officials".

FERC Account 426.4 defines lobbying activities, which should not be funded by ratepayers as follows:

> "This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing

> referenda, legislation or ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations." (D.96-01-011 pg 129)

SCE's PA Department has approximately 62 Corporate Representative/Regional Manager positions out of 113 positions.[66] The breakdown is as follows: 11 positions in Legislative & Local Government Affairs, 36 positions within its four Regions, 3 positions in its Sacramento Office, 4 positions in Coalitions, 6 in its Government Education & Resources Team, and 2 positions in its Management & Administrative Support. The major Area of Responsibility of SCE's employees that hold positions as Corporate Representatives 1, 2 and 3 are to:

> "Represent the company as a liaison and primary contact to protect and enhance the company's position in specific proceedings and to ensure coordination with corporate policy and objectives on a broad range of sensitive regulatory, rate-making and legislative issues having a moderate/major impact on company…Protects and transacts all phases of company/customer business, political, community, and civic activities at the area/corporate level. Establishes and maintains positive working relationships with governmental officials, committees, agencies, etc. **in order to influence and secure acceptance of established and proposed company operations and minimize adverse publicity"** [emphasis added].[67]

Based on ORA's analysis, the major job responsibility of SCE's 62 Corporate Representatives/Regional Managers is to represent SCE, not its ratepayers, and to engage in lobbying activities on the Company's behalf "in order to influence and secure acceptance of established and proposed company operations and minimize adverse publicity". SCE's 62 Corporate Representatives/Regional Managers do perform other job responsibilities that does not involve lobbying, and thus ORA believes that SCE's ratepayers may benefit from a few of these other activities, but not at the rate of 82.86%. SCE has not provided sufficient documentation to demonstrate that 82.86% of its activities performed in its PA are on behalf of its ratepayers and that only 10% of its

[66] The other SCE PA positions that support the Corporate Representative positions, as well as perform other duties, are classified as Administrative Aide-21 positions, Business, Budget and Program Analyst-3 positions, Executive assists-7 positions and there are 14 Management positions that oversee the operations in the seven functional work groups in PA.

Corporate Representatives/Regional Managers time is spent on lobbying activities based on its in-house survey. ORA recommends a forecast of $3,767,500 for test year, which is a conservative disallowance of 50% of SCE's forecast of $7,535,000 for its Account 920. ORA recommends that SCE's forecast of $1,954,000 for Account 921 be disallowed. ORA also recommends that the Commission ignore SCE's request to change the Commission policy to allow costs incurred for lobbying to be included in rates.

SCE has not provided ORA with sufficient documentation to substantiate its forecast for expenses recorded in Account 921. SCE claims that its 62 Corporate Representatives/Regional Managers are each given a budget for non-labor expenses recorded in Account 921, for which they are accountable. However, SCE has not provided ORA with any documentation as requested (ORA-028 questions 2, 3 and 6) detailing the type of expenses that were incurred by its 62 Corporate Representatives/Regional Managers, that engage in lobbying activities on behalf of SCE, to determine if all costs incurred and utilized in its forecast for test year should be funded by ratepayers.

IV. SUMMARY OF CORPORATE COMMUNICATIONS

SCE forecasted $5,503,000 for its Corporate Communication for test year 2003: $2,620,000 for Account 920, $1,271,000 for Account 921, $1,452,000 for Account 930, and $160,000 for Account 923. SCE's Corporate Communication was organized into four Divisions in 2000: Internal Communications, External Communications (including Customer Communications), Communications Operations and Communications Services. Table 14-H-2 below summaries ORA's forecast of SCE's test year expenses for Corporate Communications.

[67] SCE data response to ORA data request ORA-28 question 2.

Table 14-H-2

ORA's Forecast of SCE's Test Year 2003 Expenses for Corporate Communication

Account	SCE Forecast	ORA Forecast	Difference
920	$2,620,000	$2,620,000	0
921	1,271,000	1,271,000	0
923	160,000	137,000	$ 23,000
930	1,452,000	879,000	573,000
Total	$5,503,000	$4,907,000	$596,000

SCE expects to consolidate into three Divisions for 2001-2003: Internal Communications, External Communications (including Customer Communications) and Communications Operations. These Divisions within SCE's Corporate Communications Department serve as its "official voice of SCE to its customers, employees, the news media and the general public" and expenses are incurred for external and internal communications activities and department operations. SCE also assigns costs incurred for outside services for "cross-divisional" expenses incurred by all the divisions that cannot be directly attributable to one of the divisions to Account 923. SCE utilized the Last Recorded Year Method for Accounts 920, 921 and 930 and used a five-year Averaging Method for Account 923 because of fluctuations in its recorded expenses in account 923. SCE plans to increase its reliance and spending on outside consultants, which costs are recorded in account 923.

ORA did not take issue with SCE's forecasted level of expenses for its Account 920 of $2,620,000 and Account 921 of $1,271,000. The recorded costs in these accounts appear to be reasonable and have been declining due in part to its reorganization, workforce reductions and in some cases, contracting out certain services to reduce costs and are expect to remain flat. However, ORA did take issue with SCE's expense forecast for its Accounts 923 and Account 930 and ORA's findings are discussed below.

ORA utilized the last recorded year in its forecasts for SCE's Account 923, which was forecasted at $160,000 for its test year. ORA recommends an adjustment of $23,000 from SCE's estimate due to the fact that SCE provided insufficient documentation to substantiate its increase in the forecasted amount, yet SCE plans to increase its reliance and spending on outside consultants in the test year. SCE did not provide ORA with documentation to explain the planned projects or how it determined that the estimated projects would incur costs totaling $23,000. SCE's 2000 recorded expensed of $137,000 in Account 923 increased over 1999 recorded expenses of $96,000 by $41,000 or 42.7.9**%.** ORA recommends a forecast of $137,000 for Account 923, which is a 16.8% decrease in SCE's forecast of $160,000.

> ORA asked SCE in data request DR-ORA-138 question 2
>
> SCE has forecasted an increase in account 923 of $23,000. SCE argues that the increase is to expand the work by ethnic communications consultants. SCE is also utilizing an averaging method for account 923 due to various activities and changes between 1996 and 2000. Please provide the supporting documentation that explains in detail the projects that amount to the $23,000 increase.
>
> SCE's response:
>
> We based our forecast on the five-year average because the activities and costs incurred in each of those five years is equally representative of the kinds of activities and costs we anticipate for 2003. Therefore, because SCE did not base its forecast in this account on 2000 recorded costs alone, SCE does not have specific "supporting documentation that explains in detail the projects that amount to" the increase between the forecast and our 2000 recorded expense.

SCE forecasted $1,452,000 for Account 930. ORA removed $573,000 for costs incurred for Edison International (EIX) Annual Report recorded in Account 930. SCE is required to publish its own annual report, which is already funded by its ratepayers. Therefore the costs incurred to produce and distribute the EIX annual report should be funded by SCE shareholders. ORA recommends a forecast of $879,000 for SCE's Account 930 for test year.

V. SUMMARY OF FRANCHISE FEE REQUIREMENTS

SCE forecasted $69,359,858 for its Franchise Fee expenses and a Franchise Fee Factor of 0.8470% in Account 927 for test year 2003. SCE's Franchise fees are payments it makes to municipal or other governmental authorities in compliance with franchise, ordinance, or similar requirements in order for SCE to place its facilities in the public right-of-way. SCE's Franchise Fee Factor of 0.8470% is an increase of 0.0383% over the 0.8087% factor adopted in D.96-01-011. SCE claims that the increase is due to incorporations of new cities, renegotiations and renewals of franchises in its service territory between 1995 and the test year. SCE developed its franchise factor for test year 2003 by "scaling up" its recorded 2000 franchise fee factor for its known growth factor. Table 14-H-3 below summarizes ORA's test year forecast of SCE's Franchise Fee Expense.

Table 14-H-3

ORA's Forecast of SCE's Test Year 2003 Expenses for Franchise Fee

Account	SCE's Forecast	SCE's Factor	ORA's Forecast[68]	ORA's Factor	Difference	Percent of Difference
927	$69,359,858	0.8470%	$68,789,858	0.8401%	$570,000	0.83%

SCE developed its estimate for its franchise factor for 2001-2003 by utilizing its total annual franchise payments expressed as a percentage of its annual gross sales of electric energy. SCE's estimated franchise factor of 0.8470% was then multiplied by its estimated sales revenues of $8,188,755,622 to arrive at the forecasted increase in franchise fees of $69,359,858. SCE's forecasted increase in its franchise fee factor were based on the following:[69]

- Incorporation of two new cities, Rancho Santa Margarita with an expected increase of $60,000 and Aliso Viejo with an expected increase of $50,000, in SCE's service territory;
- Renegotiations and renewal of two franchises that expired in 2001 for Santa Barbara County with an expected increase of $570,000 and Ventura County with an expected increase of $373,000; and
- A scheduled increase in franchise fees from 1.4% to 1.66% for an existing franchise agreement with Long Beach with an expected increase of $735,000.

The municipalities and counties located in SCE's service territory utilize three franchise types and conditions: the Broughton Act, which uses 2% of SCE's gross annual receipts derived from use of miles of line that SCE has within that municipality jurisdiction and the terms of the agreement are Determinate, and thus can be renegotiated and renewed; the 1937 Act (Constitutional), which uses ½ of 1% of SCE's gross annual receipts from sale of electricity in that municipality jurisdiction, and the terms are Indeterminate, therefore the terms and conditions of the franchise can never be changed; and the 1937 Act (Non-Constitutional), which uses 1% of SCE's gross annual receipts

[68] SCE's estimate of total sales revenues for 2003.

from sale of electricity in that municipality jurisdiction, and the terms are supposed to be Indeterminate and the terms and conditions of the franchise are not to be changed.[70] The cities that have either incorporated or will renew their franchises will utilize the 1937 Act (Non-Constitutional), which increases SCE's franchise fee factors.

ORA learned in a phone conference with SCE on July 9, 2002 that Santa Barbara County did not renegotiate or renew is franchise with SCE in 2001 as mentioned in its testimony, instead Santa Barbara County requested an extension for one year that ends on November 4, 2002, and is therefore still utilizing the Broughton Act. If Santa Barbara renegotiates or renews its franchise with SCE it will use the 1937 Act (Non-Constitutional) and the fee would increase by $570,000. However, if Santa Barbara requests another year extension of the franchise, SCE would have over collected in the amount of $570,000. SCE's franchise fee factor would be 0.8401 instead of the 0.8470% and the amount of SCE's franchise requirement would be $68,789,858 if Santa Barbara decided to extend its franchise for one more year.

ORA recommends $68,789,858 in franchise fee expenses for Account 927 and a franchise fee factor of 0.8401%. SCE and Santa Barbara are currently in negotiations, however, Santa Barbara has not yet renewed its franchise with SCE. If an agreement is made prior to the close of the record in this GRC proceeding, the appropriate franchise fee rate should be incorporated.

VI. CONCLUSIONS

ORA recommends a forecast of $3,767,500 for Public Affairs expenses. This recommendation is a difference of $5,721,500 in SCE's request of $9,489,500. ORA

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[69] SCE has forecasted its test year Franchise Fee Factor of 0.8470% utilizing flat gross sales for 2000-2003 in order to minimize the amount that its ratepayers would have to pay. SCE's response to ORA data request ORA-Verbal-23 question 1.

[70] There have been some cities in SCE's service territory that have changed or are attempting to change the terms and conditions of its franchise type from the Broughton Act, 1937 Act (Constitutional) and 1937 Act (Non-Constitutional) to create a different franchise type and factor. Long Beach is one of the areas that established a different franchise factor. SCE informed ORA in a phone conference on July 9, 2002 that the major reason for the franchise factor change in Long Beach was due to the selling of SCE's power plants.

recommends that prior Commission policy related to lobbying be continued, as it. ORA recommends a forecast of $4,907,000 for Corporate Communications expenses. This recommendation is a difference of $596,000 in SCE' forecast of $5,503,000. ORA recommends a Franchise Fee factor of 0.8404%..

CHAPTER 14-I

QUALIFYING FACILITIES AND ENERGY SUPPLY & MANAGEMENT

I. INTRODUCTION

This portion of ORA's testimony reviews and analyzes the Southern California Edison Company's (SCE) testimony on Administrative and General Expenses (A&G) for contract administration on Qualifying Facilities (QFs) and Energy Supply & Management (ES&M). The SCE testimony is found in SCE-6 Volume 9.

SCE's QF Resources Department (QFRD) administers its QF contracts while its ES&M Department (ESMD) performs business activities associated with the sale and procurement of electricity and fossil fuels on behalf of SCE's customers. SCE records the A&G expenses incurred by the QFRD to FERC Accounts 920, 921, and 923 and those for ESMD to FERC Accounts 920, 921, and 501.

For test year 2003, SCE seeks about a 10 percent increase in QFRD's A&G expense from recorded 2000 levels (at constant 2000 dollars) owing largely to some increases in non-labor and consultant expenses. No increase in QFRD's labor expenses is contemplated by SCE in 2003.

For test year 2003, SCE also seeks about a 79 percent increase in ESMD's A&G expense compared to last recorded year 2000 levels (at constant 2000 dollars). SCE's proposed dramatic increases in both labor and non-labor 2003 ESMD expenses are not fully justified; accordingly ratepayers should not be burdened with an excessive increase in procurement staff and other unsupported expenses.

II. SUMMARY OF RECOMMENDATIONS

ORA recommends that for test year 2003:

1. Approve the total proposed amount of $3.883 Million (in constant $2000) for SCE's QFRD A&G accounts 920/921/923; and

2. a downward adjustment to SCE's proposed amounts for ESMD A&G accounts 920/921/501 by about $2.332 Million.

ORA's recommended adjustments to ESMD are as follows:

(a) That SCE's proposed amount of $8.47 Million be denied, and instead, ORA's recommended labor expense amount of $7.723 Million (in constant $2000) for ESMD's Account 920 be approved;

(b) That SCE's proposed amount of $6.29 Million be denied, and instead, ORA's recommended non-labor expense of $5.32 Million for ESMD's Account 921 be approved; and

(c) That SCE's proposed amount of $1.83 Million for Account 501 be denied, and instead, ORA's recommended amount of $1.215 Million be approved, with the condition that the consultancy expenses on Mohave coal supply be subject to the Commission's favorable decision to continue Mohave's operation as a coal plant in Application 02-05-06. Should the Commission decide to discontinue the Mohave operation as a coal plant beyond 2005 in A.02-05-06, ORA recommends the amount of $827 thousand for Account 501 (i.e., labor expense amount of $440 thousand and a non-labor expense amount of $387 thousand) be approved instead.

The above amounts are summarized below:

	QFRD SCE Proposed	QFRD ORA Recommended	Difference
Account 920	$ 3.253 Mn	$ 3.253 Mn	0
Account 921	0.362 Mn	0.362 Mn	0
Account 923	0.268 Mn	0.268 Mn	0
Total 920/921/923	$ 3.883 Mn	$ 3.883 Mn	0
	ESMD SCE Proposed	ESMD ORA Recommended	Difference
Account 920	$ 8.470 Mn	$ 7.723 Mn	$ 0.747 Mn
Account 921	6.290 Mn	5.32 Mn	0.97 Mn
Account 501:	1.830 Mn	1.215 Mn	0.615 Mn
Labor	0.930 Mn	0.540 Mn	0.390 Mn
Non-Labor	0.900 Mn	0.675 Mn 1/	0.225 Mn
Total 920/921/501	$ 16.590 Mn	$ 14.258 Mn	$ 2.332 Mn

1/ This is recommended only if Mohave will continue to operate beyond 2005. Otherwise, the amount for the consultancy expenses of about $300 thousand should be removed.

III. DISCUSSION AND ANALYSIS

A. FORECAST METHOD

As discussed further below, ORA finds reasonable the forecast methods employed by SCE. In preparing its test year 2003 estimates for Accounts 920/921/923 for QFRD, SCE uses 3 estimating methods. For Account 920, it uses the last recorded year 2000 as the basis for its forecast. For Account 921, SCE uses the 4-year historical average of 1997-2000. And finally, for Account 923, SCE uses the 5-year historical average of 1996-2000.

For ESMD, SCE uses the budget-based method for Accounts 920/921/501. The focus and structure of the ESMD organization was constantly changing in the 1996 through 2002 period, and therefore, a budget-based estimate of its costs, including the incremental costs, rather than the historical costs are more relevant for forecast purposes.

B. ASSUMPTIONS

SCE assumes that by January 1, 2003 it will have resumed the procurement function from the California Department of Water Resources (CDWR) which currently procures energy on behalf of SCE's bundled customers pursuant to ABX1.[71] SCE has not prepared an alternate forecast that would assume otherwise.[72] SCE states that "whether such power procurement responsibility actually begins exactly on January 1 cannot alter ES&M's current need to acquire the resources and capabilities to be ready to resume power procurement responsibility on that date."[73] SCE's assumption is reasonable, given Governor Davis' signature of AB 57 urgency legislation and the expedited procurement process adopted in the Procurement OIR 01-10-024.

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[71] The procurement authority granted to CDWR pursuant to ABX1 will expire on December 31, 2002 unless extended. The contract allocation issues pertaining to CDWR's contract and procurement activities on behalf of utilities are currently before the Commission in Rulemaking 01-10-024.

[72] During discovery, ORA requested SCE for a forecast of its expenses under alternative scenarios, including one where SCE will not resume the procurement of energy for its customers on 1/1/03.

[73] SCE cites to AB 57 and Commission's actions on bringing utilities back to the procurement function beginning in 1/1/03.

C. THE QUALIFYING FACILITIES RESOURCES DEPARTMENT

Issues

For 2003, the proposed labor expense is flat from year 2000 recorded cost. Since a number of QF contracts have expired by their own terms, ORA reviewed whether there is a sufficient basis to maintain the current staffing level.

Background on QFRD

The QFRD is a group of 40 full-time equivalent (FTE) staff (one who works 40 hours/week) with primary responsibility for the following business activities pertaining to qualifying facilities (QFs):[74]

1. QF contract development
2. QF contract compliance
3. QF contract management
4. QF contract payments
5. Affiliate QF contract information
6. QF general administration
7. QF contract restructuring and buyouts

In QF contract development, the QFRD negotiates new agreements with QFs of 100 KW or less. As later explained, interest in customer-generated electricity have increased QFRD's work in this area. QFRD develops and administers compliance programs to ensure QFs remain faithful to the terms of their contracts. SCE expects no appreciable change in compliance activities, and will continue with the 9 QF compliance programs currently implemented.[75] QFRD contract management deals with contract amendments, assignments, or other relief sought such as force majeure.[76] QFRD performs the payment calculations and mails the monthly statements to the QFs under contract with SCE, including responsibility for the monthly posting of short-run avoided cost (SRAC) prices. QFRD is also in charge of collecting, maintaining, and submitting

[74] QFs were created pursuant to federal law in the PURPA of 1978.
[75] See pp.9-14 of SCE-6, Vol.9 for a description of these programs.
[76] For instance, the QFRD dealt with the recent of SRAC pricing methodology issues and disputes arising from them.

affiliate QF contract information to the Commission on an annual basis. QFRD handles the general administration of QF documentation and information systems. And finally, the QFRD staff also provides technical assistance and witness support whenever SCE negotiates QF restructurings or buyouts. SCE suspended that activity during 2000.

The Number of QFs Under Contract with SCE

As of July 31, 2002, the QFRD managed 306 QF projects under contract (both standard and non-standard QF contracts) with a total contract capacity of 4,911.8 MWs.[77] Contracts administered by the QFRD since 1996 have decreased significantly.[78] SCE anticipates the number of QF contracts to be generally stable in 2003, but for a few QF contracts which may terminate or have contract terms causing them to expire prior to 2003. ORA's research shows that 60 QF contracts terminated over the 1997-2000 period.[79] Further, in the year 2001, about 19 QF contracts terminated. Through July 31, 2002, an additional 7 contracts terminated by their own terms.[80] It is expected that by yearend 2002 to 2003, a further 3 QF contracts may terminate.[81] Overall, about 89 contract terminations prior to 2003.

SCE's justification to maintain current QFRD staffing is increased QFRD activity in the area of contract development. This increase pertains to distributed generation (DG) and net energy metering (NEM), both areas of other customer generation for which the QFRD has assumed responsibility within SCE.[82] DG and NEM interconnection activities also employ the efforts of other SCE departments.[83] The QFRD coordinates all activities leading to the completion of the interconnection agreement. SCE represents

[77] See Qualifying Facilities Semi-Annual Status Report to the CPUC dated July 31, 2002 and is available on the SCE website.
[78] SCE Data Response to Question 1 in DR-ORA-134. In 1996, SCE had 402 projects under contract with 5,510 MWs capacity.
[79] See SCE Response to Q1 to DR-ORA-134.
[80] See SCE Response to Q1 to DR-ORA-154.
[81] Ibid.
[82] No specific beginning date related to the assumption of responsibilities on DG or NEM interconnection activities can be cited by SCE. See SCE response to Question 3 DR-ORA-031.
[83] See same SCE response. Other SCE departments cited are Protection Engineering, Transmission and Distribution Engineering, Customer Solutions, Special Billing, and Plant Analysis.

that QFRD has primary responsibility for the continuing administration and management of DG & NEM type generating facility interconnections.[84]

ORA estimates that the increased activity in the DG area likely occurred after the Commission adopted interconnection standards in D.00-12-037. In the 3 years prior to 2000, SCE signed only 16 DG type generation facility interconnection agreements (GFIAs).[85] In 2000, SCE signed 9 of 19 negotiated GFIAs.[86] In 2001, SCE received 93 DG facility applications of about 310 MW nameplate capacity.[87] Thirteen of these projects withdrew their application before installing equipment and 32 projects were authorized to interconnect with SCE's system during the year. The remaining 48 projects of the 93 are still in "the pipeline." As of the first quarter of 2002, SCE reports that it has so far received 31 new DG applications.[88]

The substantial increase in NEM followed the enactment in April 2001 of ABX129. That law increased the size of projects eligible for NEM to 1 MW (from 10 KW or less) for customers with certain qualified small wind and solar generating facilities. In 2001 alone, SCE received 490 NEM applications and executed 280 agreements[89]versus 45 applications and 32 agreements in the 4 years prior to 2000.[90] During the first quarter of 2002, SCE received just over 100 NEM applications. Given the current trend, SCE expects about 100 new NEM generating facility installations to be processed annually.[91]

ORA notes that the new responsibilities undertaken by the QFRD with respect to these interconnections go beyond contract development and coordination. The QFRD has an apparent continuing administrative role for other customer generation (i.e., DG and NEM), though to a somewhat lesser degree than required for QFs. ORA also notes

[84] Such activities include tracking, monitoring, and reporting the status of such facilities, as well as monitoring ongoing requirements of the agreements such as insurance coverage and any warranties made in the interconnection agreement. See SCE Response to Q5 to DR-ORA-154.
[85] Four in 1997, five in 1998, and seven in 1999. See SCE Response to Q2 to DR-ORA-154.
[86] SCE-6, Vol.9, pp.7-8.
[87] See SCE Response to Q4 in DR-ORA-031.
[88] See same SCE Response to Q4.
[89] See SCE Response to Q5 in DR-ORA-031.
[90] See SCE Response to Q3 in DR-ORA-154.

that proposed legislation in AB 58 may further boost the expected volume of other customer generation requests in NEM.[92]

Based on the foregoing, it appears that for every QF contract terminated during the recent period examined, there are 8 new other customer generation-related applications received by QFRD, about half of which resulted in executed agreements with SCE. Assuming roughly 8.5 QF contracts per FTE, we see about 10 FTEs probably made available by the terminations. SCE already has 6 QFRD employees dedicate a total of 165 hours per week (4.125 FTEs) to other customer generation. With the potential for more DG and NEM additions in 2003 and beyond, it is reasonable for QFRD to keep the current staffing level.

SCE does not seek any increase in labor expenses in 2003 for QFRD. For Account 920, QFRD's test year 2003 labor expense is estimated to be about $3.253 Million (in constant 2000 $), an amount that is equal to the year 2000 labor expense recorded.[93]

QFRD's Non-Labor Expenses

For test year 2003, SCE requests an increase in QFRD's non-labor expenses from $130,000 recorded in 2000 to $362,000 in 2003. Although this represents a 178 percent change from 2000 recorded level in Account 921, ORA notes that non-labor expenses were about 60% less in year 2000 compared to prior year 1999. When compared to 1999, the proposed amount in 2003 indicates only a 9 percent change. SCE anticipates incurring non-labor expenses for the same types of activities it had in the past, and therefore, it is reasonable to use historical recorded expenses to forecast 2003. ORA's examination showed that the QFRD's non-labor expense varied from year to year due to varying need for employee travel, training, office supplies, and photocopying.[94] Further, the expenses associated with the use of agency personnel in the QFRD business

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[91] SCE-6, Vol.9, p.8.
[92] On 8-30-02, the Senate adopted the Proposed Conference Report No.1 for AB 58 providing further impetus to the growth of net energy metering.
[93] For the record, SCE confirms that no amounts for any payroll taxes and pensions and benefits are included in QFRD's Account 920.
[94] SCE-6, Vol.9, p.22.

department during 1997 through 2000 largely accounted for the variances in non-labor costs.[95]

SCE's non-labor expense estimate of $362,000 is based on the 4-year average of the 1997-2000 recorded period. In calculating the average, SCE chose to exclude the year 1996 since non-labor expenses in 1996 were associated with a much larger staff. SCE has not adequately justified exclusion of the year 2000.[96] Although year 2000 non-labor expenses was reduced to an extremely low level due to the implementation of budget cuts and cost reductions within the company following the energy crisis, cost-cutting measures came only during late 2000.[97]

QFRD's Consultant Expenses

QFRD uses consultants to assist in QF negotiations and some litigation. With respect to QFRD's test year forecast for Account 923, SCE uses the 5-year average of the 1996 to 2000 recorded period and that amounts to $268,000. SCE indicates that during 1996-2000, its consultant costs varied from year to year showing a high of $422,000 in 1999 to a low of $134,000 in 2000. The variations to these costs largely depended on the level of QF litigation, the level of QF contract buyouts, the level of opposition in the litigation or buyout negotiations, and the pace of negotiations. SCE explains that to the extent these factors were mostly beyond its control, it is difficult to predict the precise level of consultant expenses. SCE also indicates that in the year 2000, it decided to temporarily suspend activity on QF contract buyouts and restructurings. However, SCE expects contract restructuring activities to resume by 2003, and therefore, expects to incur expenses for consultants in the test year. ORA finds reasonable SCE's use of the 5-year average, 1996 to 2000, to forecast its consultant expenses.

[95] See SCE Response to Q6 in DR-ORA-031.
[96] SCE explained that travel, conference, and training expenses were basically eliminated from the budget in 2000. Office supply expenses were also decreased. Further, all activities surrounding contract restructuring were temporarily suspended.
[97] Documents on the management directives on cost reduction measures were dated November 9 and 17, 2000, respectively.

D. THE ENERGY SUPPLY AND MANAGEMENT DEPARTMENT

Issues

In researching procurement staffing levels, ORA compared SCE with similarly situated utilities.[98] SCE's current staffing level for energy supply and contract administration already appears somewhat high. ORA is concerned that further additions will only burden the ratepayer with unjustified incremental expenses for energy supply procurement, contract administration and management.

For 2003, SCE proposes substantial increases in both labor and non-labor expenses for ESMD from levels recorded in 2000. SCE has not provided sufficient specific information to support the reasonableness of the proposed size of the incremental increase in Gas Procurement staff and certain other staff increases vis a vis the incremental ESMD procurement responsibilities in 2003. In addition, SCE's non-labor expense for Account 921 show large increases in overhead arising mainly from IT application and system special services, the latter mainly unsupported. Lastly, SCE has not provided enough information to support the proposed consultant expenses for the coal supply of the Mohave plant.

For 2003, SCE forecasts a total of $16.6 Million (FERC Accounts 920/921/501 in constant 2000 $) in A&G expenses for ESMD. This would translate to a 2003 forecast amount that is higher by $7.3 Million over the last recorded year 2000 expenses, or a 78.6 percent increase from 2000 to 2003. The year 2000 recorded expense amount for ESMD is $9.279 Million for all three accounts.

Background on the ESMD

The ESMD staff is currently responsible for the following activities within SCE for its bundled customers:

1. Power procurement;
2. Power Sales;
3. Scheduling and dispatching generation;

[98] Based on confidential information obtained by ORA.

4. Inter-utility power contract administration;
5. Coal contract administration;
6. Generation-related regulatory reporting functions;
7. Forecasting related to load and transmission and distribution system usage; and
8. Energy planning (price forecasting, power procurement planning, procurement risk management).

The ESMD currently has 7 divisions and contemplates a new division with 8 FTEs by 2003 to handle the gas procurement of the CDWR contracts which it expects will be allocated to SCE and any other new contracts it may be authorized to procure for 2003 and beyond which require gas tolling agreements. In addition to the new division, staff level increases are proposed in 5 out of the existing 7 divisions. The largest increase of 9 staff is planned for the Power Contracts Division. Overall, ESMD expects 31 additional FTEs from recorded 2000 levels. The ESMD staffing level and labor expense in each year from recorded 2000 to forecast 2001-2003 are summarized in the Attachment.

The Role of the ESMD

Given the short history of ESMD and its continually evolving role, SCE argues that recorded costs do not provide reasonable basis to forecast its 2003 expenses. We agree. ORA's review shows a markedly changed ESMD organization with changes in ESMD's primary focus in the last 7 years. Hence, historic costs and yearly trends become irrelevant.[99] The ESMD role is discussed below.

The ESMD was organized in 1996. Since then, the activities performed by ESMD have continued to evolve with changes in the restructured California electricity market. Specifically, in 1996, the ESMD was primarily in the role of obtaining gas supplies for its gas-fired generating stations and doing limited market transactions[100], including managing its portfolio of inter-utility long term power contracts and coal contracts.

[99] Other methods based on yearly trends provide lower estimates.
[100] Mainly "economy energy" type transactions on the margin. See SCE Response to Q32 in DR-ORA-031.

With electric restructuring in 1998, the ESMD's primary focus shifted from purchasing fuel for SCE's gas-fired plants (which were already divested) to procurement of energy in the wholesale spot market.[101] ESMD's primary role was to submit bids into the spot markets of the PX and ISO for its supply and demand while at the same time continuing to manage its inter-utility long term power and coal contracts. At the time, the PX operated two separate energy markets, a day-ahead and an hour-ahead market.[102] The ISO operated the real-time Imbalance energy market, the Ancillary Services market, and the Transmission Congestion Management market.[103]

In 1999, ESMD continued to purchase most of its power in the spot markets of the PX and ISO, but began to enter into some forward transactions in the PX's 6X16 markets (i.e., Block Forward markets) in July of that year.

In late 2000, SCE obtained CPUC approval to enter into bilateral contracts. Therefore, in addition to spot PX, ISO and PX BFM transactions, the ESMD conducted several competitive solicitations for a number of bilateral contracts for hedging purposes. Some of these bilateral contracts have terms that extend to 2005.

With the demise of the PX in January 2001, the ESMD performed the Scheduling Coordinator function for SCE's retail customers and its generation. Moreover, the energy crisis and the poor financial health of the utilities soon affected SCE's ability to buy power for its customers. The situation soon resulted in credit status downgrades by rating agencies, leading to the legislatively authorized takeover of the utilities' power procurement function by the CDWR pursuant to ABX1 in January 2001.

Currently, the CDWR performs the scheduling and dispatch functions for its statewide portfolio of contracts while the utilities submit their net short forecast for the day as well as a seven-day rolling forecast to the CDWR staff. The utilities also provide the ISO with energy trade schedules comparable to those submitted by the CDWR.

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[101] Coal, nuclear and hydro plants remain.
[102] The PX initially opened with day-ahead energy market operations throughout its first 4 months, then commenced the hour-ahead energy market operations on July 30, 1998. See The Market Monitoring Committee of the CalPX Report. August 17, 1998.
[103] Ibid.

The CDWR authority pursuant to ABX1 expires on December 31, 2002. A proposed decision currently before the Commission will specify the physical allocation of the CDWR contracts to the utilities.[104] If approved, the utilities will now perform all of the day-to-day scheduling and dispatch functions for the CDWR contracts allocated to their portfolios just as they currently do the same for their existing resources and for any new procurement.[105]

Further, consistent with AB 57 which contemplates the return of the power procurement function to utilities no later than January 1, 2003, the Commission authorized utilities in Decision 02-08-071 to enter into new procurement contracts for 2003 and beyond pursuant to the low case scenario forecast of their net short. Therefore, in 2003, SCE anticipates entering into an unspecified number of dispatchable, capacity contracts.

Based on the foregoing, it is reasonable to use a budget-based method for the forecast of ESMD A&G expenses.

Increases in Account 920 Expenses

For 2003, the Account 920 proposed amount is $8.47 Million, an amount that is 60.5 percent higher than recorded 2000 (at $5.274 Million).

ESMD forecasts assume that ESMD will perform many of CDWR's current energy procurement responsibilities starting on January 1, 2003. In particular, SCE indicated that 9 CDWR contracts will be assigned to SCE.[106] However, it appears that

[104] Refer to ALJ Gottstein's Proposed Decision in R.01-10-024.
[105] These functions may include: day-ahead, hour-ahead, and real-time trading, scheduling transactions with all involved parties (e.g., suppliers, the ISO and transmission providers), making surplus sales, preparing forecasts, and obtaining relevant information for these functions, such as transmission availability. Since DWR will still be financially responsible for paying the contract-related bills, the Commission also expects the utilities to verify the invoices and instruct DWR to pay the bills. Further, as drafted, the Commission also expects the utilities' operational and administrative responsibilities for the CDWR contracts to extend to the implementation of the gas tolling provisions.
[106] SCE's DR Response indicates 6 must-take and 3 dispatchable CDWR contracts. But the workpapers assume total of 20 contracts with 12 counterparties will be split between SCE and San Diego Gas & Electric, and 8 of those contracts include gas tolling.

only 6 of the 9 CDWR contracts have contract durations for the entire 12 months of 2003.[107]

In addition to CDWR contracts, SCE expects to procure additional new capacity contracts in 2003 and beyond. SCE has not indicated how many new capacity contracts it may enter into in 2003. Its budget-based estimate assumes 1,000 MW of annual or multi-year capacity contracts for each month of 2003 and 2004. It further assumes 0 to 2,932 MW of monthly capacity contracts will be required in 2003 and 2004. As of this writing, SCE has provided no support for these assumptions.[108] Assuming a typical contract size of 200 MWs and using the 2,932 MW maximum number, it yields an estimate of 15 new capacity contracts.

A review of the estimated number of fuel and power contracts actively managed by ESMD during the period beginning January 1996 through August 2002 shows that the ESMD became responsible for an increased number of contracts, which diminished in the past year with the energy crisis.[109] For instance, in 1996, ESMD managed about 67 contracts. That amount more than doubled to 149 contracts managed in 1997. This continued to increase until in the year 2000, the ESMD managed the most number of contracts recorded at 359. This yields an average contracts to staff ratio of 4.4 contracts per FTE as of the last recorded year 2000.[110] The huge increase in 2000 is accounted for by PX block forward energy (BFM) transactions which recorded 300 contracts in that year. But in 2001, the number of BFM contracts went down to 45, such that overall, only 99 contracts were managed by ESMD during the year. Prior to 2000, the ratios ranged from 1.6 to 3.2 contracts per staff. As of August 2002, there were only 36 contracts being managed by ESMD. With 9 CDWR contracts and an unspecified number of new capacity contracts as incremental additions to ESMD's diminished portfolio, it does not appear reasonable to add the full amount of the proposed 31 new FTEs in 2003. Further, by 2003, most of the solicitation work for the upcoming 2003 contracts will have been

[107] The Constellation contract is thru 6/2003 only, unless extended. The High Desert dispatchable contract starts delivery on 7/1/2003. The Alliance dispatchable contract delivery period is 6/1/2003 thru 10/31/2003.
[108] Response to DR still pending.
[109] See Attachment E in SCE Response to Q3 in DR-ORA-180.

conducted already as part of the advance solicitation to be arranged with CDWR's credit before its procurement authority expires in December 2002.

For existing divisions in ESMD, ORA recommends that 15 of 23 FTEs be granted as follows:

- that only 6 of the 9 proposed new FTEs in the Power Contracts Division (PCD) be granted;
- that all 3 proposed new FTEs in the Finance Division be granted;
- that only 2 of the 4 proposed new FTEs in the Energy Planning Division (EPD) be granted;
- that only 4 of the 6 proposed FTEs in the Energy Operations Division (EOD) be granted; and
- that the additional 1 FTE proposed in the Power Market Regulation Division (PMRD) be denied.

Increases in ESMD's Account 921 Expenses

ESMD forecasts a 76 percent increase in non-labor expenses from $3.57 Million in 2000 to $6.29 Million in 2003 (2000 constant $). In preparing its forecast, ESMD used estimated non-labor costs in its 2001 budget as a starting point. But ORA notes that the 2001 non-labor expense budget numbers is 91 percent higher than recorded 2000. The actual 2001 numbers should be used. Since SCE's cost cutting measures in late 2000 should have taken effect in 2001, we can conclude that 2001 budget numbers are not realistic. SCE admits, the budget 2001 numbers are much higher than actual, and were budgeted with a larger ESMD staff in mind.[111]

ORA notes that three cost categories were used to budget ESMD's non-labor expenses: contract, overhead, and other non-labor. Contract category reflects expenses associated with agency or non-SCE personnel. The overhead category includes all the labor and non-labor expense associated with the Office of the ESMD Manager and the administrative group, including overhead charges of IT (Application Services) and

[110] Obtained from dividing 359 contracts by 82 staff.
[111] See SCE's Response to DR-ORA.

system special projects. Over half of the non-labor expense consist of this overhead which doubles from recorded 2000 to forecast 2003. The overhead expense attributable to IT (Application Services) and System Special Projects alone amount to about $3 Million. SCE should particularly provide more support to justify the level of increased overhead cost in System Special Projects. The other non-labor category includes consultant costs, training, travel, office supplies, photocopying and other miscellaneous expenses.

ORA recommends a non-labor expense amount of $5.32 Million for Account 921 of ESMD. This estimate provides a significant increase over the recorded 2000 figure of $3.57 Million and provides sufficient funding for the test year.

Increase in Account 501 Labor Expenses

Account 501 has both labor and non-labor expense elements. Labor and non-labor expenses are in the amount of $1.1 million in 2003. The labor expenses of the proposed new Gas Procurement Division (GPD) and the existing Coal Contracts Division (CCD) are included in Account 501. As the CCD labor expense will remain flat in 2003 from the 2000 recorded level, the increased labor expense comes from the GPD. ORA found that only 5 out of 9 CDWR contracts expected to be assigned to SCE include any gas tolling provisions whereas SCE assumed a greater number in its forecast.[112] Of the five with gas tolling, 3 contracts are dispatchable, and thus, a possibility that these plants may or may not even be called upon to provide energy. It is also a possibility under the terms of the assignment of the CDWR contracts that SCE may be able to call upon the CDWR to provide the gas if it is more economic to do so. Further, the new capacity contracts are likewise expected to be of the dispatchable type. To the extent that market conditions will generally dictate how many additional natural gas contracts will be required, it is therefore uncertain whether a large number of FTEs for gas procurement will at all be necessary at ESMD. Since we do not want to entirely foreclose the possibility that there may be some, we provide SCE with incremental gas procurement staff.

As discussed in the foregoing, there is inadequate support for 8 FTEs in GPD and an adjustment is appropriate. ORA recommends that 4 out of the 8 proposed new FTEs be granted. ORA's estimate for Account 501 labor is $440,000.

Overall, for ESMD, ORA recommends that 19 out of 31 proposed new FTEs be granted.

Increase in Account 501 Non-Labor Expenses

A similar increase in Account 501 non-labor expenses is noted from $182,000 recorded in 2000 to $900,000 in 2003, a change of almost 5 times the 2000 level. Of the $900,000, about $490,000 is for CCD and the remaining $410,000 is for the GPD.

SCE indicates that the bulk of this amount is due to the consultant costs for the Mohave plant.[113] The consulting work is related to assessing the available coal supply and negotiating new coal contracts. In addition, it would also involve negotiating lease amendments with the Navajo Nation and Hopi tribes. This expense appears contingent on the Commission's future decision on the SCE application for Mohave. SCE filed application A.02-05-046 on May 17, 2002 regarding the future disposition of the Mohave Generating Plant. In that application, SCE has concluded that it probably will not be possible to extend the operation of the Mohave plant as a coal-fired plant beyond the end of 2005. Further, SCE states "even if the unresolved issues surrounding the Plant's coal supply could be satisfactorily resolved in the near future (which appears very unlikely at this point), the installation of the pollution controls probably could not be completed before the consent decree deadline, and the Plant would have to suspend operations temporarily …."[114] ORA therefore recommends that the non-labor expense for the Mohave consultancy be made contingent on the Commission's decision in the SCE application. Therefore, the Account 501 non-labor expense for CCD should be reduced by about $300,000 if and only if the Commission decides to discontinue Mohave's operation as a coal plant beyond 2005. ORA recommends a non-labor expense amount

[112] Includes both must-take and dispatchable contracts with Dynegy, the Sempra must-take contract, and the Alliance and High Desert dispatchable contracts.
[113] The coal supply contract will expire in 2005.
[114] See A.02-05-046, p.2.

of $470,000, the same amount SCE proposes for 2003, subject to the Commission's order in response to A.02-05-046.

Moreover, with only half the number of staff recommended for the GPD, the corresponding Account 501 non-labor expense for GPD should likewise be adjusted to a proportionately reduced amount. ORA recommends that SCE's proposed amount be reduced by half to bring the GPD non-labor expense amount to $205,000. These adjustments will bring the recommended total Account 501 non-labor expense amount to $675,000.

IV. CONCLUSION

Based on the foregoing, the Commission should adopt ORA's recommendations as discussed herein.

For the electronic copy of this report, two attachments relating to the Energy Supply and Mangement Department – Summary of Staffing Levels and Summary of Staffing Levels and Labor Expense, are included in a separate file

CHAPTER 15

TAXES

I. INTRODUCTION

This chapter presents ORA's recommendations relating to tax expense. Tax expense is similar to any other expense category in a general rate case filing in that it is a cost of service. However, it is unique in that estimating tax expense is not merely a matter of reviewing historical payments, and then applying objective projection criteria in order to estimate test year expense. Tax expense is the composite of projected taxable income streams, book expenses, special tax deductions, and tax credits, calculated within the combined contexts of "real world" tax law, and "regulatory world" tax policy. Tax expense also includes taxes which are not a function of income streams, but of the payment of employee compensation, and the ownership of property.

ORA and SCE do not differ on any methodologies employed to forecast tax expense. Any differences in total estimated taxes are due to differences in related inputs. ORA examined SCE's methodologies, workpapers and supporting data and determined that the test year estimate for income and other taxes is based on rational, and reasonable computations. Supporting data was detailed and could be traced to test year forecasted amounts.

Regulated tax expense is comprised of the following items: (1) federal income taxes (FIT), California Corporate Franchise Taxes (CCFT), (2) payroll taxes, and (3) ad valorem, or property taxes. The tables at the end of the chapter summarize the computation of these tax expense categories.

II. SUMMARY OF RECOMMENDATIONS

ORA recommends that test year tax expense be computed using the following parameters and assumptions:

a. For federal income tax purposes, the corporate tax rate of 35% should be used to compute FIT. This rate should be used for the net-to gross multiplier. SCE used the same FIT rate.

b. For state income tax purposes, the unitary effective tax rate of 8.0189% should be used to compute CCFT. This rate should be used in computing the net-to-gross multiplier. SCE used the same rate.

c. Payroll tax rates and wage bases forecasted by SCE were found to be reasonable and should be applied in estimating payroll tax expense. Any differences between ORA and SCE are due to differences in the test year estimate for labor expense.

d. Property tax expense and underlying forecasted valuations were found to be reasonable and should be applied in estimating property taxes. Any differences between SCE and ORA are due to differences in the test year estimated plant additions.

e. All federal and state tax timing differences should be flowed through to the ratepayer to the extent allowed by Commission policy, and federal and state tax law.

f. ORA recommends that the tax effects stemming from the Job Creation and Worker Assistance Act of 2002 be included in the test year tax estimates, including deferred taxes.

g. ORA recommends that any changes in federal and state tax law made before the close of the record in this proceeding be incorporated into the tax estimates for the test year, after review of the new law by ORA.

III. DISCUSSION

The following section provides a brief background of regulated tax expense and a discussion of certain specific tax deductions, credits and other tax policy issues applied in determining taxable income for ratemaking purposes, as well as other issues affecting revenue requirements for taxes other than income. Unless otherwise noted, all discussions apply equally to both federal and state income tax expense.

Basis for Regulated Tax Expense

While the mathematical model used to calculate tax expense is seemingly unequivocal, the underlying accounting conventions, applicable tax rates, and the determination of what constitutes allowable deductions is a function of current federal and state tax law, including new laws expected to affect the test year, regulatory tax policy as determined by numerous Commission decisions, and ORA recommended tax and adopted tax policy. Much of existing Commission tax policy was established in

Order Instituting Investigation 24 (OII 24), D.84-05-036, 15 CPUC 2d 42 (1984). Numerous subsequent decisions adopted a variety of changes in ratemaking tax policy in order to comply with changes in federal and state tax laws.

The goal of ORA is to minimize tax expense, therefore, minimize revenue requirements for taxes. Another way to articulate ORA's goal is that the test year's income tax expense estimate should reflect, to the very extent possible, the current deduction of expenses in which there is a book/tax timing difference. In D.84-05-036, the Commission stated, "[f]or the present, we will continue our current policy regarding flow-through treatment of timing differences consistent with applicable tax law."[115] ORA recommends that the Commission continue to adopt policies which result in the test year tax estimate reflecting, to the very extent possible,[116] the flow-through of forecasted expenditures. It is important to note that in most cases, it is the regulated utility's *parent corporation*, which actually pays the income taxes of the regulated utility as part of a consolidated or combined income tax return. Therefore, it is ORA's position that the regulatory goal of estimating tax expense is to mirror, to the extent permissible by tax law, the actual tax liability of the regulated unit payable to the parent corporation.

The estimated total taxes owed in the test year is an approximation of what will be SCE's share of taxes owed by the entire consolidated group. Whether SCE actually remits to the parent its share of taxes owed is always a legitimate question for the regulator. Typically, a utility is part of a combined group of corporations, which files a consolidated income tax return with the Internal Revenue Service and a separate tax return with the appropriate state agency. SCE is a multi-state corporation; it is part of a consolidated group of corporations, and files a Unitary tax return with the State of California.

State Income Tax Rate

For those utilities with operations within and outside California, ORA's policy is to analyze and consider the allocation procedure under the Unitary tax method.

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[115] See D.84-05-036, discussion at Section I, pgs. 32-33a. The Commission refused to adopt additional normalization requirements beyond those required for depreciation.

[116] ORA's ability to flow-through certain tax deductions and benefits is limited by Income Tax Normalization requirements of the Internal Revenue Code, as well as tax policy established in D.84-05-036. For example, currently, ORA cannot use disallowed expenses as tax deductions.

Application of the Unitary method results in a CCFT rate, which is lower than the statutory rate. For California State income tax purposes, SCE's actual tax liability is not solely dependent on its California operations. SCE's CCFT must be determined with reference to a combined report of its entire utility operations. In other words, SCE's actual CCFT tax return is filed under the Uniform Division of Income for Tax Purposes (Unitary) Method.

Under this unitary method, income derived from the conduct of a corporation's business from sources within and without the state of California is *apportioned* to California under a three-factor formula set forth in the Uniform Division of Income for Tax Purposes Act. The combined report applies this formula, which determines the relationship of California revenues (double weighted), wages and average net tangible property of all of SCE's operations in California to the same three factors for the total of SCE's utility system. Using the three-factor apportionment formula may result in a corporation's effective state income tax rate for ratemaking purposes being lower than the statutory tax rate within any one state. Since multi-state corporations' California tax returns include deductions from out of state operations, their effective CCFT tax rate can be less than the statutory rate.

SCE used a lower effective tax rate in estimating its CCFT for the test year 2003. Its methodology is rational, reasonable and based upon tax return information filed with its 1999 tax returns. ORA concurs with the estimated rate of 8.0189%.

Incremental California Franchise Tax Rate

ORA recommends SCE's effective CCFT rate be used in order to develop the net-to-gross multiplier. The net-to-gross multiplier is an integral part of the summary of earnings and is used to determine the gross revenues that a utility requires to receive in order to recover certain costs, which are a function of revenues. Since the focus of the net-to-gross multiplier is on the increment in revenues needed to receive a specified addition (or decrease) to net revenues, the effective tax rate on that increment, and not the statutory CCFT rate, may be the appropriate rate to incorporate into the net-to-gross multiplier. Using the effective CCFT tax rate produces in a lower net-to-gross multiplier, therefore, a lower net marginal increase in revenue requirements.

The application of an incremental CCFT tax rate lower than the statutory rate is consistent with Commission policy set forth in D.84-05-036. Further, applying the effective CCFT rate is to the ratepayers' benefit as it may yield a revenue requirement for tax expense, which more closely approximates the real world CCFT liability of a regulated utility. SCE used an effective CCFT rate to calculate the net-to-gross multiplier. ORA concurs with this rate.

Tax Normalization

Normalization is a ratemaking concept, which aims to adjust a utility's operating expenses in the test year by eliminating abnormal, non-annual events that are known and certain to change in a regularly recurring manner. For example, accelerated depreciation is a tax expense, which is normalized over the life of an asset when computing ratemaking tax expense. It is known and certain that toward the end of the life of an asset, straight-line (book) depreciation will exceed accelerated tax depreciation. However, at the conclusion of the asset's life, the total depreciation charges under both book and tax methods will be equivalent.

Income tax normalization permits a utility to include in its current ratemaking expense, an amount of income tax expense that is higher than what the utility will actually pay. This is based on the theory that the taxes saved by the accelerated depreciation (taken on the real world tax returns) are merely deferred. Utilities generally use accelerated methods of depreciation on their real world tax returns, while using the straight-line method for book purposes. IRS rules require that utilities use book depreciation rates on all plant purchased or constructed after 1980 when computing regulated tax expense. To mitigate the effect of normalization, the tax effect of the differences between accelerated and straight-line depreciation is booked to a deferred tax reserve. The deferred taxes are used to reduce rate base.

There cannot be a "violation" of normalization if the tax attribute alleged to be "violated" is not subject to normalization under the federal statute. For example, the adoption of the unitary tax method for estimating CCFT is not a normalization "violation" because the Internal Revenue Code (IRC) does not preclude its use by

regulatory agencies as a condition for the utilities to claim tax accelerated depreciation deductions.

Because of current tax law, ORA and utilities are required to adopt normalization for depreciation on assets placed in service after 1980. However there is no federal tax requirement that normalization be used for other tax timing differences. In fact, it is the policy of this Commission to flow through non-plant tax timing differences.

Tax Depreciation

For FIT purposes, tax depreciation for all post 1980 plant has been normalized using book lives and rates. For 1980 and prior years' plant, the appropriate accelerated depreciation has been flowed through. For CCFT purposes, tax depreciation has been flowed-through in estimating CCFT taxable income. Tax depreciation for ratemaking purposes does not include depreciation on plant costs disallowed in previous rate cases.

Tax depreciation includes certain adjustments. Electric depreciation has been adjusted to exclude depreciation on Contributions in Aid of Construction, (CIAC), and has also been adjusted to include gains and losses from the disposition of assets. This latter adjustment represents an important tax attribute with regard to how ratepayers benefit from the loss on sale of post 1980 assets ORA examined workpapers provided by SCE and determined that tax losses as a result of the sale of post 1980 assets are properly flowed-through to the ratepayer by including such losses with the tax depreciation deduction.

Software Expenditures

There are two different types of software related expenditures: internally developed software, and purchased software. Internally developed software may be deducted currently or capitalized and amortized over a three-year period. Purchased software must be capitalized and amortized over a three-year period. Once a tax method of accounting has been established, it must be consistently applied.

SCE has elected to deduct internally developed software currently. In other words, for ratemaking income tax purposes, these costs lower regulated taxable income in the test year, thereby lowering ratemaking income tax expense. However, purchased software costs are capitalized and amortized over the requisite period.

ORA agrees that internally developed software costs should be flowed through to the ratepayer in the form of current tax deductions.

Payroll Taxes

Payroll taxes and their respective rates and wage bases are: Federal Insurance Contribution Act (FICA) 6.20%, $89,100 wage base, Medicare 1.45%, no wage base, Federal Unemployment Insurance (FUI) .80%, $7,000 wage base, and State Unemployment Insurance (SUI) .80%, $7,000 wage base. ORA agrees with these rates and wage bases.

Property Taxes

ORA's tax deduction for property taxes is based upon the test year estimated full accrual of ad valorem taxes due on property held as of the lien date. This amount is higher than the property taxes estimated for book purposes because for book purposes, only the estimated actual calendar year payments are considered. The difference between the full year accrual and the book amount is the lien date adjustment which has been flowed through as a current tax deduction for estimating test year taxable income. This is consistent with SCE's ability to deduct for actual FIT and CCFT purposes the full year lien date accrual amount.

ORA analyzed SCE's method of estimating ad valorem taxes for the test year and found its methodology reasonable. The differences between ORA's property tax estimate and SCE's is solely due to differences in plant estimates.

Job Creation and Worker Assistance Act of 2002.

The Job Creation and Worker Assistance Act of 2002 includes certain tax incentives, which may affect tax depreciation and deferred taxes in the test year. In short, the new tax law provides for bonus depreciation in the first year of service equal to 30% of the depreciable tax basis of qualified assets acquired September 11, 2001 through September 10, 2004.

The new tax law primarily affects deferred taxes because depreciation deductions under the new law must be normalized for ratemaking purposes. However, deferred taxes, which lower ratebase, have been adjusted by ORA to reflect the estimated tax benefits SCE will receive as a result of application of the tax law.

Interest Expense

For FIT purposes, applying the weighted average cost of debt to ORA's estimated rate base derived ORA's interest deduction. Differences in the total amount of interest expense deductible for regulated income tax purposes are, therefore, the result of differing rate base estimates between SCE and ORA. The unamortized deferred investment tax credit (ITC, discussed below) balance was not deducted from rate base for this calculation. This method of "interest synchronization" results in a higher interest deduction which lowers regulated FIT expense. SCE also used this approach in its results of operations. For CCFT purposes, the unamortized ITC was deducted from rate base by ORA and SCE before applying the same debt cost factor. This distinction in calculation methods is predicated on the difference between FIT and CCFT tax law; ITC is not available for CCFT purposes.

Investment Tax Credit (ITC)

FIT expense was reduced by the annual amortization of ITC. Under current federal tax law, ITC must be amortized over the life of the underlying plant when estimating regulated federal income tax expense. Generally, this method of normalizing ITC, applies to plant placed in service after 1980. Public utility corporations have two normalization methods to choose from when electing a method to amortize ITC for regulated tax purposes. Under option one, the tax benefits of ITC are flowed through to ratepayers by deducting deferred ITC from rate base; as each year passes, the deferred ITC balance decreases, thereby ratably restoring rate base over the book life of the plant which generated it. Under option two, the tax benefits of ITC are ratably flowed through as a direct reduction of estimated FIT. SCE uses option two.

CHAPTER 16-A

INTRODUCTION / SUMMARY

I. INTRODUCTION

This chapter contains ORA's analyses and recommendations for Electric Plant-In-Service – Introduction / Summary. The bulk of this chapter is devoted to describing how ORA has organized its investigation of plant additions, calculating various loadings that are added to ORA's estimates of direct additions, developing the appropriate starting point to which new plant additions are added, and calculating an appropriate weighting percentage to compute the Weighted Average Plant-In-Service balances. Also included in this chapter is a brief discussion of the problems ORA had in analyzing capital additions associated with the Customers Business Unit. In addition, several minor plant accounts (Plant Held for Future Use and two small intangible accounts) are analyzed.

II. SUMMARY

Chapter 16 of this report is organized into seven chapters – this introductory chapter and six chapters (16-B through 16-G) that analyze SCE's proposed plant additions. ORA has elected to subdivide Chapter 16 in this manner so as to closely follow the way SCE has subdivided itself into ten Business Units (BU), each of which develops its own capital expenditures, which are include in SCE's total Capital Budget. (SCE has separate BUs for SONGS, Palo Verde, Coal, and Hydro; ORA has one witness (and one chapter) analyzing plant additions for all these areas. In addition, SCE has a separate BU for Customers, which ORA discusses later in this chapter. The net result is that ORA has seven chapters devoted to analyzing plant additions even though SCE has ten BUs.)

SCE has provided exhibits and workpapers that attempt to explain and justify the direct capital expenditures for each of its BUs (other than for Customers). In its organization of its capital exhibits and workpapers, SCE makes a distinction between direct capital additions and the various loadings that are added to the direct amounts; its workpapers only discuss direct additions. Consequently, ORA's analyses of the capital

additions for each of SCE's BUs are restricted to direct additions; the following six chapters present those analyses of the proposed direct additions.[117] The various loadings that are added to the direct additions are discussed later in this chapter, and ultimately get allocated to the direct capital additions found reasonable in the following six chapters.

When SCE prepared this application, it did not have access to recorded 2001 data; it was required to estimate three years of plant additions (2001, 2002, and 2003). ORA, on the other hand, had access to recorded 2001 plant data. Therefore, it only had to estimate additions for 2002 and 2003. This has resulted in a large adjustment to the 2002 beginning-of-year plant balance; the recorded balance is $216.8 million less than the amount estimated by SCE.

SCE's Results of Operations (RO) computer model automatically calculates Weighted Average Plant-In-Service balances based on the completion dates of each of the proposed capital projects. ORA believes that the Weighted Average that results from that computation is too high. Historically, the overall weighting percentage has been lower than the percentage developed by the model. ORA has used this lower weighting percentage in its calculation of the 2003 Weighted Average Plant-In-Service balance.

SCE has a separate BU devoted to Customers capital additions. ORA's witness for this area was unable to find any workpapers or testimony describing/justifying SCE's proposed capital additions. ORA is recommending that these additions be disallowed.

Three plant categories (Radio Frequency, Hydro Relicensing, and Miscellaneous) are classified by SCE as Intangibles. Hydro Relicensing is analyzed by ORA in Chapter 16-B. However, the other two Intangible categories will be discussed later in this chapter. In addition, Plant Held for Future Use will be discussed in this chapter.

[117] In Chapter 16-C, ORA's Transmission and Distribution witness does analyze direct additions, but uses recorded total plant (including loadings) in the development of his recommendations.

Table 1 End-Of-Year (EOY) Plant-In-Service Balances Test Year 2003 (Includes All Overheads - $000)			
	ORA Recommended	SCE Proposed	Difference SCE - ORA
2002 EOY Balance	$21,452,853	$21,896,633	$443,780
2003 EOY Balance	$22,033,768	$22,789,163	$755,395

Table 1 summarizes the end-of-year plant balances for SCE and ORA. The "ORA Recommended" column reflects the adjustments recommended by ORA's witnesses in Chapters 16-A through 16-G. Please note that this table includes direct additions and all the various loadings that are added to the direct additions; the year-end plant balances listed above were computed after the various loadings had been added and retirements had been removed.

Table 2 Weighted Average Plant-In-Service Balances Test Year 2003 (Includes All Overheads - $000)			
	ORA Recommended	SCE Proposed	Difference SCE - ORA
2003 Wtd Avg Balance	$21,699,800	$22,347,841	$648,041

Table 2 shows the 2003 Weighted Average Plant-In-Service balance for ORA and SCE. The "ORA Recommended" column reflects the adjustments recommended by ORA's witnesses in Chapters 16-A through 16-G. As with Table 1, this table includes direct additions and all the various loadings that are added to the direct additions, as well as retirements. Table 2 also reflects ORA's and SCE's use of different methodologies to compute the weighting of the 2003 additions. The 2003 Weighted Average Plant-In-Service balance is a component of rate base; these numbers will appear in the rate base tables in Chapter 18.

At the end of this chapter, ORA has included Table 3 (a more detailed version of Tables 1 and 2) that shows net plant additions and weighted average plant additions for

different functional categories of plant. Table 3 includes direct additions, all the various loading that are added to the direct loadings, and retirements.

III. ORGANIZATION OF CHAPTER 16

ORA has elected to subdivide Chapter 16 into seven chapters – this introductory chapter as well as the six following capital chapters (16-B through 16-G) that analyze SCE's proposed plant additions. Each of the following six chapters looks at a particular type of plant addition, including nuclear generation, coal generation, transmission and distribution, etc. These six chapters closely correspond to SCE's ten Business Units (BU).[118] Each of SCE's BUs develops forecasts for capital spending, and each develops exhibits and workpapers to justify its proposed capital spending. In the following six chapters, ORA's witnesses will be discussing and analyzing those exhibits and workpapers.

Each BU develops forecasts for capital spending that are incorporated into SCE's 3rd Period 2001 Capital Budget, dated November 16, 2001. SCE uses these estimates of capital expenditures to develop the estimated weighted average capital additions that it uses in its rate base calculations for the years 2001, 2002, and 2003.

IV. USE OF DIRECT ADDITIONS

In its capital exhibits and workpapers, SCE makes a distinction between direct capital additions and the various loadings that are added to the direct amounts. The capital spending plans developed by SCE'S BUs consist solely of direct costs; the estimates developed by the BUs do not include the various corporate-level loadings that ultimately are added to the direct additions. Since SCE's workpapers only discuss direct additions, ORA's analyses of the capital additions for each of SCE's BUs are also restricted to direct additions.[119] The following six ORA chapters present those analyses of the proposed direct capital additions.

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[118] There is not a one-to-one correspondence between ORA's six capital analysis chapters and SCE's ten BUs because SCE has four separate BUs for generation, while ORA has only one witness (and one chapter) devoted to this area. ORA has also eliminated a chapter on capital additions for the Customers BU; that topic is discussed later in this chapter.

[119] In Chapter 16-C, ORA's Transmission and Distribution witness does analyze direct additions, but uses recorded total plant (including loadings) in the development of his recommendations.

Many (but not all) of SCE's proposed project costs include estimates for contingencies. In some instances (evidently when there is uncertainty associated with the estimated amount), SCE includes an additional contingency amount in its direct additions estimate. Since these contingency amounts are included in the direct additions, they are included in the estimates contained in the exhibits and workpapers and are subject to ORA's analysis in the following six capital chapters.

V. LOADINGS ADDED TO DIRECT ADDITIONS

Besides direct plant additions, capital balances also include loadings that are added to the direct additions. These loadings consist of AFUDC and Corporate Overheads. As stated previously, the capital additions analyzed by ORA's witnesses in the next six chapters do not include anything other than direct costs. AFUDC and Corporate Overheads are added to the direct additions by SCE's RO computer model.

The process of adding Corporate Overheads and AFUDC to the direct costs discussed in the exhibits and workpapers is a multi-step process that is performed by SCE's RO computer model for each of the hundreds of capital additions SCE proposes to add each year.

The first step in this computation is to enter each of the proposed budget items into the RO model. This information includes descriptive data for the particular project, including any previous expenditures in prior years (Construction Work In Progress – CWIP), the expected completion date, whether the project is eligible for receiving Corporate Overhead and AFUDC allocations, and the forecasted direct expenditures in future years. For the most part, a budget item will be eligible for receiving Corporate Overheads and AFUDC allocations unless it is used and useful at the time of purchase and does not require any further construction. Examples of this type of "exempt" plant item include computers, tools, and furniture and equipment; many categories of General Plant additions fall into this category.

The second step in the process is to estimate the monthly expenditures for each budget item. Because it is not possible to determine monthly amounts precisely, it is assumed that the monthly expenditures will occur uniformly throughout the construction period of the project.

The third step is to allocate Corporate Overheads to all eligible direct expenditures. This is done using a simple ratio. The numerator is simple the monthly direct expenditure of the project. The computer adds up all of the expenditures for all of the projects that are eligible for Corporate Overheads; that becomes the denominator of the ratio. The total amount of Corporate Overheads to be allocated is multiplied by that ratio to determine the corporate overhead allocation for that month for that particular budget item. As an example, if the monthly expenditure for a particular project was $50,000, and the total overhead-eligible direct expenditures for the year were $5,000,000, the ratio would be 1/100. Therefore, $1/100^{th}$ of the total Corporate Overheads would be allocated to that project on that month.

The fourth step is to calculate the AFUDC amounts for each month. This calculation is more complex, but it basically involves calculating a CWIP balance up through the previous month, and adding to that ½ of the current month's direct additions and ½ of the current month's Corporate Overheads. That sum is then multiplied by the AFUDC rate to obtain the monthly AFUDC amount for that particular project for that month.

The fifth step is to compute the CWIP balance for each month. This calculation involves taking the previous month's CWIP balance and adding to that the current month's directs, the current month's Corporate Overheads, and the current month's AFUDC; any closings to plant are then removed.

The last step involves closing out the project, including it in the plant balances, and allowing it to earn a return through rate base.

ORA is recommending that certain modifications be made to these computations. As originally developed, SCE's model improperly calculated AFUDC for the months that plant projects were closed; for those particular months, the model was including a full month of AFUDC, even though the project was starting to earn a return. SCE agreed with ORA's analysis, and corrected its model.

ORA has also asked SCE to modify the way that the model handles Corporate Overheads. Corporate Overheads are generated from five expense categories: Administrative and General (A&G), Pensions and Benefits (P&B), Payroll Taxes, Property Taxes, and Injuries and Damages. Portions of these expenses are ultimately

capitalized. These capitalized pieces constitute Corporate Overheads and are allocated to the various plant projects as described above. However, the original five expenses are subject to revisions by ORA's witnesses. If these expenses change, the amounts that are capitalized should also change. As originally configured, the Corporate Overhead figures were static; that is, changes to any of the five expenses would not automatically flow through to the Corporate Overheads total. In a data request, ORA asked SCE to automate this calculation. In the most recent version of the model, SCE linked four of the five expenses to the Corporate Overheads total; if estimates for these expenses are lowered, the capitalized portions in Corporate Overheads will also be lowered. Only adjustments to the Pensions and Benefits estimates must be manually reflected in Corporate Overheads.

VI. FORMAT OF COMPUTER-GENERATED PLANT TABLES

The Plant tables produced by SCE's RO computer model do not precisely conform to the BU format used in its workpapers, which can complicate matters. For example, SCE's RO model creates a General Plant line, even though there is no BU with that name. Instead, SCE's model aggregates various capital expenditures (items such as furniture and equipment, telecom, computers, etc.) into the General Plant category; Chapter 16-G (which analyzes capital additions for the Corporate Center) is completely rolled into General Plant by SCE's model. Similarly, portions of other plant chapters will actually end up as part of General Plant. This "relocation" of capital additions does not affect the total amount of capital additions; it simply is a different way of "slicing up the pie."

VII. USE OF RECORDED 2001 PLANT DATA

When SCE prepared its estimates for this application, it did not yet have access to recorded 2001 data. As a result, SCE's exhibits and workpapers contain estimates for 2001 plant additions. Those estimates were based on SCE's 3rd Period 2001 Capital Budget, dated November 16, 2001.

Each of ORA's witnesses had access to 2001 recorded data. Therefore, ORA's capital witnesses had no need to develop estimates for 2001 plant additions; ORA's analyses and recommendations only cover 2002 and 2003 capital additions.

Plant-In-Service balances are cumulative in nature; additions during a year are added to that year's beginning-of-year (BOY) plant balance. Therefore, the last (most recently) recorded BOY plant balance serves as the "starting point" to which all future estimates for capital expenditures are added. Because of access to recorded 2001 data, the "starting point" for ORA is the recorded 2002 BOY balance. For SCE, this "starting point" is the recorded 2001 BOY balance; it then needs to add its estimates for 2001 capital additions to derive its estimate for the 2002 BOY balance. ORA's use of this more up-to-date starting point has resulted in large Plant-In-Service differences. ORA's recorded 2002 BOY balance is $216.8 million less than SCE's estimated 2002 BOY balance.

VIII. WEIGHTED AVERAGE PLANT-IN-SERVICE

All of the analyses, recommendations, and adjustments made by ORA's witnesses to the capital additions in all seven chapters of Chapter 16 are reflected in the Weighted Average Plant-In-Service balance. It is this balance that is transferred to Rate Base, and SCE is allowed to earn a return on it. However, before that can take place, it is necessary to determine at what point during the year the adjusted capital additions should be booked.

When a capital project is completed, it is added to the Plant-In-Service balance, and it begins earning a return. However, plant additions occur throughout the year; the timing of these completions must be taken into consideration so that returns will not be earned before the projects are completed. This "timing" is accomplished by "weighting" a project according to its completion date. A project completed early in the year should be weighted at close to 100%; it should earn a return for nearly the entire year. Conversely, a project completed very late in the year should get an almost 0% weighting.

SCE's RO computer model automatically calculates Weighted Average Plant-In-Service balances based on the estimated completion dates of each of the proposed capital projects. The RO computer model's ability to accurately calculate weighted average

plant balances is only as good as the accuracy of the estimated completion dates it is given; if those dates are overly optimistic or pessimistic, the resulting weighted average plant balances will similarly be in error.

As a check of the reasonableness of the estimated completion dates loaded into the RO computer model, ORA calculated the overall weighting percentage that resulted from the RO model's calculation of the 2003 Weighted Average Plant-In-Service balance. The 2003 weighted average balance generated by the computer is equivalent to a 50.55% overall weighting percentage. In response to an ORA data request, SCE provided recorded monthly plant balances for the years 1992 through 2001. With that data, ORA was able to calculate the recorded overall weighting percentages for the nine-year period 1993 through 2001. The overall weighting percentages for that nine-year period averaged 42.51%.

Clearly, there is a significant difference between when the computer model calculates that capital projects will be completed, and when capital projects have been completed in the past. Based on the data within the computer model, it is calculating that 2003 capital additions will be completed earlier in the year than they have been historically. The 2003 completion dates loaded into the RO computer model are overly optimistic; ORA believes that those 2003 projects will be completed later in the year based on its analysis of historical data. ORA has sought various ways to allow the computer model to generate the 42.51% overall weighting percentage that ORA believes is reasonable.

In response to a data request requesting suggestions on how to accomplish this weighting percentage change, SCE stated that the model does not accommodate a composite weighting percentage approach. However, in response to a verbal request from ORA, SCE did provide a revised version of the model that allowed ORA to more easily change the completion dates that had been loaded into the model.

ORA has developed a methodology whereby the model can be forced to compute the desired overall weighting. To explain this methodology, it is necessary to briefly differentiate between the two different kinds of plant additions contained in the model. The first kind of addition involves capital projects that are coded into the model with definite completion dates (such as October 2003). The second kind of addition involves

capital projects that are assumed to be continuous (such as new service connections) and have no completion dates; these types of additions are coded into the model with a "Monthly" designation, and the computer spreads the estimated additions equally among all 12 months of the year. ORA's methodology involves shifting the completion dates of enough of both types of plant additions to adjust the overall weighting percentage to the desired level.

Changing plant additions that have definite completion dates is straightforward. ORA simply went into the model, found all of the projects that had 2003 completion dates earlier than December, and gave them December dates. However, even with all of the completion dates pushed back to the end of the year, the overall 2003 weighting did not drop to the desired 42.51% level. Therefore, ORA needed to change some of the plant additions designated as "Monthly." This type of change is more difficult. Simply changing the "Monthly" designation to a December 2003 date would produce erroneous results; the computer model would add together all of the expenditures in prior years (which previously had been spread equally among the months of the prior years) and put that total amount into December 2003. As an example, if a project designated as "Monthly" had $1,000 in CWIP, and was estimated to add $1,000 in each of the years 2001, 2002, and 2003, changing the "Monthly" coding to December 2003 would result in the model booking $4,000 in December of 2003; that would clearly be wrong. Instead, ORA's procedure was to add a duplicate "Monthly" project to the model. ORA selected a "Monthly" capital project that had a large addition estimated for 2003. That project was duplicated in the RO model. The original estimate was then changed to zero-out the 2003 additions. The duplicate was changed to zero-out all of the years except 2003; the "Monthly" designation of the duplicate project could then be changed to a definite completion date. This has no impact on the prior years' additions, because all of the prior years in the duplicate project had been zeroed-out. In that fashion, enough additional projects could be given later completion dates so that the RO computer model develops a 2003 Weighted Average Plant-In-Service balance that is equivalent to the 42.51% overall historical weighting found reasonable by ORA.

The last section (specifically, lines 37 through 46) of Table 3 (at the end of this chapter) shows ORA's and SCE's estimates for 2003 weighted average additions for

various plant categories. The estimates for SCE come directly from the computer model. ORA's estimates are derived manually by multiplying the 2003 estimates for net additions (lines 23 through 32) by the 42.51% weighting factor. Line 47, Estimated 2003 Weighted Average Plant-In-Service, is a component of Rate Base and is a line item in the tables in Chapter 18. ORA's estimated weighted average balance is also used as a check for the computer model; completion dates were adjusted by ORA until the total weighted average generated by the computer and the total on line 47 were in close agreement.

IX. CAPITAL ADDITIONS FOR THE CUSTOMERS BU

The Customers Business Unit is one of the 10 BUs created by SCE. SCE provided ORA with a breakdown of capital additions by BU. That document showed that there were five plant additions associated with the Customers BU, totaling $792,000 in 2002 and $2,616,000 in 2003. On page 110 of Exhibit SCE-8, SCE states that the capital additions associated with the Customers BU are discussed in Exhibit SCE-5, Vol. 2. ORA's witness for this area was not able to find any type of discussion, description, analysis, or justification in the indicated volume; nothing could be found in any of SCE's other exhibits or workpapers. Absent any type of justification for these proposed additions, ORA has removed them from the plant balances.

X. PLANT HELD FOR FUTURE USE / INTANGIBLES

Plant Held for Future Use (PHFU) consists of property obtained for future transmission, distribution, and/or general plant facilities. PHFU does not accrue AFUDC while it is waiting to be used; neither does it receive allocations of Corporate Overheads. In D.87-12-066, the Commission established guidelines concerning how long property could remain classified as PHFU. SCE analyzed the various properties it was holding and found that they had either been released for sale, or had exceeded the Commission's guidelines for the anticipated use date. Therefore, SCE included no PHFU balance for either 2000 or 2001. However, SCE is planning to acquire land and building rights for a new Viejo substation. This acquisition is forecasted to occur in December 2002, and is estimated to cost $7.195 million. As discussed in Chapter 16-C, ORA has reduced that amount by 30%.

Three different plant categories (Radio Frequency, Hydro Relicensing, and Miscellaneous) are classified by SCE as Intangibles. Hydro Relicensing is included in the workpapers for the Hydroelectric Generation BU and is analyzed there. However, Radio Frequency and Miscellaneous are not included in any of SCE's workpapers. SCE is not proposing any additions to either of these Intangible categories, and ORA does not recommend any adjustments.

XI. CONCLUSIONS

ORA recommends that:

1. The recorded 2002 BOY Plant-In-Service balance be used as the "starting point" for computing test year plant balances; that recorded balance is $216.8 million less than the estimated 2002 BOY balance used by SCE.
2. An overall 42.51% weighting percentage be found reasonable for computing the 2003 Weighted Average Plant-In-Service balance.
3. ORA's estimates in Tables 1, 2, and 3 be adopted.

For the electronic copy of this report, Table 3, Electric Plant In Service, is attached as a separate file

CHAPTER 16-B

GENERATION

I. INTRODUCTION/SUMMARY

This chapter addresses SCE's capital expenditures in nuclear, coal, hydro and other generation and it presents ORA's analysis, findings, and recommendations.

ORA's analysis and review of SCE's request included, but was not limited to review of the following: SCE's testimony, supporting workpapers, compliance with Commission decisions and an examination of other data received through interviews and data requests.

The following Table represents the difference between SCE and ORA total capital expenditure estimates. (See under the *Conclusions* section for a more detailed breakdown by generating facilities.)

Capital Expenditures
SCE share
Nominal, in $millions

Year	SCE	ORA	Difference
2002	37	21	16
2003	49	36	13
2004	61	41	20
2005	47	33	14

This chapter presents ORA's forecasts of Generation Plant additions for 2002 and 2003. This consists of estimated capital expenditures for Palo Verde, (nuclear), Mohave (coal), Four Corners (coal), hydroelectric facilities, and other generation. ORA has also forecast capital additions associated with the SONGS 2&3 nuclear facilities for 2004 and 2005.

According to SCE, "due to cost recovery uncertainties driven by industry restructuring we have been very conservative for several years in making investments in

these (generation) resources. Thus, a significant investment program is now needed to preserve the plants' long-term viability."[120]

In the course of ORA's review of SCE's Test Year capital estimates, it was evident that projects defined as safety-related, environmental and regulatory took precedence over all other projects. However, SCE mentioned that there are no prioritization criteria for all other capital projects. This inevitably limited ORA's ability in reviewing capital projects with other performance objectives.

In some instances SCE has provided information about other project alternatives explored by the utility and cost/benefit analysis. However, this type of information was not consistently provided for all capital projects.[121]

Furthermore, SCE pointed several times throughout its generation capital GRC application that:[122]

> SCE cannot rigidly "fix" the detailed specific scope of capital work to be implemented in future years. SCE requires flexibility to optimally respond to changing…(regulatory) requirements, plant reliability or operability changes, results of studies and conceptual or preliminary engineering, industry developments, replacement energy costs, and other evolving factors.

The need for flexibility in using capital expenditures to meet changing conditions is a theme resonant in all the generation areas.

ORA interpreted SCE's message for flexibility to mean that the utility reserves the prerogative to change the allocation of capital expenditures depending on changing needs and circumstances. Therefore, ORA's analysis in determining generation capital estimates took a perfunctory review of each project work scope. But, in the absence of knowing how each individual project is part and parcel of a greater plan, ORA decided to focus primarily on the level of capital expenditures.[123]

SCE's estimates for capital projects are usually developed through a bottom-up approach with an action request from a project manager/engineer. The selection of a proposed project is contingent upon receiving budget approval.

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[120] Exhibit SCE-3, Volume 8: Coal Capital, page 5, lines 4-7.
[121] Bear in mind that capital projects categorized as safety, regulatory and/or environmental are not subject to cost/benefit analysis.
[122] Exhibit SCE-3, Vol. 3, page 4.

As described in SCE's testimony, the budget approval process goes through several different stages of review, depending on whether SCE is the operating agent or a co-owner of these generating facilities. For example, the approval process of SONGS and Mohave undergo a multifaceted approval process consisting of various internal and external review committees, with the Administrative Committee being the final arbiter of the budget approval and of unresolved project planning issues. On the other hand, as a co-owner of Palo Verde and Four Corners, SCE is represented primarily in two committees – the Engineering & Operations (E&O) and the Audit committees.

Thus, a project selection is driven by the size of the budget (as approved by the Administrative Committee or the Coordinating Committee) and by project requirements as determined by engineering review at the field level and the E&O Committee. This process is consistently applied to all generating stations. Though safety and regulatory capital projects take precedence over all other projects and, therefore, are not limited to budget constraints.

II. DISCUSSION

A. SONGS 2&3 CAPITAL

The most salient policy issue raised for SONGS 2&3 is SCE's proposed transition from Incremental Cost Incentive Pricing (ICIP) ratemaking mechanism to a return to cost-of-service ratemaking in 2004. It describes this transition as follows:[124]

> Because SONGS 2&3 will remain under the ICIP ratemaking during 2003, this exhibit does not contain a forecast of capital expenditures until the year 2004. Under SONGS 2&3 ICIP ratemaking, SCE fully recovers incremental capital in the same year incurred. With the return to conventional cost-of-service ratemaking in 2004, SCE proposes to recover incremental capital expenditures through capitalization and depreciation over the remaining operating life of the plant.

Capital projects are initiated to meet regulatory requirements, licensing requirements, safety. Other projects fall into what SCE categorizes as "special projects" for plant improvements in performance and cost-effectiveness.

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[123] The only exception was for Other Generation capital, due to the scope and limited costs of those projects.

According to SCE, engineers in the field usually initiate projects for plant improvements by issuing an Action Request, and they are also responsible for developing project cost estimates on the basis of personal experience, pricing manuals and/or inquiries with vendors.

There is a multi-layered "work authorization or approval" process in place, which involves local, department, corporate review and final approval from all the plant owners (i.e. through established committees) to determine the validity of the project and the accuracy of the cost estimate.

On the decision-making process SCE mentions in its testimony that it reviews the capital budget quarterly.[125] However, "the discussion focuses on the year-to-date performance and emergent items for the current budget year. Action items are assigned to the cost professionals to initiate or modify budgets as a result of this review. There is no formal presentation package and no meeting minutes are kept for these reviews."[126]

There are three major work categories identified for SONGS 2&3: 1) Special Projects, 2) Plant Modifications and 3) Department Annual Program (DAP).[127]

SCE is requesting $61 million for 2004 and around $47 million for 2005 for projects in service in 2004-2005.

According to SCE:[128]

> The Site Integrated Project Committee (SIPC) has the responsibility to approve and establish the timing (prioritization) of SONGS' projects. SCE identifies and implements O&M and capital projects as necessary to meet regulatory requirements, for continued safe and reliable plant operation, or to optimize overall cost-effective plant operation. SCE does not rigidly "fix" the specific scope of work to be implemented in future years. SCE requires flexibility to optimally respond to changing NRC requirements, plant reliability or operability changes, industry issues, and other evolving factors. SIPC manages the projects within the established budget or obtains an approved budget revision. However, adherence to budget is never to interfere with regulatory compliance and safety requirements…

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[124] Exhibit No: SCE-3, Vol. 1 - Policy, page 10, lines 16-22.
[125] Exhibit No.: SCE-3, Vol. 3, page 5, line 8.
[126] DR-ORA-080, question #1a.
[127] See Exhibit SCE-3, Vol. 3, Tables III 1 through 4 for a cost breakdown within each of these categories.
[128] Data Request ORA-Verbal-15, question #1.

> SCE carefully controls the timing of capital expenditures to achieve the most cost effective timeframe for such expenditures. SIPC integrates all outage, non-outage, capital and O&M projects to ensure proper timing and resource allocation.

ORA found out that there were only two projects that have been vetted and approved by the SIPC for 2004-2005 and these are: 1) the Used Fuel Dry Storage project and 2) Cycle 13 Modifications (Units 2&3) -- Used Fuel Rack Modifications.[129]

The most substantial project listed in terms of cost is the Used Fuel Dry Storage estimated at $22 million for 2004 and around $12 million for 2005. This is for continued safe storage of used fuel in the SONGS 1 used fuel pool "until it is all removed and placed in dry storage, and routine equipment shutdown and decontamination activities are complete."[130] The removal of all used fuel from the SONGS 1 used fuel pool will be done in the 2004-2005. Once that removal occurs, shutdown O&M costs will be removed from rate base.[131]

ORA requested information as to how the establishment of Yucca Mountain as permanent repository for spent nuclear fuel and high-level radioactive waste might change/modify the need for this Used Fuel Dry Storage Project.[132] And in SCE's opinion:[133]

> The funding request in this GRC is not impacted by the status of the Yucca Mountain Project. If licensed, DOE indicates the first possible date for used fuel acceptance at the facility would be 2010. SCE must construct and load the Used Fuel Storage Facility because the SONGS 2 & 3 fuel pools will run out of space prior to the date SONGS 2 & 3 used fuel can be first transported to the permanent repository (currently identified as 2021).

The following is a description of the capital items to be removed from SONGS 2&3 Post-Test Year estimate (2004-2005):

1) Wetlands Reclamation

ORA removed the following amounts:

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[129] Data Request ORA-Verbal-15, question #1.
[130] Exhibit No: SCE-3, Vol. 1 - Policy, page 14, lines 9-12.
[131] Exhibit No: SCE-3, Vol. 1 - Policy, page 14.
[132] President G.W. Bush signed House Joint Resolution 87 on July 23, 2002, designating Yucca Mountain as a permanent repository to meet nuclear waste storage needs for the entire nation. (See Press release dated July 23, 2002, at www.whitehouse.gov/news/releases.)

For 2004 $12 million (SCE share $9 million)

For 2005 $12 million (SCE share $9 million)

This is a change from SCE's Notice of Intent and its Application filing. The amendment of the Earth Island lawsuit settlement on August 17, 2001, effectively ended SCE's obligation to restore additional wetlands acreage at San Deguito. However, SCE requests to continue with this project, because "it is in the ratepayers' best interest to proceed with plans to restore about 20 additional acres…" and that through the sale wetlands credits this additional acreage restoration "is expected to have no effect on customer rates (since it will be self-funded)…"[134]

ORA inquired as to how this sale works and whether any analysis was conducted specific to this issue. SCE's response states that:[135]

> No formal analysis was conducted. The process consists of three main steps, each of which must be completed before the next will be initiated, in order to ensure that the project is self-funding and that success is highly likely: (1) SCE negotiates Mitigation Banking Agreement (MBA) per U.S. regulations with authorizing regulatory agencies. If the agreement is acceptable to SCE, then (2) SCE pre-sells rights to future restoration credits to a third party for a negotiated price. The negotiated price must cover at least construction cost plus contingency. Purchaser must deposit an amount sufficient to cover construction costs prior to construction. Deposit is not refundable once permits for construction are acquired, but rights to credits may be sold by purchaser. (3) Construction (restoration) of additional acreage proceeds, concurrent with construction of mitigation project acreage, followed by 3-5 years of monitoring to verify restoration success in accordance with MBA. Upon verification of restoration success, authorizing agencies issue credits, which are then turned over to purchaser for payment of balance of negotiated credit price.

ORA cannot support this type of project without any clear evidence of its benefits to ratepayers and suggests that if SCE is keen to proceed with this Wetlands Reclamation project it should do so at shareholders' risk.

2) Used Fuel Pool Racks Modifications (Boraflex)

ORA removed the following amounts:

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[133] Exhibit No.: SCE-3, Vol. 3, page 16, Footnote #10. And DR-ORA-081.
[134] Exhibit No: SCE-3, Vol. 3, page 46, lines 3-6 and pg. 47, lines 6-8.
[135] DR-ORA-097, question #2.

For 2004 $694K (SCE share $521K)
For 2005 $761K (SCE share $571K)

After its General Rate Case Application filing SCE changed its estimate for this project and it was confirmed in a data request response.[136] ORA accepts this change.

3) Replacement of Offsite Sirens / Monitors

ORA removed the following amounts:

For 2004 $3,635K (SCE share $2,728K)

For 2005 $300K (SCE share $225K)

The replacement of Community Alert Siren system was requested for 2004 and 2005 for SONGS 2&3. SCE acknowledges that the sirens currently in use have seriously deteriorated, are obsolete and that there are only two spare sirens available for 49 old/obsolete sirens. FEMA has not conducted an assessment/drill of this alarm system in five (5) years. SCE maintains that it needs another two-year testing period for a new system. So the question ORA posed is: What happens between now and 2004 if there is equipment failure? SCE mentions that in case there is an unexpected multiple failure that cannot be fixed with the equipment on hand (i.e. the two spare sirens available for the 49 existing sirens), SONGS would then install new equipment prior to the 2004 replacement program.[137]

The following are the reasons cited by SCE for not including this project prior to the end of the ICIP period – prior to December 31, 2003:[138]

> The offsite community alert siren system fulfills Federal regulatory requirements (10CFR50.47, NUREG-0654 and FEMA REP-10), is a licensing commitment, and is a vital communication tool for protecting the health and safety of the public. SONGS has a regulatory responsibility to maintain the sirens in an operable condition. Adequate testing is needed to ensure a seamless transition to the new system without risking public health and safety. The current plan for replacing the balance of the sirens and the control and monitoring system achieves this goal.

[136] DR-ORA-Verbal-3, question #2.
[137] Exhibit No: SCE-3, Vol. 3, page 29.
[138] DR-ORA-Verbal-3, question #3.

As discussed in the testimony, SCE identifies and implements capital projects as necessary to meet regulatory requirements, for continued safe plant operation, or to optimize overall cost-effective plant operation. SCE carefully controls the timing of capital expenditures in an attempt to manage the risk associated with determining the most cost effective timeframe for such expenditures.

> Based on the material condition of the mechanical sirens and the expected useful life in 1999, SCE initiated plans to replace the Offsite Community Alert Siren System. At this point, we determined that replacing the sirens during the ICIP period was not necessary to meet regulatory requirements, for continued safe plant operation, or to optimize overall cost-effective plant operation.

SCE investigated and selected an appropriate vendor and performed preliminary qualification tests on electronic sirens from late 1999 through 2000. In July, 2001, SCE obtained pre-approval from FEMA to replace the sirens. Nuclear's Computer Engineering Division is currently writing the specifications for the digital control system required to support the new sirens. Specifications are due by August, 2002. The design of the new control and monitoring system is expected to be completed in March, 2003. Once the design is complete, the control and monitoring system will be developed and tested, starting in April, 2003, and installed to function in parallel with the existing control and monitoring system in March 2004.

> The two electronic sirens installed in 2001 have provided us with valuable data points on solid state technology and solar power arrays. As a result of the satisfactory performance of the sirens installed in 2001, two additional electronic sirens will be installed in early 2003. This will provide one entire jurisdiction, or geographic area, with which to properly test and integrate the new control and monitoring system. Design and testing will continue on the system through 2003 and into 2004.

Starting in March, 2004, the remaining 45 sirens will be replaced along with the control and monitoring system. Work is progressing on the project but can not be completed prior to 2004 due to the engineering required for the control and monitoring system, which is not expected to be completed until March, 2004.

There might be some weight to the engineering timing required to test this system. ORA was not provided with information to support that contention. However, SCE is deferring to act on a critical part of its public safety mechanism until the plant reaches a crisis mode.

This approach becomes even more bewildering, when one considers SCE's request for an incremental in O&M of about $6 million for new security requirements at SONGS 2&3 as a result of September 11 threats.[139] And at the same time SCE maintains that the replacement of sirens to alert the community in case of dangers will have to wait another two years - until the pilot program on the new sirens is complete. ORA views that there is no justification for the delay in implementing this project now under the Incremental Cost Incentive Pricing mechanism, especially in light of the fact that there has been no recent FEMA assessment to assure the reliability of the existing sirens.

Overall, a comparison of SCE's GRC request with a five-year average (1996-2000) of capital expenditures and with the Last Recorded Year (2000) indicate steep increases for years 2004 and 2005 that far exceed the most recent historical record.

[139] See Adjustment #45 on New Security Requirements for SONGS 2&3 under ORA's O&M section.

SONGS 2&3 Capital Expenditure Increase

At SCE share

Comparison with 5-Yr Avg
(1996-2000)

Years	SCE	5-Yr Average	Increase	% increase
2004	61,318	23,414	37,904	162%
2005	47,456	23,414	24,042	103%

Comparison with Last
Recorded Year (2000)

Years	SCE	LRY (2000)	Increase	% increase
2004	61,318	10,672	50,646	475%
2005	47,456	10,672	36,784	345%

Sources:

- 5-Year Average and Last Recorded Year from DR-ORA-124
- SCE's estimates are from Table III-1, Exhibit No.: SCE-3, Vol.3, page 14.

ORA views SCE's GRC capital expenditure forecast as excessive in light of the historical record. Thus, ORA proposes to include in its 2004 and 2005 SONGS 2&3 capital forecast the following:

- The Used Fuel Dry Storage project and Cycle 13 Modifications (Units 2&3) -- Used Fuel Rack Modifications: as previously mentioned these are the only two capital projects, which have been properly evaluated and authorized by the SIPC; in addition, to recognizing the need for used fuel storage. However, ORA views these expenditures as exceptional and as such are not reflective of future capital expenditure forecasts.
- ORA removed and/or changed amounts as explained in points 1 through 3 above.

- Furthermore, ORA added a five-year average (1996-2000) to cover capital expenditures for all other projects under SCE's GRC request to meet regulatory requirements, as well as special projects, plant modifications and department annual program expenses. ORA maintains that a five-year average (1996-2000) is more indicative of future capital expenditures and therefore expenditures have been limited to this level.

Thus, ORA proposes the inclusion of the following projects and capital expenditures:

SONGS 2&3 CAPITAL

2004	Work Order	SCE	ORA		Difference
Special Projects					
Used Fuel Dry Storage	1839-6022	22,325	22,325	(a)	-
Wetlands Reclamation	1839-0455	12,000	-	(b)	12,000
Used Fuel Pool Racks	1832-6033	1,500	-	(c)	1,500
	1838-6033	400	1,206	(c)	(806)
Replace Offsite Sirens	1836-0319	3,635	-	(d)	3,635
All Other Projects		41,810	31,198	(e)	10,612
Total Capital @ 100% of cost		81,670	54,729		26,941
Total @ SCE share		61,318	41,074		20,244

2005					
Special Projects					
Used Fuel Dry Storage	1839-6022	11,860	11,860	(a)	-
Wetlands Reclamation	1839-0455	12,000	-	(b)	12,000
Used Fuel Pool Racks	1838-6033	2,000	1,239	(c)	761
Replace Offsite Sirens	1836-0319	300	-	(d)	300
All Other Projects		37,055	31,198	(e)	5,857
Total Capital @ 100% of cost		63,215	44,297		18,918
Total @ SCE share		47,456	33,245		14,211

Sources:
SCE's estimates are from Table III-1, Exhibit No.: SCE-3, Vol.3, page 14.
ORA's estimates are from:
(a) Table III-1, Exhibit No.: SCE-3, Vol.3, page 14.
(b) DR-ORA-097 and Differences between NOI and Application
(c) DR-ORA-Verbal-3, question # 2.
(d) Table III-1, Exhibit No.: SCE-3, Vol.3, page 14
(e) DR-ORA-124 for five-year average of capital expenditures

ORA's proposal limits SONGS 2&3 capital expenditures at the recorded five-year average (1996-2000) level of $31,198K (at 100% of project cost), or $23,414K at SCE's

share. SCE also "expects near term capital expenditures to remain similar to the recent 5-year average of $30 million (at 100% of project cost) per year…"[140]

ORA considers the capital increases specific to years 2004 and 2005, in reference to the Used Fuel Dry Storage project and Cycle 13 Modifications (Units 2&3) -- Used Fuel Rack Modifications, as one-time exceptional capital expenditures.

ORA recorded the proposed changes for SONGS 2&3 capital expenditures as one blanket line item in SCE's Results of Operations model.

B. PALO VERDE CAPITAL

SCE is requesting $19.4 million in capital expenditures for Palo Verde. Again as described in SONGS 2&3, SCE requests flexibility in the management of capital expenditures in order to meet changing circumstances and requirements.

According to SCE, Palo Verde capital expenditures will be dealt with as follows:[141]

> Pursuant to the current Palo Verde ratemaking mechanism capital expenditures incurred prior to 2003 will be recovered as "expense" and any portion incurred in 2003 will begin the capitalization and depreciation process for conventional recovery over the operating life of the plant. SCE capital projects placed in service for Palo Verde will be $19.4 million in 2003 (SCE share, year of expense) at which time the steam generator replacement will be completed on Unit 2.

The most significant capital expenditure is for Unit 2 Installation of Steam Generator at $9.4 million. This constitutes approximately half of the total capital estimate for Palo Verde.[142]

ORA reviewed the minutes of the meetings of the Palo Verde Engineering and Operating Committee (E&O Committee) from 1996 to date and found that the issue of steam generator replacement for Unit 2 as a result of degradation has been an on-going topic of discussion among the various Palo Verde co-owners.

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[140] Exhibit No: SCE-3, Vol. 1 - Policy, page 11, lines 16-17 and Exhibit No: SCE-3, Vol. 3, page 2, lines 17-19.

[141] Exhibit No: SCE-3, Vol. 1 - Policy, page 13, lines 9-11, and page 14, lines 1-3.

[142] SCE states that "due to the nature and timing of the Project, the (SG) Steam Generator installation is not likely to be deferred (in favor of other projects)." (Jose Perez, SCE Manager, email dated October 4, 2002.)

SCE explained that Palo Verde capital projects are part of a multi-year capital improvement plan and that supporting documents are not available for projects scheduled to begin in 2003.[143]

On the basis of the information provided in SCE's testimony, workpapers and data request responses, ORA proposes that a 5-year average of historical expenditures (1996-2000) be used as more indicative of the 2003 capital forecast at $8.2 million, and that the Unit 2 Installation of Steam Generator at $9.4 million be added as an extraordinary capital expenditure. Thus, the total estimate for Palo Verde amounts to $17.6 million, which represents a difference of $1.8 million from SCE's forecast.

ORA recorded the proposed changes for Palo Verde capital expenditures as one blanket line item in SCE's Results of Operations model.

C. MOHAVE CAPITAL

SCE is requesting a total of about $7 million for 2002 and $10 million for 2003 in capital expenditures for Mohave. The estimate for year 2002 is comparable to the 5-year (1996-2000) capital expenditure average. However, the 2003 estimate is a 33% increase from the 5-year average.

These capital projects have been approved after undergoing an internal review process consisting of local, departmental and corporate review, as well as external review through the E&O (Engineering & Operation) Committee and the Coordinating Committee.[144] However, the projects approved may or may not be implemented depending on whether there are other superseding requirements, i.e. in terms of regulatory compliance and/or safety.

In its testimony, SCE asserts that the "capital investment plan includes a number of projects that will result in O&M cost savings…" which fall in two categories: [145]

> (1) estimated reductions in future years; and, (2) avoided increases in future years. Each is a forecast that is developed by the engineering as a component of the project justification process. These estimates (where

[143] DR-ORA-147, question #1.
[144] "Currently, all capital expenditures are subject to Corporate CRT (Capital Review Team) review because of SCE's distressed financial condition." (Exhibit SCE-3, Volume 8: Coal Capital, page 18, lines 6-7.)
[145] Exhibit SCE-3, Volume 8: Coal Capital, page 4, lines 7-8, and DR-ORA-095 question # 5.

applicable) are summarized in the justification document for the particular project.

However, ORA found that SCE's request for Mohave capital expenditures in 2002 at $7 million and in 2003 at over $10 million will result in zero (0) and $40K in O&M cost reductions respectively.[146] No details were provided in SCE's testimony, workpapers and data request responses about how it determined O&M cost avoidance for those projects.

SCE ascertains that these capital investments are necessary to maintain reliable operations through 2005, for example in terms of employee safety and environmental protection. And the utility stresses that "no spending or investment to extend operation beyond 2005 is included in its estimate."[147]

This latter statement is important, because SCE filed Application 02-05-046 regarding the Future Disposition of Mohave.[148] The application raises various contentious issues over SCE's ability to secure coal supply and transportation, access to a water source, and meeting with environmental targets as stipulated under a 1999 Consent Decree. ORA questions whether SCE's approach of keeping to the "same capital investment levels as experienced prior to the impact of divestiture" is warranted now that there is a likelihood of a shutdown. This inevitably raises serious issues and uncertainties about the benefit of capital investments as envisioned in the GRC, especially in light of the fact that SCE proffers to adopt "the same capital investment levels as experienced prior to the impact of divestiture (meaning 1996-1998)."[149]

ORA filed a motion to dismiss without prejudice A. 02-05-046 on the basis that there is insufficient information on the future disposition of Mohave, as elaborated in its filing, in terms of economic analysis and alternative approaches. The provision of such information is essential in determining whether the capital expenditures are warranted as formulated in the GRC. ORA is considering only those projects that are earmarked as regulatory, safety and environmental. Even though there is no prioritization criteria

[146] Exhibit SCE-3, Vol. 8, Appendix A, Table A1 and DR-ORA-095 question #5.
147 Exhibit No: SCE-3, Vol. 1 - Policy, page 19, lines 3-5.

[148] For a more detailed description of Application 02-05-046, see ORA's Generation Expenses for Mohave.
[149] Exhibit No: SCE-3, Vol. 1 - Policy, page 18 lines 8-9.

adopted by SCE in determining which capital projects are critical for operation between now and 2005, SCE states that:[150]

> SCE does not have a prioritization list for its capital improvements projects. Projects are evaluated individually... In general, performance objectives associated with employee safety or environmental objectives are considered to have high priority. Capital projects intended to improve plant reliability are viewed from a standpoint of their relative net present value and benefit to cost ratio.

ORA examined the testimony and determined that capital projects identified as safety-related and/or environmental total $514K in 2002, and $1.1 million for 2003. In addition, ORA recalculated Mohave's Blanket Work Orders at a 5-year average (1996-2000) to $384K to reflect expenditures during the more recent period rather than using SCE's 10-year average. (See Appendix A for ORA's Mohave capital estimate.)

All capital projects for Mohave, including Blanket Work Orders, will total of around $898K for 2002 and approximately $1.5 million for 2003, instead of the $7 million which SCE is requesting for 2002 and over $10 million for 2003. This amounts to a difference of $6 million (2002) and approximately $9 million (2003) from SCE's estimate. Thus, ORA is deferring Mohave's remaining capital request to A. 02-05-046 on the *Future Disposition of Mohave* or any other subsequent proceeding.

The following is a summary of the capital amounts to be removed for Mohave:

For 2002	$6 million (SCE share)
For 2003	$9 million (SCE share)

ORA recorded the proposed changes for Mohave capital expenditures as one blanket line item in SCE's Results of Operations model.

D. FOUR CORNERS CAPITAL

SCE is requesting capital funding of $8.8 million for 2002 and $4.1 million for 2003 for Four Corners.[151] This funding request represents:[152]

[150] DR-ORA-112, question #3 under "Coal".
[151] These expenditures are at SCE's share of 48%.
[152] Historical expenditures in DR-ORA-162.

- For 2002, a threefold increase from a 5-year average of historical expenditures (1996-2000) and a 120% increase from the Last Recorded Year (2000); and
- For 2003, a 71% increase from a 5-year average of historical expenditures (1996-2000) and a 4% increase from the Last Recorded Year (2000).

These levels of expenditures are justified by SCE on the basis of the aging equipment, which is in some cases is over 30-year old and now at or near the end of its useful life.[153]

As the operating agent of Four Corners, Arizona Public Service (APS), presents specific capital projects and budget estimates to the E&O Committee, and a Coordinating Committee acts as the final arbiter of budget approval and budget items seeking resolution.[154] SCE, as a co-owner of this facility, maintains an oversight role in both these committees.

SCE's capital estimates of $8.8 million for 2002 and $4.1 million for 2003 will result in $543K and $683K in O&M cost reductions respectively.[155]

As in previous generation-related capital expenditures, SCE prioritization is limited to those projects identified as safety-related, environmental and/or regulatory. But, SCE has no system in place for how other capital projects with different performance objectives are to be prioritized.[156]

ORA found that the work scope data provided for each capital project in SCE's workpapers was lacking in detailed cost breakdown of estimates. On the details of the estimate and how it was developed, SCE states:[157]

> Supporting cost estimating information applicable to Four Corners Generating Station capital expenditures were developed by Arizona Public Service Company (APS).

And therefore, this information was not available for ORA's review.

[153] Exhibit SCE-3, Vol. 8, page 74.
[154] DR-ORA-136, question 2b on Four Corners.
[155] Exhibit SCE-3, Vol. 8, Appendix A, Table A1 and DR-ORA-095 question #5.
[156] DR-ORA-148, question # 3.
[157] DR-ORA-095, question #4.

SCE also mentions that the capital projects provided in its GRC application are not part of an integrated program.[158] ORA interpreted that to mean that projects are included on the basis of ad hoc formulation and planning.

In light of the negligible O&M savings as a result of these capital expenditures, the lack of information on the prioritization of projects, and the lack of a detailed cost breakdown for each capital project, ORA maintains that capital expenditures for Four Corners be limited to a 5-year average (1996-2000) of historical cost at $2.4 million and the addition of projects identified by SCE as safety-related, environmental and/or regulatory. [159] (See Appendix B for project work order list.) These latter projects amount to $481K for 2002 and $499K for 2003. ORA's total estimates represent an increase of approximately 20% over the most recent recorded average of capital expenditures for Four Corners and result in a difference of $6 million for 2002 and $1.2 million for 2003 from SCE's forecast.

ORA recorded the proposed changes for Four Corners capital expenditures as one blanket line item in SCE's Results of Operations model.

E. HYDRO CAPITAL

The Hydro capital funding request is $17.7 million for 2002 and $15.1 million for 2003. [160] SCE indicates in its testimony that:[161]

> With the exception of a one-time change in accounting treatment which caused hydro capital expenditures to appear higher in 2000, capital expenditures on hydro have decreased somewhat in recent years.

SCE's capital estimates for 2002 and 2003 represent an increase of 18% and of 5% respectively from the 4-year average of historical expenditures (1996-1999).[162] The

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[158] DR-ORA-148, question # 1.
[159] There were no environmental projects for 2002 and 2003.
[160] See breakdown in Table VI-20 on Hydro Generation Projects: 2001-2003 Expenditures. (Exhibit No.: SCE-3, Volume 9, pages 106-112.
[161] Exhibit No.: SCE-3, Volume 1, page 25, lines 1-3.
[162] ORA noted year 2000 as an anomaly due to the one-time accounting change mentioned in Footnote # 161, and therefore not useful in a comparison between 2002 and 2003 annual forecast and a 5-year average of recorded expenditures (1996-2000). (See Recorded Direct Capital Expenditures in DR-ORA-124.)

utility maintains that this level of capital expenditures is necessary in maintaining reliable service of aging units.[163]

Furthermore, consistent with similar requests for other generating facilities, SCE is proposing in 2003 a change in ratemaking mechanism from performance-based to cost-of- service ratemaking.[164] ORA has considered forecast expenditures within this context.

Project proposals are initiated by the project manager or sponsor, and then are approved by the Hydro Finance Team, which sorts these projects in descending order of priority. [165]

Hydro capital projects are categorized "in (the) order of decreasing Corporate strategic importance are: (1) Safety, (2) Environmental/Regulatory, (3) Cost, (4) Reliability / Availability, and (5) Lost Generation."[166] There is no further prioritization outlined beyond this order in determining the pipeline of projects in terms of importance, for example critical projects in meeting reliability performance objectives.

As stated previously in other capital areas, a detailed estimate breakdown and an explanation on how it was developed were not available for all Hydro capital projects. For example, ORA asked SCE to provide a detailed breakdown of capital additions for wicket gates replacements. SCE's response - pursuant to Public Utilities Code 583 and General Order No. 66C Public disclosure restricted- provided only two line items marked as *Wicket Gate Cost* and *Labor to Install*.[167]

On the basis of the information provided in SCE's testimony, workpapers and data request responses, ORA contends that a 4-year average (1996-1999) is more indicative of recent historical capital expenditures, and year 2000 was omitted from the analysis due to change in accounting treatment as identified by SCE.

Furthermore, SCE raised the issue of aging hydro facilities/equipment as the main justification for its level of capital expenditure forecast. However, upon reviewing SCE's workpapers, ORA found out that eighteen (18) project documents have a projection on probability of failure and out of these only four (4) projects in 2002 and 2003 were

[163] Exhibit No.: SCE-3, Volume 9, page 78.
[164] Exhibit No.: SCE-3, Volume 1, Executive Summary, III. Hydroelectric Generation.
[165] In certain cases a further review by the corporate Capital Review Team (CRT) may be needed for some projects. (Exhibit No.: SCE-3, Volume 9, page 79.)
[166] DR-ORA-106, question # 3.

evaluated at a 45% or higher probability of failure.[168] These five projects totaled in cost $238K in 2002 and $460K in 2003. These amounts can be easily absorbed within the proposed average historical expenditure level (1996-1999).

Thus, ORA recommends that the 2002 and 2003 capital estimates be limited to $14.4 million: for those respective years this represents a difference of $3.2 million and $689K from SCE's estimate.

ORA recorded the proposed changes for Hydro capital expenditures as one blanket line item in SCE's Results of Operations model.

F. OTHER GENERATION CAPITAL

There are only two projects outlined for Other Generation Capital and these are:

1. SCE will purchase and installation of the Selective Catalytic Reduction (SCR) System for the six diesel generators in 2002, in order to meet the NOx requirements for 2003. "The SCRs will reduce NOx by 905 to levels below the RTC holdings. Excess RTC (Reclaim Trading Credit) holdings will be sold and credited against O&M expense. The capital expenditure for the SCR is $2.5 million in 2002.[169]
2. A project for the repair and upgrade of the fuel pier in 2002, which consists of "refurbishing an existing pier on Catalina Island and constructing fuel offloading facilities to permit direct fuel deliveries by barge to the Pebbly Beach Generating Station.[170]

The repair and upgrade of the fuel pier project was estimated at a cost $0.8 million in 2002.[171] However, in DR-ORA-146, SCE mentions that the Fuel Pier project's actual cost is less than the amount identified in its testimony.[172] Thus, ORA removed $445K from Other Generation capital.

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[167] DR-ORA-064, question # 2.
[168] Workpapers SCE-3, Volume 9, Chapter VI, pages 88, 97, 169, and 174.
[169] Exhibit No: SCE-3, Vol. 10, Other Generation page 15, lines 10-15.
[170] DR-ORA-146, question # 2a.
[171] Exhibit No: SCE-3, Vol. 10, Other Generation page 15, lines 22-25.
[172] DR-ORA-146, question # 2a.

SCE also states that long-term generation requirements for Santa Catalina Island (SCI) "will occur outside the rate case period and are not included in the capital forecast for this GRC."[173]

[173] Exhibit No: SCE-3, Vol. 10, Other Generation page 15, lines 16-21.

III. CONCLUSIONS

On the basis of SCE information and ORA's analysis and findings, the capital expenditure estimates differ in the following amounts:

CAPITAL EXPENDITURE ESTIMATES 2002 - 2005

Nominal ($000)
SCE share

	SCE	ORA	SCE exceeds ORA by:
2002			
Mohave	7,194	898	6,296
Four Corners	8,858	2,858	6,000
Hydro	17,690	14,432	3,258
Other Generation	3,300	2,855	445
Subtotal	37,042	21,043	15,999
2003			
Palo Verde	19,479	17,643	1,836
Mohave	10,442	1,563	8,879
Four Corners	4,135	2,876	1,259
Hydro	15,121	14,432	689
Subtotal	49,177	36,514	12,663
2004			
SONGS 2&3	61,318	41,074	20,244
2005			
SONGS 2&3	47,456	33,245	14,211

APPENDIX A

IMPACT OF MOHAVE FUTURE DISPOSITION APPLICATION
Capital Expenditures for 2002 and 2003
Nominal $ - SCE Share
Source: SCE-3, Vol. 8, Table A-1 in Appendix A and pages 92-96

Environmental

Direct Replacements	Work Order	**2002**	**2003**
Inactive Sump Water Line to Influent Tank	1320-0618	45,000	
Replace Ground Water Wells	1320-0625	56,000	280,000
Upgrades And Modifications	**Work Order**		
Ash Canyon Landfill Improvements	1320-0626	77,000	88,000

Safety

Direct Replacements	Work Order		
Boiler Insulation Replacement	1320-0629	196,000	196,000
Swamp Cooler Replacement, Mill, B&C/Machine Shop	1320-0624	28,000	
Upgrades And Modifications	**Work Order**		
Air Preheater Hot End Basket Handling Platform	1320-0616	112,000	
Fire Pump/Motor Replacement	1320-0646		140,000
New Plant Additions	**Work Order**		
Facility Substation Addition	1320-0617		476,000
Subtotal		514,000	1,180,000
Plus Mohave Blanket Work Orders*		383,590	383,590
Total ORA estimate		897,590	1,563,590

* Mohave Blanket Work Orders: from DR-ORA--095
Question # 21a.

APPENDIX B

Four Corners

100% of Project Costs
Nominal ($000)
Source: SCE-3, Vol. 8, Table A-1 in Appendix A and pages 92-96

Plant Safety

Work Order #	Direct Replacements	2002	2003
1330-0365	Purchase Overhaul &Maintenance Tools	140	140
1330-0374	Elevator Controls Replacement, Units 4 &5		
	Upgrades And Modifications		
None	Training Facility		300
1330-0367	Modify Drainage System Adjacent to LVWW Pond	512	
	New Plant Additions		
None	Lined Ponds	350	600
Subtotal	At 100% of Project Cost	1,002	1,040
Subtotal	SCE's share (at 48%)	481	499
Plus	5-Year Average of Capital Expenditures (1996-2000)*	2,377	2,377
Total ORA Estimate		2,858	2,876

* Source DR-ORA-162.

CHAPTER 16-C

TRANSMISSION AND DISTRIBUTION

I. INTRODUCTION

This chapter contains ORA's analysis and recommendations for Transmission and Distribution (T&D) Electric Plant additions proposed by Southern California Edison (SCE) for the years 2002 and 2003[174]. Electric Plant is made up of all the equipment (poles, transformers, cable, tools, etc) necessary to deliver electricity to the end user, as well as the labor used in designing and installing this equipment.

II. SUMMARY

Table 16C-1 contains SCE's forecast of total T&D capital expenditures for years 2001 - 2003. For discussion purposes SCE divided the capital forecast into eight major categories.

[174] ORA uses recorded 2001 per ORA witness Wilson

Table 16C-1
SCE Proposed Capital Expenditures
2001-2003
($000's)

Categories	Prior	2001	2002	2003
Customer Growth	$0	$154,198	$147,028	$164,505
Load Growth	43,798	81,190	159,045	170,597
Capital Replacement And Automation	0	171,871	281,586	324,525
Storms and Claims	0	29,990	30,889	31,816
Customer Requests	2,965	42,678	41,247	55,770
Conversion of Overhead Lines	10,546	42,296	59,774	65,082
Capitalized Software Savings	0	0	(1,400)	(3,000)
Other	25,030	31,168	38,182	19,316
Total	$82,339	$553,390	$756,351	$828,611

Capital expenditures are booked as additions to plant in service, a component of ratebase, when the associated projects become operational. SCE's forecast uses recorded 2000 as its base and reflects expenditures budgeted for the years 2001-2003. ORA utilized recorded 2001 as the base year for its recommendations and estimated expenditures for the years 2002-2003. Table 16C-2 compares SCE's proposed and ORA's recommended T&D capital forecast for years 2002 and 2003.

Table 16C-2
Electric Plant Expenditures
2002-2003
($000's)

Year	SCE Proposed	ORA Recommended	Difference SCE - ORA
2002	$756,351	$529,445	$226,906
2003	828,611	580,027	248,584

III. BACKGROUND

SCE forecasts T&D capital expenditures using their capital budgeting process. SCE describes the process as several cross-functional management teams reviewing the planned capital projects and expenditure before becoming part of the approved capital budget. The capital budget is made up of two kinds of expenditures, capital projects and blanket work orders.

Capital projects have a scheduled Close Date and all expenditures are held in Construction Work In Progress (CWIP) until the project is closed. The expenditures are then removed from CWIP and included in ratebase as additions to plant in service. Blanket work orders are annual estimates which are closed monthly. The SCE filing simply divides the annual estimate by 12 and monthly closes that amount to plant in service.

If capital projects and blanket work orders are on schedule and on target, then the capital expenditures are directly related to the projected plant in service levels. SCE's filing incorporates an October 2001 construction budget as the basis for forecasting the level of expenditures and the timing of when those expenditures will close to plant in service.

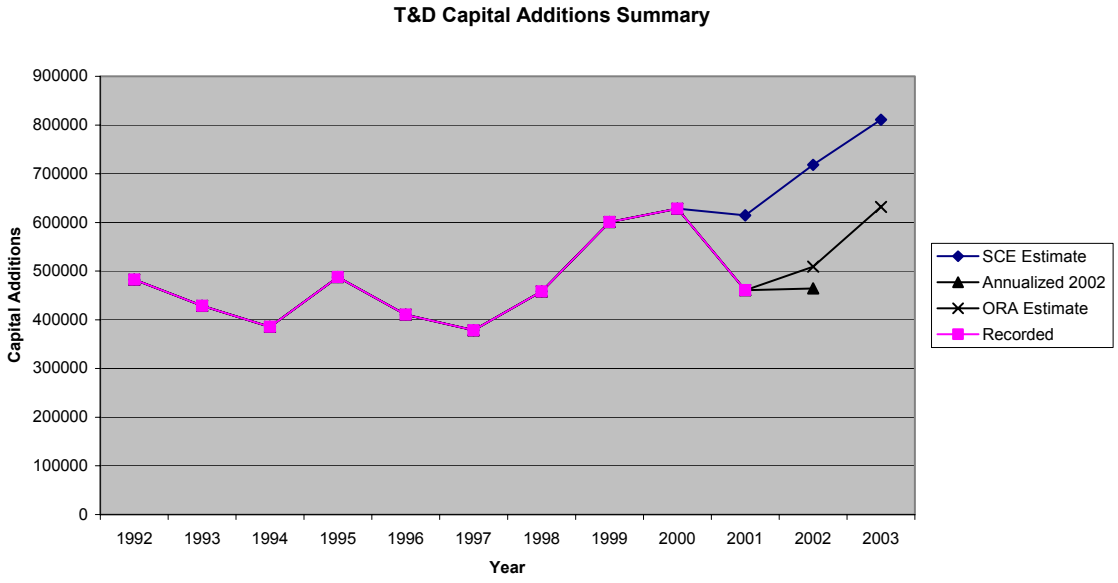
IV. DISCUSSION

Although SCE's testimony on T&D capital develops capital expenditures for each of the years 2001 to 2003, the ultimate objective is to forecast the level and timing of

additions to plant in service for each of those years. These are the amounts that are included in the calculation of the weighted average rate base on which SCE earns its rate of return.

SCE's response to ORA Data Request No. 030 listed recorded Gross Plant Additions for the period 1992 through 2001. Gross additions are the expenditures which are closed or booked to plant and made part of ratebase. Gross additions are loaded which means they include Corporate Overheads and other non-direct expenditures. Recorded additions for the years 1992-2001 are shown on Figure 16C-1 along with SCE's estimates for 2001-2003.

FIGURE 16C-1



ORA compared SCE forecast plant additions for 2001 and the first half of 2002 to recorded data to determine the degree SCE was differing from its proposed expenditures. The recorded data were provided to ORA in response to data requests175. That comparison of SCE's forecast versus SCE actual plant additions is shown in Table 16C-2.

[175] Data Requests 145 and 179

TABLE 16C-3
Gross Additions
($000's)

Year	SCE Recorded	SCE Forecast	Difference	% Difference
2001	$456,728	$614,399	$157,671	25.7%
2002	$464,712[176]	$718,166	$253,454	35.3%

ORA observed, noted, and evaluated the differences between forecast and actual Gross Additions. ORA reviewed the workpapers supporting SCE T&D expenditures. Capital projects include additions for contingencies. Such additions vary from zero to 40%. In addition, SCE adds 22.7% to project estimates for Division Overhead, an addition which amounts to $285.7 million from 2001 - 2003[177]. Additions such as these, to the extent that they may be overstated, could account for differences in budgeted versus actual project expenditures and ultimately plant additions.

Blanket work orders may also be overstated. The largest category of capital expenditures is Capital Replacement and Automation. Within this category, SCE proposes to spend $621.9 million in total for Infrastructure Replacement (IR) from 2001 to 2003. Within IR is Budget Item 480. This is the heart of the IR expansion. Started in 1999, SCE proposes to spend $254.4 million for this budget item alone. This item then is responsible for over 40.7% of the total IR expenditures.

SCE constantly reminds us that these figures are based on judgement and nobody can predict when a particular piece of equipment will fail. More importantly, these expenditures are discretionary and 2001 planned expenditures were adjusted by SCE due to its financial problems caused by the energy crisis. Based on recorded 2002 information, it appears its financial problems are continuing and may continue into 2003.

ORA concludes SCE's capital budget was not an accurate basis for developing plant additions for 2001 and 2002 and should not be used to forecast plant additions for

176 Annualized (recorded Jan – June)
177 DR-ORA-046

test year 2003. It is more appropriate to utilize and incorporate actual, recorded capital additions into forecasting plant additions for 2002 and 2003.

ORA adjusted the forecast years 2002 and 2003 capital expenditures to be consistent with the actual plant additions recorded and closed for 2001 and the first half of 2002. ORA determined that SCE overstated the 2001 and 2002 forecast of plant additions by 25% and 35% respectively. Accordingly ORA adjusted the 2002 and 2003 capital expenditures forecast by SCE downward by 30%.

When ORA's capital expenditures recommendations in Table 16C-2 are loaded with AFUDC and corporate overheads and added to plant in service, the resulting forecast of plant additions amounts to $509,407 in 2002 and $631,723 in 2003. These amounts are consistent with plant additions recorded during the period 1992 – 2001 (see Figure 16C-1). Although less than SCE's request, ORA's plant additions recommendations are significantly higher than the recorded 2001 amount and the annualized recorded 2002 amount (see Table 16C-3). ORA believes its recommendations provide the utility with sufficient funds for its plant expenditures through the test year.

The following table summarizes ORA's Capital Additions resulting from ORA's capital expenditures recommendations.

Table 16C-4
Capital Additions Summary
$000's

SCE	2001	2002	2003	Total
SCE Estimate	$614,399	$718,166	$811,209	$2,143,774
ORA Estimate	456,728	509,407	631,723	1,597,858
Difference	$157,671	$208,759	$179,486	$545,916
% Difference	25.7%	29.1%	22.1	25.5%

V. CONCLUSIONS

The Commission should reject the SCE forecast of T&D capital expenditures for forecast year 2002 and test year 2003. The Commission should accept the ORA forecast of T&D capital expenditures for forecast years 2002 and 2003.

CHAPTER 16-D

SHARED SERVICES

I. INTRODUCTION

SCE forecasted $24,960,000 for 2002 and $34,617,000 for 2003 in capital additions for its Corporate Real Estate (CRE) business unit of Shared Services. SCE's CRE is responsible for all activities related to the management of SCE's property and buildings, which includes planning, design, construction and maintenance of all of its facilities that are not directly used in the generation, transmission or distribution of electricity. ORA's forecast for SCE's Shared Services CRE capital additions is $10,856,000 for 2002 and $8,255,000 for 2003 shown in Table 16-D-1 below.

Table 16-D-1

ORA's Forecast of SCE's Test Year 2003 Shared Services Capital Additions

	SCE Forecast		ORA Forecast	
	2002	**2003**	**2002**	**2003**
Blanket Work Order				
Various Major Capital Maintenance	6,044,000.00	5,995,000.00	6,044,000.00	5,995,000.00
Various Major Structures (i.e. Security improvements)	0.00	10,948,000.00	0.00	0.00
Security System Enhancements	804,000.00	667,000.00	804,000.00	667,000.00
Access/Intrusion Security Control	638,000.00	650,000.00	638,000.00	650,000.00
Underground Tank Upgrades	490,000.00	543,000.00	490,000.00	543,000.00
Various Rights-of-Way Acquisitions (that are not part of approved corporate projects)	793,000.00	800,000.00	0.00	0.00
Critical Facilities Infrastructure Upgrades	2,920,000.00	400,000.00	2,920,000.00	400,000.00
Field Facility Infrastructure Improvements	7,044,000.00	8,063,000.00	0.00	0.00
Total	18,693,000.00	28,066,000.00	10,856,000.00	8,255,000.00
Capital Projects Under $1 Million				
Miscellaneous Department Furniture and Office Equipment	468,000.00	749,000.00	0	0
Ongoing Furniture Modification	302,000.00	300,000.00	0	0
Transportation Services Dept. Various Items	250,000.00	245,000.00	0	0
Total	1,020,000.00	1,294,000.00	0	0
Capital Projects Over $1 Million				
Strategic Facilities Plan	5,247,000.00	3,757,000.00	0	0
General Office 2 Seismic Upgrades		1,500,000.00	0	0
Total	5,247,000.00	5,257,000.00	0	0

II. DISCUSSION/ANALYSIS

SCE implemented its infrastructure "bundling" project or Strategic Facilities Plan (SFP) in 1998. SCE apparently delayed making major infrastructure upgrades in 1990 due to anticipation of regulatory decisions relating to its proposed merger with San Diego

Gas and Electric and delayed performing infrastructure upgrades again in 1996-1997 due to workforce reductions and electric restructuring. SCE's management decided to proceed with its "bundling" project in 1997. ORA believes that some of the costs SCE has forecasted relating to its implementation of its SFP are excessive and redundant. For example, SCE forecasted $10,948,000 for Various Major Structures, however SCE only briefly describes projects amounting to $4,500,000 of the $10,948,000 for security improvements and remains silent on its forecasts for the difference of $6,448,000. SCE forecasted an additional $1,471,000 for Security System Enhancements and another $1,288,000 for Access/Intrusion Security Control and some of the security line items listed in the forecasts for the three areas mentioned above appear to be some of the same or similar items and are thus redundant and not prudent investments, and should not be funded 100% by its ratepayers. During the process of planning and implementing its major facilities upgrades, which seems reasonable and is discussed below, SCE's management decided to do somewhat more than was necessary and began to remodel its General Office Complex and other facilities.

ORA was able to observe some of these projects during its field visit in May of 2002, and noticed that SCE had demolished some of its corridors and "hardwall" offices during its major overhaul remodeling project, and purchased expensive artwork and furniture when it "took advantage of an opportunity in the course of our major facility infrastructure upgrades to adopt an "open landscape" office environment with standardized design for employee workstations".[178] SCE's recorded 1998 expenses for its SFP were $4,651,000 and increased to $20,318,000 in 1999, and then decreased to $7,373,000 in 2000.[179] SCE's costs incurred and forecasted for its "open landscape" under its SFP was a discretionary decision made by its management staff and was not consistent with providing safe and reliable electricity service to its ratepayers at a reasonable cost.

SCE did not provide ORA with sufficient documentation to fully substantiate its forecast of $24,960,000 for 2002 and $34,617,000 for 2003 in plant expenditures. SCE

[178] SCE workpapers Volume 4, Chapter VIII, Part 1 of 2 page 31.
[179] SCE workpapers Volume 4 Chapter VIII, Part 2 of 2 page 129.

has not provided cost benefit analysis to demonstrate the value associated with its demolishing and major remodeling projects. Further, SCE did not provide sufficient documentation for ORA to independently reconstruct its forecast of $24,960,000 for 2002 and $34,617,000 for 2003 in capital additions. The majority of SCE's forecasted costs for projects over $1 million for "various projected costs for anticipated new projects undefined" appear to be primarily comprised of costly "wish lists" compiled with brief generalized comments about the projects as support.

ORA was able to tour some of SCE's facilities and based on this investigation and independent analyses, only $10,856,000 for 2002 and $8,255,000 for 2003 are appropriate for costs relating to major capital maintenance (i.e. heating/ventilation and air conditioning, roofing repair/replacement, carpet replacement, other (water systems, lighting, irrigation, and asphalt repair/replacement), security system enhancements, access/intrusion security control, underground tank upgrades, and critical facilities upgrades. SCE's costs sharply increased from $4,651,000 in 1998 to $20,318,000 in 1999 to adequately address SCE's major infrastructure upgrades, improvements, and remodeling activities. Table 16-D-2 below summarizes ORA's forecast of SCE's CRE capital additions for test year.

Table 16-D-2

ORA's Forecast Summary of SCE's Test Year 2003 CRE Capital Additions

2002	**SCE Forecast**	**ORA Forecast**	**Difference**
Blanket Work Order	18,693,000.00		7,837,000.00
		10,856,000.00	
Capital Projects Under $1 Million	1,020,000.00	0	1,020,000.00
Capital Projects Over $1 Million-SFP	5,247,000.00	0	5,247,000.00
Total	24,960,000.00		14,104,000.00
		10,856,000.00	
2003	**SCE**	**ORA**	**Difference**
Blanket Work Order	28,066,000.00		19,811,000.00
		8,255,000.00	
Capital Projects Under $1 Million	1,294,000.00	0	1,294,000.00
Capital Projects Over $1 Million-SFP	5,257,000.00	0	5,257,000.00
Total	34,617,000.00		26,362,000.00
		8,255,000.00	

III. SFP CORPORATE FITNESS CENTER

On May 12, 1998, SCE's CRE began construction on its new corporate fitness center, to be used by all of its employees, which was also part of its SFP. The corporate fitness center was completed on December 9, 1999 and SCE claims that the "objective of the fitness center are to increase the number of employees who engage in regular physical activity and to leverage the knowledge and expertise of the Fitness Center staff across the company by expanding health education to address emerging health and safety issues".[180] The total cost was $1,545,078 and its costs are included in its test year forecast. These costs were later recorded in its Continuing Property Record Accounts. SCE's Human Resources Department is responsible for the start up and ongoing operation costs of the corporate fitness center, and incurred costs in 2000 for $384,000.[181]

[180] SCE response to ORA data request DR-ORA-114 question 3.
[181] These costs will be addressed in ORA's Chapter 14-G, Pensions and Benefits for Account 926.

ORA believes that the costs incurred for SCE's fitness center should not be funded by its ratepayers. SCE did not request approval from the Commission prior to constructing its corporate fitness center however SCE has included the costs incurred for construction of this facility in its capital additions. Further, SCE employees can enroll in private fitness programs and are eligible to receive reimbursement for annual membership through their SCE health benefits, which is already funded by its ratepayers. SCE's shareholders reap benefits from healthy and productive employees, which reduce SCE's operating expense for sick and injured employees, and in turn can increase shareholder value, thus shareholders should fund the fitness center.

IV. CONCLUSIONS

ORA recommends a forecast of $19,111,000: $10,856,000 for 2002 and $8,255,000 for 2003 for SCE's capital additions related to CRE in the test year, which is a reduction of $40,466,000 in SCE's forecast of $59,577,000. ORA also recommends that the costs incurred for SCE's corporate fitness center be removed for ratemaking purposes.

CHAPTER 16-E

INFORMATION TECHNOLOGY

I. INTRODUCTION

SCE's TY2003 Information Technology (IT) Non-Software Capital Project TY2003 estimate of $67,402,000 is mostly comprised of $52,646,000 in capital projects classified as "Blanket Budget Items". SCE describes "Blanket Budget Items" as on-going projects with no one completion date, covering on-going expansion, replacement, and upgrade activities. SCE spent $25,107,000 in Y2K Capital expenditures. (SCE-6, Vol. 5, p. 34)

II. SUMMARY

ORA believes that the Y2K expenditures are abnormal, non-reoccurring expenditures and are not forward on-going expenditures, since the Y2K expenditures will not occur in TY2003. ORA recommends subtracting the Y2K expenditures from the historic expenditure levels. The "Blanket Budget Items" cost is a component of the Information Technologies' "Total Non-Software Capital Projects" estimate (see Table 16-E-1). ORA recommends using the historic "Blanket Budget Items" Information Technology capital expenditure data **without** the Y2K expenditures and taking a five-year average as the best TY2003 estimate. The five-year average without Y2K costs for "Blanket Budget Items" is $34,887,000 (see Table 16-E-2). SCE's "Blanket Budget Items" TY2003 estimate is $52,646,000. Therefore, ORA recommends SCE's capital Information Technology TY2003 request be adjusted by $17,759,000. ORA's TY2003 recommendation for "Total Non-Software Capital Projects" Information Technology capital work is $49.6 million (see Table 16-E-1).

Table 16-E-1			
Information Technology Non-Software Capital Project Forecast			
Test Year 2003			
(Nominal Dollars in thousands)			
	SCE	ORA	Difference
Project Categories	Proposed	Recommended	SCE - ORA
Total Major Projects	$ 8,020	$ 8,020	$ -
Total Blanket Budget Items	$ 52,646	$ 34,887	$ 17,759
Total Projects Under $1 Million	$ 6,532	$ 6,532	$ -
Total Blanket Purchase Orders	$ 203	$ 203	$ -
Total Non-Software Capital Projects	$ 67,402	$ 49,642	$ 17,759

III. FIVE-YEAR AVERAGE WITHOUT Y2K EXPENDITURES

A. FIVE-YEAR AVERAGE IS THE BEST TY2003 ESTIMATE

SCE's "Total Non-Software Capital Projects" three-year forecast for 2001-2003 is (1) $33,870,200 for 2001, (2) $47,062,000 for 2002, and (3) $67,401,800 for 2003. SCE's TY2003 Information Technology "Total Non-Software Capital Projects" estimate of $67,402,000 is mostly made of $52,646,000 in capital projects classified as "Blanket Budget Items."

SCE spent $25,107,000 in Y2K Capital expenditures (see Appendix 16-E). (SCE-6, Vol. 5, p. 34) SCE spent $11.0 million in 1998, $13.2 million in 1999, and $0.9 million in 2000. ORA believes much of the Y2K capital expenditures were taken from capital "Blanket Budget Items." SCE describes "Blanket Budget Items" as on-going projects with no one completion date, covering on-going expansion, replacement, and upgrade activities. ORA has made its recommended adjustment from the capital category of "Blanket Budget Items."

ORA believes the "Blanket Budget Items" historic expenditure levels are variable (see Table 16-E-2). The five-year average for "Blanket Budget Items" including Y2K costs is $39,908,000. SCE's $52,646,000 TY2003 estimate for "Blanket Budget Items" is significantly greater than the $39,908,000 five-year average that includes the Y2K costs.

ORA believes that the Y2K expenditures are abnormal, non-reoccurring expenditures and are not forward on-going expenditures, since the Y2K expenditures will not occur in TY2003. ORA recommends subtracting the Y2K expenditures from the historic expenditure levels (see Table 16-E-2). ORA recommends using the historic Information Technology capital data **without** the Y2K expenditures and taking a five-year average as the best TY2003 estimate. ORA has subtracted the Y2K costs from the "Blanket Budget Items" (see Table 16-E-2) that is a component of the "Total Non-Software Capital Projects" estimate (see Table 16-E-1).

The five-year average for "Blanket Budget Items" without Y2K capital costs is $34,887,000 (see Table 16-E-2). SCE's $52,646,000 TY2003 estimate for "Blanket Budget Items" is significantly greater than the $39,908,000 five-year average including Y2K costs and is even greater than the $34,887,000 five-year average without Y2K costs.

Table 16-E-2
Information Technology Non-Software Blanket Budget Items
Historic Data With Y2K Captial Costs Subtracted
(Nominal Dollars in thousands)

Year	1996	1997	1998	1999	2000
Total With Y2K Costs	$ 27,869	$ 33,489	$ 58,399	$ 46,203	$ 33,580
Y2K Costs	$ -	$ -	$ 11,008	$ 13,180	$ 919
Total Without Y2K Costs	$ 27,869	$ 33,489	$ 47,391	$ 33,023	$ 32,661

Five-Year Average With Y2K costs: $39,908,000

Five-Year Average **Without Y2K** costs: $34,887,000

SCE TY2003 Estimate: $52,646,000

ORA's TY2003 recommendation for "Total Non-Software Capital Projects" Information Technology capital work is $49.6 million (see Table 16-E-1). Therefore, ORA recommends an adjustment of $17,759,000 in SCE's request for Information Technology related capital expenditures for TY2003.

IV. CONCLUSIONS

ORA believes that the Y2K expenditures are abnormal, non-reoccurring expenditures and are not forward on-going expenditures, since the Y2K expenditures will not occur in TY2003. ORA recommends subtracting the Y2K expenditures from the historic expenditure levels. ORA recommends using the historic Information Technology capital data **without** the Y2K expenditures and taking a five-year average as the best TY2003 estimate (see Table 16-E-2). ORA recommends an adjustment of $17,759,000 in SCE's request for Information Technology related capital expenditures for TY2003. Therefore, ORA's TY2003 recommendation for "Total Non-Software Capital Projects" Information Technology capital work is $49.6 million (see Table 16-E-1).

APPENDIX 16-E

SCE spent $68.1 million ($42,987,000 in A&G and O&M expenses and $25,107,000 in capital expenditures) for the Y2K compliance project during 1998 –2000 and these costs were absorbed by the budgets of the affected business units.

SCE's current financial crisis limited SCE's ability to complete planned and budgeted workloads and projects. SCE states, "[i]n addition, both IT's Copper Wire Replacement (IR) Program are ongoing projects that experienced additional capital deferrals subsequent to the Y2K effort due to SCE's financial crisis. As a result, SCE cannot isolate the work scope or budget changes for these projects attributed solely to SCE's Y2K effort." (Data Request No. 113, Question 1 d. i.) SCE cannot isolate the work scope or budget changes attributed solely to the Y2K efforts on two ongoing IT capital projects because SCE experienced additional capital deferrals after the Y2K project effort due to SCE's financial crisis. This shows the current financial crisis limited SCE's ability to complete planned and budgeted workloads and projects.

SCE did not incur negative incidents of adverse quality of service, reliability, customer service or safety due to the project or work activity deferrals that occurred for Y2K. SCE states that though: "There is no analysis that identifies the positive and negative impact of deferring each project listed in response to 1.c. However, as noted in response to 1.a. and 1.b. above [in SCE's Data Request No. ORA-113], there are no recorded incidents of adverse quality of service, reliability, customer service or safety due to the project or work activity deferrals that occurred for Y2K". (Data Request No. ORA-113, Question 1.d. i.)

SCE spent $68.1 million ($42,987,000 in A&G and O&M expenses and $25,107,000 in capital expenditures) for the Y2K compliance project during 1998 –2000 and these costs were absorbed by the budgets of the affected business units. SCE did not record incidents of adverse quality of service, reliability, customer service or safety due to the project or work activity deferrals that occurred for Y2K.

CHAPTER 16-F

CAPITALIZED SOFTWARE

I. INTRODUCTION

This chapter contains ORA's analyses and recommendations for Electric Plant In Service – Capitalized Software. These plant additions consist of new software systems, as well as enhancements and upgrades to existing software systems. Capitalized Software projects are developed similar to plant additions and are similarly included in SCE's Capital Budget.

II. SUMMARY

Table 1 compares ORA's recommended and SCE's proposed levels for Capitalized Software direct plant additions for the years 2002 and 2003. As discussed in Chapter 16-A, these are direct additions, and do not include Corporate Overheads and/or AFUDC.

Table 1
Electric Plant In Service – Capitalized Software
Test Year 2003
($000)

	ORA Recommended	SCE Proposed	Difference SCE - ORA
2002 Additions	$31,002	$31,862	$860
2003 Additions	$40,574	$40,574	$0

As Table 1 shows, ORA has slightly reduced SCE's proposed direct additions for 2002, and has accepted its proposed additions for 2003. ORA's 2002 adjustment concerns SCE's use of contingency amounts in one of the Capitalized Software projects. This recommended adjustment is discussed in greater detail in Section IV below

III. REVIEW OF SCE'S PROPOSED ADDITIONS

For the purpose of developing capital budgets, SCE has organized itself into 10 Business Units (BU); Capitalized Software is one of those 10 BUs. Each BU provides

justification for any and all capital projects that are in its area of responsibility. Plant additions for this BU include new software systems as well as the continued development of existing ones.

SCE categorizes its Capitalized Software projects according to their expected useful lives. SCE uses 5, 10, and 15-year lives, with all of its proposed 2002 and 2003 additions falling into the 5 and 10-year categories. SCE supplied ORA with workpapers providing details on many different Capitalized Software projects. However, most of these projects were completed in 2001 (in which case they would be included in the recorded 2002 beginning-of-year balance), or they are scheduled to be completed after the 2003 test year. For the purposes of determining a 2003 revenue requirement, only those projects being completed in 2002 and 2003 are of interest. Only five Capitalized Software projects (three have multi-year phases, bringing the total number of plant bookings to eight) are scheduled to be booked to plant during those two years.

IV. ORA'S ANALYSIS

SCE has proposed completing (and adding to Plant-In-Service) five Capitalized Software projects. Several of the projects are being phased in over two years, resulting in four capital additions in 2002, with four more being completed in 2003. Beginning in 1990, SCE began to capitalize various software projects. In D.92-11-051, the Commission adopted certain policies regarding capitalizing software. In Ordering Paragraph 6, SCE was ordered to show how the capitalization of software costs benefited ratepayers.

A. ECONOMIC FACTORS

In this GRC, SCE has provided numerous workpapers purporting to show these ratepayer benefits. In only one instance were cost savings mentioned as a justification for a project. For that one project, the Work Management System, SCE claims it will become cost effective in 2009. If economics were the sole criteria for judging the reasonableness of a project, ORA would probably recommend disallowing this addition; an economic "break even" point of 2009 is too far in the future to benefit many of SCE's current customers. However, as discussed in the next section, Capitalized Software projects can be found reasonable for other than economic reasons.

B. NON-ECONOMIC FACTORS

Non-economic factors must also be considered when attempting to judge the reasonableness of a proposed project. As one example of this, Section 3.1 of the Assigned Commissioner's 8/8/2002 Scoping Memo discusses investment planning. It seems clear that the Commission is placing increased emphasis on how utilities plan their future systems and expenditures. The Work Management System (discussed above) is a good example of a software tool that should enhance SCE's planning abilities. This system manages the activities associated with initiating, planning, scheduling, performing, closing, tracking, and managing transmission and distribution work. With this system operational, SCE's planning abilities should be enhanced, and it should experience greater management control of future transmission and distribution projects. ORA finds this project reasonable.

The remaining four Capitalized Software projects that are scheduled to be completed in 2002 and 2003 were also carefully analyzed by ORA. The four projects (along with a brief description) are:

People Soft – A software system that helps manage payroll and benefits for SCE's employees. One phase will be finished in 2002; the second will be completed in 2003.

Outage Management System Replacement – A software enhancement to an existing system. It will be used to facilitate the restoration of service to customers following power outages, as well as storm response management. It will process incoming customer calls, identify outage locations, and dispatch repair crews. This is a 2002 project.

Mainframe Software License – Software that increases the functionality of SCE's mainframe computer, which supports the Customer Service System and payroll. One phase will be finished in 2002; the second will be completed in 2003.

Usage Information System – This is a software project that will automate and streamline the existing process used to gather and report SCE customer usage date to the ISO. This is a 2003 project.

Each project helps SCE increase its efficiency and/or increases its management capabilities. ORA believes that each of these four projects is useful and rates for each

should be allowed, although ORA does question the cost of one of them, as is discussed in the next section.

C. CONTINGENCIES

Included in the direct costs of these Capitalized Software projects are dollars associated with Division Overheads and Contingencies. In response to an ORA data request, SCE separated out the Division Overhead and Contingency amounts from the rest of the direct costs. The amounts for Division Overheads appeared reasonable, but one project, the Outage Management System Replacement, had a 16% ($1.28 million) Contingency built into the estimate; all the other projects included no dollars for Contingencies. ORA issued another data request, requesting an explanation for this difference. SCE responded by stating that $0.42 million was for unforeseen capacity and storage needs for the project; ORA finds this amount reasonable. However, the remaining amount ($0.86 million) is a "true" contingency.

In an attempt to justify this amount, SCE cites William H. Roetzheim, author of the book *Software Project Cost and Schedule Estimating – Best Practices*. According to SCE, Mr. Roetzheim recommends that various contingency factors be applied to projects, depending on the state of completion when the contingency is applied. For example, during the planning phase of a project, SCE quotes Mr. Roetzheim as recommending a 50% contingency; if a contingency is calculated during the design phase, the recommended percentage drops to 10%. Since SCE developed its contingency factor during the design phase, it used a 10% factor.

ORA conducted an internet search, and was able to locate articles authored by Mr. Roetzheim. In several of those articles, he does mention the use of contingency factors. However, in those articles, Mr. Roetzheim indicates that estimates can be <u>either</u> higher or lower than expected. He applies "plus or minus" factors when he calculates contingencies. In the article *Estimating Software Costs*, Mr. Roetzheim states, "By the time the detailed design is complete, an implementation-oriented estimate will be accurate within <u>plus or minus</u> 10 percent." (Emphasis added) ORA does not believe that SCE's rationale for including contingencies is sufficiently persuasive to justify the addition of an additional $0.86 million to the Outage Manage System Replacement project, and has removed that amount from its estimate for 2002 direct additions.

D. EXPENSING PROJECTS FOR TAX PURPOSES

Because of provisions in the tax law, Capitalized Software projects have the option of being expensed for tax purposes. SCE has included a table in its RO model for selecting how these projects should be treated for taxes. These tax ramifications are discussed in Chapter 15 of this report.

V. CONCLUSIONS

ORA recommends that $0.86 million in Contingencies be removed from the 2002 Outage Management System Replacement project. ORA finds that the remainder of SCE's proposed Capitalized Software projects are reasonable.

CHAPTER 16-G

CORPORATE CENTER

I. INTRODUCTION

This chapter contains ORA's analyses and recommendations for Electric Plant In Service – Corporate Center. These plant additions consist primarily of blanket work orders for furniture and equipment that support the Corporate Center, including equipment/accommodations for the handicapped. All of these work orders are small, with no one work order exceeding $206,000 annually.

II. SUMMARY

Table 1 compares ORA's recommended and SCE's proposed levels for Corporate Center direct plant additions for the years 2002 and 2003. As discussed in Chapter 16-A, these are direct additions, and do not include Corporate Overheads and/or AFUDC.

Table 1
Electric Plant In Service – Corporate Center
Test Year 2003
($000)

	ORA Recommended	SCE Proposed	Difference SCE - ORA
2002 Additions	$984	$984	$0
2003 Additions	$984	$984	$0

As Table 1 clearly shows, ORA has accepted SCE's proposed direct additions for both years. The reasons for this acceptance are discussed in Section IV below.

III. REVIEW OF SCE'S PROPOSED ADDITIONS

For the purpose of developing capital budgets, SCE has organized itself into 10 Business Units (BU); Corporate Overheads is one of those 10 BUs. Each BU provides justification for any and all capital projects that are in its area of responsibility. Plant additions for this BU include all blanket work orders for furniture and equipment that

support the Corporate Center. SCE provides the following definition for blanket work orders:

> *Blanket work orders are established to simplify the approval process for expenditures involving multiple locations or projects. Blanket work orders accumulate work order expenditures by jobs that are similar in nature, are recurring, routine, and/or whose costs are within monetary guidelines. For example, blanket work orders are established for the purchase of furniture and equipment and personal computers.*

Because of the minor nature of these direct plant additions, SCE did not initially provide any details regarding them.

IV. ORA'S ANALYSIS

ORA's Master Data Request only requires SCE to provide justification for capital projects exceeding one million dollars. Because the proposed Corporate Center direct additions were not close to reaching that threshold, no detailed information was provided. However, as part of its investigation, ORA did issue both deficiency requests and data requests in an effort to obtain more information regarding the Corporate Center direct additions. As part of its request, ORA was given 5 years of recorded direct additions for the years 1996 through 2000. A summary of these recorded data is contained in Table 2, below.

Table 2
Recorded Corporate Center Additions
($000)

Year	Corporate Center Recorded Direct Additions	5-Year Average
1996	$1,112	
1997	$2,759	
1998	$2,431	
1999	$1,974	
2000	$338	
Total	$8,614	$1,723

As Table 2 shows, the direct additions have averaged $1,723,000 per year. This historical average is 75% greater than the level of additions proposed by SCE for the years 2002 and 2003. ORA finds reasonable SCE's proposed reduction in Corporate Center capital spending. ORA believes that 2002 and 2003 capital spending for furniture and equipment for the Corporate Center should be reduced from historical levels, and agrees with the magnitude of the reduction being proposed by SCE.

V. CONCLUSIONS

ORA recommends that SCE's proposed expenditure of $984,000 for 2002 and 2003 direct plant additions for the Corporate Center be adopted.

CHAPTER 17

DEPRECIATION AND AMORTIZATION EXPENSE AND RESERVE

I. INTRODUCTION

This chapter presents the analyses and recommendations of ORA regarding SCE's Depreciation Expense and Reserve for test year 2003. A summary of the ORA recommendations and summary of the differences between the SCE and ORA estimates are described in Sections II and III respectively.

The purpose of depreciation is to allow a utility to recover the original cost (less net salvage) of fixed capital investment over the useful life of the plant by means of equitable plan of charges through operating expenses. Depreciation expense is a function of the level of plant balance and of the parameters (net salvage value and service life) that are applied to gross salvage amount received less the cost of removing the asset. The depreciation calculations were made on a straight-line remaining–life basis using rates calculated in accordance with CPUC standard practice U-4. The depreciation rates that SCE is proposing for 2003 were based on the net salvage, average service lives, remaining lives and mortality dispersion patterns developed from the depreciation study it submitted in this proceeding.

Under SCE proposed rates, SCE would recover approximately $716 million of annual depreciation and amortization expenses in 2003. The $716 million represents an increase of approximately $148 million over the current depreciation and amortization expenses, excluding amounts associated with nuclear plants. The $148 million increase comprises of two components: (1) $71 million is attributable to changes in plant balances between 2000 and 2003 and (2) $77 million is attributable to changes in depreciation rates resulting from modification to net salvage value and service life developed from SCE's depreciation studies. The primary cause of the proposed increase

is the proposed increase in net salvage rates, i.e. estimated increases associated with future cost of removal (negative salvage). The differences in estimates of plant balances between SCE and ORA also result in a portion of the ultimate depreciation expense differences.

The following is a summary of the estimated increase of $77 million attributable to changes proposed by SCE in service lives and net salvage:

Table 17-1	
Summary of Estimated Increase	
($ in Million)	
Salvage Analysis	86
Service Live Analysis	-9
Net Increase	77

II. RECOMMENDATIONS

ORA reviewed SCE's proposed test year 2003 life and salvage analysis and depreciation rates and expenses. The following are ORA's recommendations:

a) ORA recommends that SCE should be required to use the current depreciation rates including the current parameters for the **service lives** and the **net salvage** to calculate its depreciation expenses for non-nuclear plant for test year 2003.

b) ORA recommends that SCE's request to amortize recorded easement costs over 60 years, starting in 2003, should be denied. Easements are non-amortizable costs.

c) ORA recommends that San Onofre Nuclear Generating Station (SONGS) sunk cost balance should be amortized over the remaining life of the plant's NRC license life and not over the estimated remaining plant life that SCE is proposing. This recommendation is consistent with SCE's proposal to amortize Palo Verde Nuclear Generating Plants (PVNG's) sunk costs over the plants NRC's license life.

d) ORA recommends that the Commission should institute an investigation into the sky-rocketing costs that are associated with negative salvage value and the resulting increases in depreciation rates being claimed by utilities before it increases SCE's current depreciation rates. The Commission should consider the

use of other methods, such as the establishment of "sinking funds" or "pay as you go" mechanism to compensate utilities for the actual costs incurred to salvage their property. Alternatively, SCE should provide a complete showing on this issue and alternatives in its next GRC.

III. SUMMARY OF DIFFERENCES

The differences in depreciation and amortization expense between ORA and SCE are due to the differences in depreciation rates, differences in capital additions and other adjustments to SCE rate base. The differences in the weighted average depreciation reserve are due to the differences in weighted average plant estimates for test year 2003. ORA takes issue with SCE's depreciation rates and depreciation study. The differences in depreciation expense and weighted average depreciation reserve for test year 2003 amount to the following, as shown below:

TY 2003 ($ in 000)	SCE	ORA	SCE Exceeds ORA	
Depreciation Expense(Less ISO)	715,667	578,610	137,057	1/
Wtd. Average Deprec. & Amort. Reserv.	(12,291,779)	(12,180,908)	(110,871)	
1/ Amount attributable to Depreciation rates	77,000			
Amount attributable to SONGS	21,000			
Amount attributable to Plant Additions	39,057			
	137,057			

IV. DEPRECIATION STUDY

Depreciation rates for the test year were developed using recorded plant and depreciation reserve balances as of December 31, 2000. SCE has included an updated depreciation study showing the results of its mortality and net salvage analysis for plant and equipments in its workpapers. Historical data was used to provide estimates of average service lives, survivor curve types, and net salvage rates.

After reviewing SCE's studies and workpapers, ORA concludes that for the purpose of calculating the estimated depreciation expenses in 2003 for non-generating

facilities, SCE should be required to continue to use the existing depreciation rates and the existing service lives and net salvage rates, i.e. to maintain the status quo. The following is support for ORA's proposal.

A. Service Lives For Non-Nuclear Assets

Service life represents the estimate of expected life of utility assets. SCE used the Simulated Plant Records (SPR) method of life analysis to determine the average service life and the survivor curve, which were used to calculate the remaining average life of the plant and the annual accrual rates. SCE concludes from its studies that the average service lives of the company's assets have increased in recent years and consequently resulted in a modest lowering of the estimated depreciation expenses for 2003 by approximately $9 million.

ORA has reviewed the proposed service lives and the justifications contained in SCE's workpapers for each of the accounts. Except for the new service lives being proposed for easement, ORA takes no issue with SCE's study of asset service lives or the $9 million revenue requirement reduction proposed by the company. However, ORA recommends the Commission require SCE to retain its current asset service lives for the purpose of calculating the company's depreciation expense for the test year. SCE's current asset service lives is more appropriate for the following reasons. First it is consistent with ORA's recommendation that SCE should also be required to retain its the current net salvage rates which contributes to the significant change in depreciation rates. Second, it will eliminate the service life issue with easement mentioned above. Third, during its review, ORA observes that only a few of the accounts actually experienced any significant increase in their service lives. The majority of the accounts either experienced minimal or no changes at all. On the basis of materiality, retaining current service lives would be justifiable. Finally, SCE acknowledged that engineering judgment heavily influence the results concluded from its study. Clearly, the absence of conclusive analytical results renders the conclusions contained in SCE's study to varying interpretation depending on the bias and judgment of the reviewer. Using existing current service lives would reduce such inaccuracies.

However, should the Commission adopt SCE's proposed asset service lives, ORA recommends that the Commission should reject the service live SCE proposes for easement. As discussed below, easements have indefinite lives and are considered non-amortizable assets. Therefore, ORA recommends that SCE request to start amortizing easement in 2003 should be denied.

i. Easements

Currently, SCE does not amortize the costs associated with easements for hydro, transmission, distribution and general plant. However, SCE proposes to amortize these costs over 60 years, starting in 2003, because the company now asserts that the amortization of easement is appropriate and complies with accounting rule, and with existing Commission's precedence which allows both PG&E and SDG&E to recover easement costs in rates.

ORA disagrees with SCE's request to amortize easement costs. Easement has traditionally been known to be attached to land. For many years, SCE has followed this procedure and has not amortized these costs, presumably because such a choice is appropriate. In Electric Plant Instruction (EPI) 7, contained in the Accounting and Reporting Requirement For Public Utilities and Licensees published by the Federal Energy Regulatory Commission (FERC), the following items are identified as costs that attaches to land and land right: " the cost of land Owned in fee by the utility and rights. Interests, and privileges held by the utility in land owned by others such as leaseholds, **easements**, water and water power rights, diversion rights, submission rights, right-of way, and other like interest in land." Also, the National Association of Regulatory Utility (NARUC) Commissioners, in their publication on Depreciation Practices characterizes land as a "non-depreciable and non-amortizable asset because land does not have a limited life." SCE fails to show that the easement costs the company proposes to amortize starting in 2003 are costs that do not attach to land.

SCE argues for equitable treatment on the basis of existing Commission precedence, which allows PG&E and SDG&E to amortize easement costs. Those

previous decisions that allowed PG&E and SDG&E to amortize easement costs are inconsistent with accounting rules for easements. SCE's current policy of not amortizing easements is the correct and prescribed accounting treatment. To ensure uniformity and equitable treatment, ORA urges the Commission to apply this policy for Edison. ORA and the Commission may revisit the policy for PG&E and SDG&E in the companies' next GRCs. Therefore, ORA recommends that SCE's proposal to start amortizing easements should be denied.

B. Service Life For Nuclear Plants

The Commission in D.96-01-011 and D.96-12-083 authorized the calculation of depreciation expense for San Onofre Nuclear Generating Station (SONGS) plants and Palo Verde Nuclear Generating (PVNG) plant. The 1996 decisions provided for SCE to recover recorded ratebase "sunk" costs for SONGS and PVNG nuclear plants over an eight-year period, and directed that all subsequent incremental capital investments be expensed in accordance with procedures established under the Incremental Cost Incentive Pricing (ICIP) mechanism.

In conjunction with the recent URG D.02-04-016, SCE revised the amortization period for SONGS and PVNG sunk costs from 8 to 10 years, starting in 2001. Beginning in 2002, SCE proposes to amortize the January 1, 2002 sunk cost balances over the estimated remaining useful life of SONGS and PVNG, respectively. For SONGS the remaining useful life of the plant was based on the reliability of the plant's existing steam generator. According to SCE, the reliability of the steam generator cannot be guaranteed beyond 2012. For PVNG, SCE confines the remaining useful life of the plant to the remaining NRC license period which is 2024. ORA agrees with the estimated useful life SCE has estimated for PVNG plants.

ORA takes issue with SCE's confining of the remaining useful life of SONGS sunk costs to the estimated reliability of the plants steam generator. The remaining useful life of the SONGS facility should be based on the plant's NRC license life, similar to what the company has proposed for PVNG. SCE's proposal to amortize SONGS sunk cost over the remaining life of the steam generator is inappropriate because of the

uncertainty over SCE's estimated useful life of the steam generator, including the uncertainty over whether or not the steam generator will be replaced at some point in the future before the company's estimated useful life elapses. There are no such impending uncertainties with the plant's NRC license life. The ratemaking difference between ORA and SCE amounts to about $21 million in the test year. Over the long term, there is not much difference in the estimating methodology. It is simply a timing difference and SCE is ultimately made whole over the long term under either proposal. This recommendation does not impair SCE's ability to recover its plant investment should SONGS steam generator become inoperable before the end of its NRC license life. ORA's recommendation simply extends the number of years over which SCE will be allowed to recover SONGS sunk cost, thereby minimizing the current annual accruals and rates. During the test year, ORA's recommendation results in annual depreciation expenses of $21 million associated with SONGS, which is lower than SCE's estimate of $42 million, a difference of $21 million.

C. Net Salvage Rates

Net salvage represents the gross salvage amount, less the cost of removing the asset when it is retired from service. It can either be positive or negative. The salvage is negative when it costs more to remove and dispose of an asset than the asset is worth. Net negative salvage value is determined by subtracting the cost of removing an asset from the salvage value.

The most significant aspect of SCE's study is the estimated increase in negative salvage caused by the estimated increase in the cost of removal in 2003. To better understand the implications of SCE's request for the increased cost of removal funding in 2003, ORA considered the following: As of December 31, 2000, SCE's recorded Gross Plant was approximately $14 billion. The estimated negative salvage costs associated with these assets during the same period was approximately $3.4 billion. The $3.4 billion represents additional amount that SCE will theoretically incur to ultimately remove or retire investment of $14 billion in gross plant as those assets are replaced or retired over time. Under traditional cost of service ratemaking, SCE is allowed full

recovery of the $14 billion plus the $3.4 billion from ratepayers. For 2003, the results of SCE's depreciation study suggest that the funding for current negative salvage needs to be increased from $3.4 billion to $5.7 billion. The increase in negative salvage between the current base year and the test year is approximately $2.4 billion over the life of the assets, which is about a 70% increase. The annual revenue requirement associated with this increase is approximately $86 million in the 2003 test year over the current annual level.

ORA has reviewed and analyzed SCE's depreciation study for net salvage. As discussed below, contrary to SCE 's request for Commission approval to use the newly developed net salvage rates to calculate its 2003 depreciation expenses, ORA recommends that SCE should be required to use the existing net salvage rates for such purpose. SCE's study is inadequate and should not be relied on to establish a new level of net salvage in this proceeding. The dramatic increases for negative salvage amounts developed from SCE's study focuses heavily on the use of ratios and averages and less on why the negative salvage amounts continue to grow at alarming rates. SCE has an obligation to minimize costs to ratepayers, but provides no testimony on what the company is doing to mitigate these costs.

In recent years, utility requests for increased funding for negative salvage appears to be on the rise. To some extent, SCE request for increased reimbursement for negative salvage is somewhat similar to PG&E's request in the company's last GRC. In the PG&E's proceeding, the Commission in Decision (D). 00-02-046, page 359, rejected the company's request and in doing so expressed serious concern stating as follows:

> "There are important policy reasons for rejecting revenue requirement increase that are justified on the basis of new depreciation parameters. As TURN observes, depreciation does not affect PG&E's ability to provide safe and reliable service. Even if the proposed or current rates of depreciation are reduced, shareholders will still recover their investments in plant over time. At the same time, we are determined that it is necessary to set the authorized revenue requirement in this GRC

at a level that is consistent with the provision of adequate utility service by PG&E. Thus, to carry out our policy position on revenue requirement increases, we will make changes in authorized depreciation parameters when presented with compelling reasons for doing so."

ORA's review of SCE's depreciation study and the company's request for increased negative salvage reinforces the same concern and observation expressed by the Commission above. A review of the company's study in conjunction with financial data gleaned from the company's FERC Form 1 provided no compelling reasons for increasing the negative net salvage cost in 2003. Amid all the information and data presented by SCE to justify the need for increased funding, the fundamental and overriding question that needs to be addressed is: "Is SCE recovering enough funds in current depreciation rates to cover current ongoing cost of removal?" Answers to this question are most critical because it would either validate SCE's position for increased funding and by how much, or affirm the appropriateness to keep the net salvage rates at their current levels.

To address the question posed above, ORA reviewed historical data provided by SCE for the cost removal and net salvage for all accounts between 1996 and 2000. ORA performed an account-by-account analysis of selected accounts. The revenue requirement associated with the selected accounts represents about fifty percent of the revenue requirement increase being proposed for net salvage for all accounts. The selected accounts include the following FERC Accounts: Account No. 355---Poles and Fixtures; Account No. 356---Overhead Conductors & Devices; Account No.364---Poles Tower and Fixture; Account No.365---Overhead Conductors and Account No.369---Services.

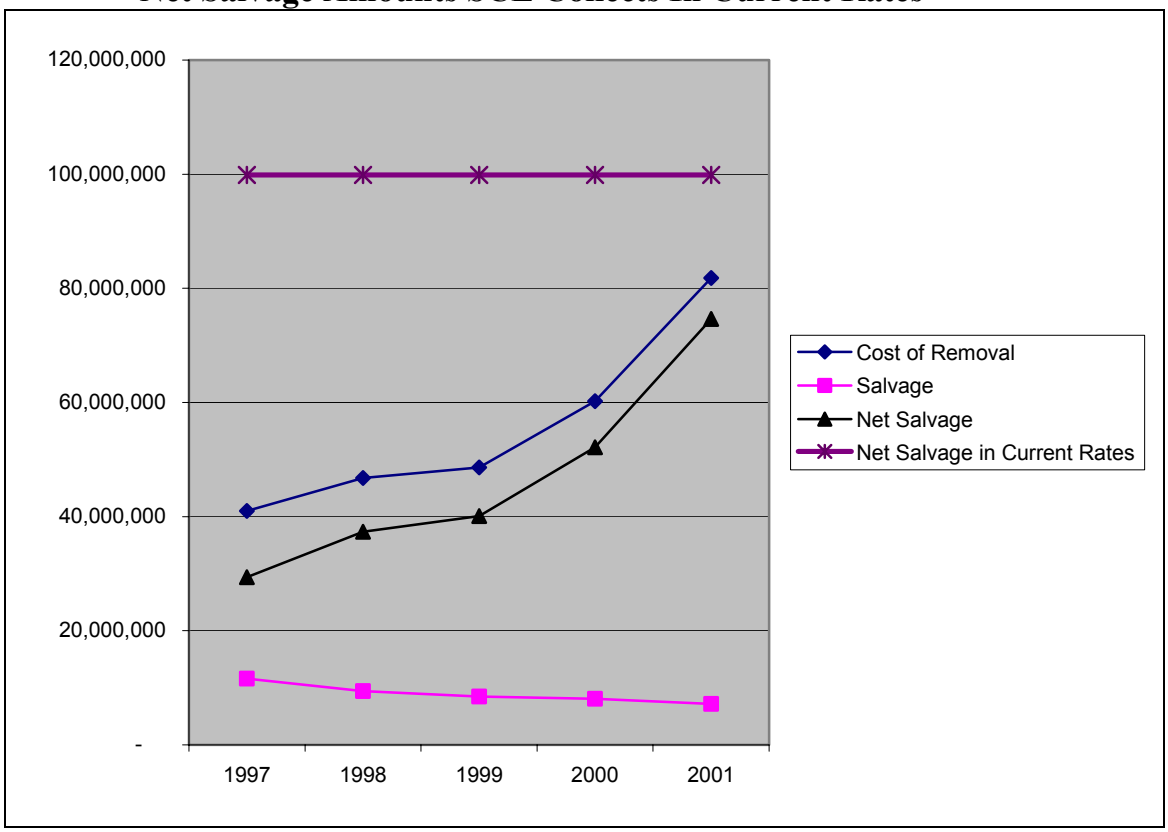
A Summary of ORA's analysis is shown below in Table 17-2:

FERC Account Nos.	355	356	364	365	369
Approved Depreciation In current Rates With Embedded Net Salvage	7,793,666	15,660,636	27,942,170	31,868,439	26,392,829
Estimated Depreciation Without Embedded Net Salvage	4,585,161	3,373,236	12,231,550	8,066,770	10,946,349
Estimated Embedded Net Salvage In Current Rates	3,208,505	12,287,400	15,710,620	23,801,669	15,446,480
Estimated Embedded Net Salvage In Proposed Rates	8,771,474	18,857,667	29,512,563	29,804,019	27,841,714
Estimated Increase In Embedded Net Salvage In Proposed Rates	5,562,969	6,570,267	13,801,943	6,002,350	12,395,234
Highest Amount Recorded For Net Salvage *Between 1996-2000*	3,170,698	1,185,610	14,859,569	8,186,499	2,973,383
Recorded NeT Salvage					
1996	(1,089,400)	(480,704)	(4,994,580)	(3,645,667)	(1,602,423)
1997	(1,221,732)	(287,604)	(9,529,664)	(4,776,511)	(2,876,350)
1998	(1,488,854)	(663,713)	(13,357,856)	(4,769,494)	(2,823,188)
1999	(2,497,980)	**(1,185,610)**	(11,612,521)	(5,795,624)	(2,673,006)
2000	**(3,170,698)**	(570,447)	**(14,859,569)**	**(8,186,499)**	**(2,973,383)**
Current Net Salvage Percentages	-50	(50)	(100)	(110)	(60)
Proposed Net Salvage Percentages	-115	(95)	(175)	(120)	(100)

As shown in Table 17-2 for all of the accounts analyzed, SCE is collecting more funds for net salvage than the company has actually incurred over the years. As the data shows there appears to be sufficient cushion in current rates to cover any potential increase in the near future. In fact, as shown in Table 17-2, SCE is collecting more in rates than it is incurring on net salvage which implies that the company's current depreciation rates could be too high. Therefore, one can conclude that SCE's study to support its proposed depreciation rates is flawed and will result in giving SCE higher base rates than are justified or required to provide safe and reliable service.

The second analysis performed by ORA was to affirm the conclusion from Table 17-2. As opposed to the account-by-account analysis, the objective here was to compare the total amounts of net salvage that SCE currently recovers in rates to the total amounts of net salvage reported in the companies FERC Form 1 between 1997 and 2001. The Figure below presents such comparison.

Figure 17-1
Recorded Costs of Removal & Net Salvage Compared To The Net Salvage Amounts SCE Collects In Current Rates



Again as shown in Figure 17-1 above, SCE is collecting sufficient funds in current rates than the company actually incurs for net salvage. Although there has been an upward trend in the costs of removal since 1997, SCE continues to collect approximately $100 million annually in rates, far exceeding the amount it actually incurred during those years. As further illustrated in the graph, even when SCE incurred its highest cost of removal in 2001, the company still spent approximately $20 million less than it collected in rates. Based on SCE's proposed depreciation rates, SCE would

be collecting additional $86 million for net salvage in addition to the $100 million SCE currently collects in present rates. If approved, SCE would be collecting approximately $186 million for net salvage in the proposed depreciation rates by 2003. This would amount to SCE collecting double the amount the company actually incurred in 2001, which was the highest amount incurred by the company in the last five years. ORA believes that any increase is unjustifiable at this time. SCE has not offered compelling reasons to support its proposal for making significant changes to the current authorized depreciation parameters.

ORA is recommending in this case that SCE's request to increase its net salvage rates in 2003 should be denied because ORA's analysis suggest that the current depreciation rates are sufficient to cover on-going cost of removal expenses. Under the current situation where the company is collecting more funds for net salvage than it is spending, shareholders reap enormous cash flow benefits; more so when assets are abandoned and the funds for cost of removal previously collected in rates are not spent by the company.

V. NEED TO CONSTITUTE AN OII TO INVESTIGATE COST OF REMOVAL AND NET SALVAGE EMBEDDED IN DEPRECIATION RATES AND ALTERNATIVE RATEMAKING METHODS.

In PG&E's last GRC the Commission was compelled to address PG&E's increased estimate of negative salvage value. In that proceeding, ORA recommended that the Commission convey an OII to investigate negative salvage for all energy utilities. Again in this proceeding, negative salvage has become an issue facing the Commission. ORA believes that negative salvage will continue to be an issue because of the current ratemaking methodology used by energy utilities to estimate and fund their negative salvage, and the current upward trend associated with the annual cost of removal.

Therefore, ORA recommends that the Commission should constitute an OII to investigate the reason for the trend, the validity of reported negative salvage by all energy utilities, and the method of calculating and reporting negative salvage before it authorizes

any increase in SCE's current depreciation rates. Other issues that should be reviewed in the OII include investigating the use of alternative methods such as the use of "sinking funds" or "pay-as-you-go" methods of accounting and reimbursing utilities cost of removal obligations. Alternatively, the Commission should direct SCE to address these issues and alternative ratemaking methods in its next GRC application.

CHAPTER 18

RATE BASE

I. INTRODUCTION

This chapter contains ORA's analyses and recommendations for Rate Base. Rate Base is the depreciated asset value of SCE's net investments used to provide service to its customers. The major components of Rate Base are Fixed Capital, Adjustments, Working Capital, and Deductions for Reserve. SCE is allowed to earn a return on the sum of these Rate Base components. All components of Rate Base are developed on a weighted average basis.

II. SUMMARY

Table 1 compares ORA's recommended and SCE's proposed estimates for 2003 Rate Base.

Table 1
Rate Base
Test Year 2003
($000)

	ORA Recommended	SCE Proposed	Difference SCE - ORA
2003 Rate Base	$8,559,262	$9,186,306	$627,044

As Table 1 shows, ORA's recommendation for Rate Base is significantly lower than SCE's estimate. ORA's estimate reflects adjustments made by several different witnesses. Some of these adjustments are discussed in this chapter, and the rest are discussed in the chapters where they were originally analyzed and developed.

Table 4, at the end of this chapter, presents a more detailed breakdown of the components that make up Rate Base.

III. OVERVIEW OF RATE BASE

The overall purpose of Rate Base is to develop an appropriate level of utility investments, on which a return can be earned. The four major components of Rate Base

are Fixed Capital, Adjustments, Working Capital, and Deductions for Reserve. Rate Base is calculated on a weighted average basis to properly reflect the fact that additions occur throughout the year. The weighted average is calculated using a 13-month average (the sum of the monthly balances from December of the prior year through December of the current year, less ½ of the December balances, all divided by 12). The rest of this section discusses the analyses and recommendation being made by ORA on the various components of Rate Base. It should be noted that not all of the Rate Base components will be discussed in this chapter; many of the components are developed and discussed in other chapters.

IV. FIXED CAPITAL

Fixed Capital, the first of the four components of Rate Base, is simply another name for the 2003 Weighted Average Plant-In-Service balance that was originally discussed and analyzed in Section VIII of Chapter 16-A. Fixed Capital is itself further divided into four areas: Plant-In-Service, Capitalized Software, Other Intangibles, and Plant Held for Future Use.

As discussed in Section VIII of Chapter 16-A, the Results of Operation (RO) computer model needs to be "forced" by ORA to generate a Weighted Average Plant balance that is equivalent to the 42.51% weighting percentage recommended by ORA. Once that has been accomplished, the computer model automatically segregates all the weighted average plant additions into the four Fixed Capital components listed above, as itemized on Table 4.

V. ADJUSTMENTS

The second component of Rate Base is Adjustments; it consists solely of Weighted Average Customer Advances (Advances). Advances consist of funds paid by customers for the construction of facilities required to serve those customers. Advances are recorded as a liability, representing the obligation of the utility to eventually return the funds paid by the customer. Capital additions either wholly or partially constructed with Advances are included in Plant-In-Service balances. However, since SCE did not put-up these funds out of its own pocket, it should not be entitled to earn a return on

them. Therefore, a weighted average balance for Advances is calculated and is subtracted from Rate Base.

To estimate Advances, SCE developed a rolling five-year average of end-of-year (EOY) Advance balances from 1996 through 2003; the EOY balances were converted to weighted averages, and were subtracted from Rate Base. ORA analyzed SCE's methodology and finds it reasonable. ORA recommends that SCE's estimates for Advances be adopted.

VI. WORKING CAPITAL

The third component of Rate Base is Working Capital. Working Capital is itself further divided into Materials and Supplies, and Working Cash. The remainder of this section is devoted to analyzing those two components.

A. MATERIALS AND SUPPLIES

Materials and Supplies (M&S) represent the balance of inventories maintained for new plant construction, as well as for the operation and maintenance of existing plant. Several different accounts have been set up to track M&S balances. SCE has separate accounts for Total SCE M&S, Adjusted Total SCE M&S, Total Non-SCE M&S, Total Power Transformers M&S, and Total Undistributed Stores. In addition, SCE tracks Unpaid Invoices, which are deducted from M&S. SCE's methodology for calculating 2003 M&S involved examining recorded 2000 data and developing ratios between the various M&S accounts. SCE developed ratios to maintain the relationships between recorded M&S and Undistributed Stores Expenses and Unpaid Invoices. Ratios are then applied to the monthly level of total M&S to develop forecasted Undistributed Stores Expense and Unpaid Invoices for the test year.

ORA has concerns with SCE's methodology. It appears that there are multiple levels of uncertainty in the calculation – the reasonableness of using only one recorded year to develop ratios, the question of whether the account ratios in 2000 are a reasonable proxy for future years, and whether SCE's 2002 and 2003 estimates of the various accounts that constitute total M&S are reasonable. Because of these questions, ORA decided to develop its own M&S methodology.

ORA first sought to see if there was any relationship between M&S balances and plant additions; it seemed plausible that M&S inventories may increase if the level of plant additions increased. However, that did not appear to be the case; over the last six recorded years (1996 through 2001), the ratio of M&S balances to plant additions ranged from a low of 7.22% to a high of 16.99%. ORA felt that this range of ratios was too large, and concluded that M&S balances could not be reasonably estimated using plant additions. Because M&S balances seem to be independent of plant additions (and because ORA lacks confidence in SCE's methodology), ORA concluded that a simple 5-year average of recorded M&S balances was a reasonable method to estimate future M&S balances.

ORA reviewed the weighted average M&S balances for the years 1997 through 2001. Initially, ORA questioned whether it was appropriate to include recorded 2001 data in the average. In D.02-04-055, the Commission cautions against using recorded 2001 data for setting a revenue requirement. Indeed, the recorded weighted average M&S balance for 2001 was higher than any other recorded year. However, ORA ultimately concluded that the recorded 2001 balance was not so abnormally high to warrant its exclusion. Therefore, the 5-year average of recorded weighted average M&S balances was computed by ORA, and used as the foundation for its test year 2003 estimate. On top of that foundation, ORA added an additional $6.5 million to account for M&S associated with Palo Verde. Historically, recorded M&S balances have not included anything for Palo Verde. That is scheduled to change beginning in 2003. Therefore, the estimated Palo Verde M&S must be added.

Table 2 (below) compares ORA's and SCE's estimates for 2003 M&S.

Table 2
Weighted Average M&S
Test Year 2003
($000)

	ORA Recommended	SCE Proposed	Difference SCE - ORA
2003 Wtd Avg M&S	$61,345	$66,693	$5,348

B. WORKING CASH

Working Cash is included in Rate Base to compensate SCE's investors for the funds advanced by them. When a utility incurs expenses before it receives revenues from its customers, it has to dip into its own pockets to pay the bills; Working Cash compensates the utility and makes it whole. Working Cash amounts will vary depending on the levels of expenses recommended by ORA's witnesses. Because changes in expenses impact Working Cash, it is important that all expense adjustments be properly incorporated. Ideally, any changes to expense levels should automatically be reflected in Working Cash. Originally, SCE's RO model required that, for several expenses, any changes had to be manually loaded into the model. At ORA's request, SCE has revised its model so as to automate this task for those expenses most likely to change.

Working Cash is itself composed of two pieces, the Operational Cash Requirement and the so-called lead/lag calculation. ORA has carefully reviewed SCE's estimates for the Operational Cash Requirement and found them reasonable. However, ORA does recommend several adjustments to the lead/lag calculation.

Calculation of Franchise Requirements for Working Cash

Franchise Requirements are those expenses imposed on SCE by cities and counties for the right to do business within their jurisdictions. Franchise Requirements appear twice in SCE's RO computer model – once as a line item in the Summary of Earnings table, and once as a line item in the lead/lag calculation. SCE's model calculates Franchise Requirements the same in both places; this is not correct. In the Summary of Earnings table, Franchise Requirements are based on the revenue requirement that is developed in this GRC; the revenue requirement excludes revenues to pay for fuel and purchased power costs. However, in the lead/lag study, Franchise Requirements should be based on the total revenues received by SCE, including revenues to pay for fuel and purchased power. Obviously, the Franchise Requirements computed for the lead/lag should be much larger that the Franchise Requirements calculated in the Summary of Earnings. In a phone conversation with SCE, it acknowledged this flaw in its model. SCE has stated that in future versions of its model, this problem will be fixed. In the model version it is using, ORA has made the necessary corrections to ensure that the two different Franchise Requirements are calculated correctly.

Domestic Customer Revenue Lag

When SCE calculated its revenue lag for Domestic customers, it reduced the result by one day in anticipation of the adoption of a late fee payment charge. As discussed in Chapter 10, ORA is recommending that late payment charges not be imposed on Domestic customers. Therefore, ORA is adding back the one day that had previously been removed from the revenue lag, increasing the total from 37.07 days to 38.07 days.

P.B.O.P. Provisions

SCE has calculated an expense lag of 276 days for Postretirement Benefits Other than Pensions (P.B.O.P.). ORA's witness for this expense has questioned SCE's calculation. In response to ORA's questions, SCE has revised its P.B.O.P. lag estimate downward to 82.5 days.

VII. DEDUCTIONS FOR RESERVES

The fourth component of Rate Base is Deductions for Reserve. It is itself composed of six different account balances: Accumulated Depreciation Reserve, Accumulated Amortization, Accumulated Deferred Taxes – Plant, Accumulated Deferred Taxes – Capitalized Interest, Accumulated Deferred Taxes – CIAC, and Unfunded Pension Reserve. All but one of the six are analyzed and discussed in other chapters in this report; only Unfunded Pension Reserves is discussed here. (Accumulated Depreciation and Accumulated Amortization are discussed in Chapter 17; the other three balances are discussed in Chapter 15.)

Unfunded Pension Reserve

The Unfunded Pension Reserve represents SCE's estimate of future liability with respect to employee retirement benefits. It is deducted from Rate Base in accordance with Commission Decision 76106, dated August 1969. SCE based its estimate on a 5-year rolling average of the changes in the year-end amounts. The year-end estimates are converted to 13-month weighted averages, where they are then deducted from Rate Base. ORA has examined SCE's methodology, and agrees with its estimates. As Table 3 shows, both ORA and SCE are estimating a test year 2003 weighted average Unfunded Pension Reserve balance of $105.1 million.

Table 3 Weighted Average Unfunded Pension Reserve Test Year 2003 ($000)			
	ORA Recommended	SCE Proposed	Difference SCE - ORA
2003 Wtd Avg Reserve	$105,080	$105,080	$0

VIII. CONCLUSIONS

ORA recommends that its Rate Base estimates listed on Table 4 be adopted. This results in a Rate Base estimate $627 million lower than that proposed by SCE.

For the electronic copy of this report, Table 4, Total Company Weighted Average Rate Base, is attached as a separate file

CHAPTER 19

TOTAL COMPENSATION

I. INTRODUCTION

SCE's Total Compensation represents cash (base salaries and incentive compensation) and non-cash compensation (i.e. pension and benefits) paid to SCE employees. SCE's aggregate compensation is 4.3% above market levels based on the Final Report - Total Compensation Study performed by Hewitt Associates, international Human Resources consulting firm.

II. DISCUSSION/ANALYSIS

The report describes in detail the methodology utilized by Hewitt Associates to compile, analyze and compare the study data. Hewitt Associates divided SCE's workforce into five job categories (Physical/Technical, Clerical, Professional/Technical, Managerial/Supervisory, and Executive) and performed a competitive analysis of total compensation under the management of SCE and ORA. SCE and ORA requested that Hewitt Associates provide an update to the study to accompany SCE's 2003 General Rate Case Submittal. The study data in the report is effective as of June 30, 2000. Table 19-1 below provides a summary of the results for SCE's Total Compensation Study performed by Hewitt Associates, which shows SCE's competitive status for each major component of compensation (base salary, base salary plus annual incentives, benefits, and total compensation).

Table 19-1

Summary Results of SCE's Total Compensation Study

Job Category	**SCE Population**	**SCE Payroll Dollars**	**Base Salary**	**Base Plus Incentives**	**Benefits**	**Total**
Physical/Technical	3,994	$205,027	5.1%	1.6%	7.8	2.6%
Clerical	2,930	105,679	-1.7	-1.3	10.6	0.8
Professional/Technical	4,134	293,188	3.2	6.8	14.3	7.9
Managerial/Supervisory	1,732	168,237	1.4	3.1	0.2	2.7
Executive	28	13,241	-0.4	-3.5	30.3	-1.1
Overall	**12,818**	**$785,373**	**2.6%**	**3.4%**	**9.3%**	**4.3%**

III. CONCLUSIONS

In this proceeding, ORA is not recommending that the Commission adjust SCE's 2003 revenue requirement based on the findings that SCE's aggregate compensation is 4.3% above market levels as reported in the Total Compensation Study performed by Hewitt Associates. However, ORA recommends that the Commission continue to monitor SCE's position relative to the market in future studies.

CHAPTER 20

POST TEST YEAR RATEMAKING

I. INTRODUCTION

As part of its GRC application, SCE has requested a Post Test Year Ratemaking (PTYR) mechanism for the years 2004 and 2005. The proposal combines aspects of both the GRC attrition mechanism used in the past and SCE's current PBR mechanism. Among other things, the PTYR mechanism will provide rate relief for the company for costs related to increased expenses and capital additions for its GRC related operations for those two years. Rates for the year 2006 would then be addressed in the company's next GRC NOI/application filing. SCE also requests incentives to ensure the maintenance of service quality and a procedure to address major exogenous changes in costs. ORA has analyzed the company's proposal and recommends certain modifications, particularly in the areas of rate relief for capital additions and incentives to maintain service quality.

II. SUMMARY

ORA does not oppose a mechanism that provides SCE the opportunity to earn its authorized rate of return for its GRC related operations during the years 2004 and 2005. However, ORA does not agree with SCE's PTYR proposal, which exceeds the scope and complexity of previous mechanisms authorized by the Commission for this purpose.

With respect to the revenue requirement and revenue increase for the years 2004 and 2005, the following table shows the differences between ORA's recommendation and SCE's request.

Table 20-1

Post Test Year Revenue Increases

(Dollars in thousands)

	ORA	SCE	SCE>ORA
Post Test Year 2004			
Present Rate Revenues[182]	$3,127,000	$3,580,453	$452,965
Post Test Year Revenues	3,018,000	3,502,214	483,541
Increase (decrease)	(108,815)	(78,239)	30,576
% Increase (decrease)	(3.5%)	(2.6%)	
Post Test Year 2005			
Present Rate Revenues	$3,088,119	$3,582,784	$494,655
Post Test Year Revenues	3,132,551	3,698,683	566,132
Increase (decrease)	44,432	115,899	71,467
% Increase (decrease)	1.4%	4.6%	

Much of the difference in revenue change recommendations between ORA's recommendation and SCE's request is due to differences in ORA and SCE test year 2003 estimates for expenses and capital. The remaining differences are caused by (1) ORA's use of a post test year non-labor escalation factor that is based on more recent information than SCE's non-labor factor and (2) ORA's use of historical data to derive estimated post test year plant additions as opposed to SCE's use of its capital budget.

With respect to SCE's PTYR proposal as detailed in Exhibit SCE-10, Chapter IV, ORA does not agree with the following:

[182] Present rates for 2004 include those associated with the SONGS ICIP since the ICIP will end 12/31/03 and SONGS will be included in GRC related base revenues for the years 2004 and 2005. SCE estimates that the 2004 present rate revenues associated with the non-fuel portion of the SONGS ICIP amount to $459,932,000.

1. Plant addition estimates for 2004 and 2005 that are derived through SCE's capital budgeting process and the resulting increases in capital related costs for 2004 and 2005.
2. SCE's proposed incentive mechanism to maintain service quality.

ORA does not oppose SCE's PTYR proposal with respect to the following:

1. An annual advice letter providing notice of the revenue requirement change for the following year.
2. O&M escalation using the GRC escalation rate methodology, updated at the time of the advice letter filing.
3. An annual revenue adjustment to reflect the number of nuclear refueling outages as adopted in this proceeding and updated for escalation.
4. A procedure to address major exogenous changes in SCE's costs.
5. Annual reporting of service quality performance.

III. SCE'S REQUEST

SCE's PTYR proposal is contained in Exhibit SCE-10. In principle, it reflects various aspects of previously authorized GRC attrition mechanisms and performance base ratemaking mechanisms. In particular, the annual advice letter procedure, the O&M escalation methodology and the annual adjustment revenue adjustment to reflect the number of nuclear refueling outages at SONGS have been included in prior SCE attrition mechanisms approved by the Commission[183]. Likewise, the advice letter procedure, a mechanism to address major exogenous changes, service quality incentive mechanisms and annual reporting of service quality performance are part of SCE's current PBR mechanism[184]. To ORA's knowledge, use of a budget to derive capital related costs has never been a part of any previous attrition or PBR mechanism adopted by this Commission for the major energy utilities.

[183] For example, see D.91-12-076, SCE's test year 2002 GRC decision which authorized attrition for the years 2004 and 2005

[184] See D.96-09-092 and D.02-04-055.

IV. ORA'S ANALYSIS

The major issue developed in this chapter concerns the estimation of plant additions for each of the post test years. Differences in post test year revenue requirements are also affected by slight differences in labor and non-labor escalation factors for 2004 and 2005 as well as the residual effects of the various test year 2003 differences in revenues and costs.

A. ESTIMATED POST TEST YEAR PLANT ADDITIONS

The capital related portion of SCE's revenue requirement estimate for the post test years is based, in part, on the accumulated plant balances estimated for 2003 and annual plant additions for each of the years 2004 and 2005. Capital related costs such as net return on rate base, income taxes, property taxes and depreciation expense are directly related to the accumulated plant balance for that year. ORA does not dispute the use of the estimated accumulated plant balance at the end of 2003 as the starting point to estimate plant balances for both 2004 and 2005. In fact ORA used its estimate of the end of year 2003 plant balance for this purpose. However, as discussed below, ORA believes that SCE's estimates of plant additions for 2004 and 2005 are unreasonable. For that reason, ORA based its estimates of plant additions largely on an average of recorded information

SCE used estimates of plant additions contained in its capital budget developed in October 2001, to quantify plant additions for the post test years 2004 and 2005. This is the same budget that was used to estimate 2001, 2002 and 2003 plant additions in determining the test year 2003 plant level. In that budget, SCE estimated total company plant additions amounting to $820,917,000 for 2001 and $880,184,000 for 2002 and $1,047,168,000 for 2003. Recorded 2001 additions amounted to only $601,729,000, which results in a $219,188,000 (26.7%) difference from the budget based estimate for that year. For the first 6 months of 2002 SCE has booked $304,498,000 in plant additions. If that amount were annualized, the resulting $608,998,000 amount would be $271,188,999 or 30.8% lower than the budgeted amount for 2002. For a variety of reasons, including the inaccuracy of the plant budget, ORA's plant witnesses estimated

substantially lower plant additions for test year 2003 when compared to SCE's estimate (see Chapter 16). ORA's estimate of $731,013,000, is $316,155,000 or 30.0% lower than SCE's budget estimate. For these reasons, ORA did not estimate plant additions for 2004 and 2005 based on SCE's budget. Instead, except for SONGS capital costs, ORA averaged 1995 through 2000 recorded plant additions (in constant 2000 dollars) and escalated that amount to 2004 and 2005. Seven year averages have been used in past SCE attrition year calculations for estimating plant additions for the years between GRC test years. Based on the average of recorded additions, and including SONGS estimates developed on Chapter 16-B, ORA estimates plant additions to be $887,964,000 for 2004 and $904,668,000 for 2005 as opposed to SCE's estimates of $1,306,949,000 for 2004 and $1,142,835,000 for 2005. Table 20-2 summarizes this discussion.

Table 20-2
Plant Additions
(Dollars in thousands)

Year	Recorded	ORA Est	SCE Est	SCE>ORA	
1996	$672,176				
1997	587,639				
1998	692,884				
1999	933,442				
2000	920,924				
2001	601,729	$601,729[185]	$ 820,917	$219,188	36.4%
2002	608,998[186]	658,462	880,184	221,722	33.6%
2003		731,013	1,047,168	316,155	43.2%
2004		887,964	1,306,949	418,985	47.2%
2005		904,668	1,142,835	238,167	26.3%

ORA's estimates for 2004 and 2005 provide SCE with more money than the company has been spending since the energy crisis began to affect its capital spending. While the amounts are less than what is embodied in SCE's request, it clearly provides additional capital beyond the current spending levels. That money can be used by SCE to

[185] ORA incorporated 2001 recorded plant data in its estimate of testyear 2003 plant balances.
[186] Annualized from 6 months of recorded data

ramp up its spending for discretionary projects that have recently been curtailed. Whether SCE actually does spend the additional money, or not, would be an important consideration in determining capital expenditures in the company's next GRC

ORA's methodology for estimating post test year plant additions is similar to that used in past Commission-adopted attrition methodologies. The averaging of recorded plant addition information to estimate future plant additions was an element of a generally simple mechanism that was not subject to much controversy and which provided the utility with the opportunity to earn a reasonable rate of return during the years between GRCs. ORA is unaware of any attrition methodology adopted by the Commission which exclusively used a budget to determine plant additions for the attrition years. For SONGS, ORA did make a separate estimate of plant additions based on a combination of recorded costs and SCE's plant budget. SONGS will be returning to traditional cost of service regulation beginning in 2004, the first post test year. For that reason and also the fact that SCE made a more substantial showing on post test year plant additions for SONGS than it did in the other areas, ORA did not use recorded information exclusively in developing its SONGS plant addition recommendations.

B. LABOR AND NON-LABOR ESCALATION

ORA and SCE differ slightly in the escalation factors that are used to escalate expenses from 2003 levels to 2004 and 2005 levels. The differences are caused by ORA's use of more recent information and are discussed in Chapter 5.

C. TEST YEAR 2003 ESTIMATES

Other differences between ORA and SCE regarding the amount of revenue change in the post test years is caused by different estimates of the various test year 2003 areas related to sales, expenses, plant and rate base. For example, the amount related to labor and non-labor escalation will be lower in ORA's case simply because the amount to be escalated (expenses estimated for test year 2003) is less than that used by SCE.

D. PERFORMANCE INCENTIVE MECHANISMS

In SCE's PBR mechanism that was first authorized by D.96-09-092, the Commission adopted a series of performance incentives in the areas of electric system

reliability, employee safety and customer satisfaction. As part of this GRC, SCE has requested similar performance incentives to maintain its service quality. ORA's recommendations employee safety are developed in Chapter 14-D. Briefly, ORA recommends that the employee safety performance measure be established with a penalty only incentive, rather than a reward and penalty incentive as requested by SCE. ORA's analysis and recommendations regarding the electric system reliability and customer satisfaction performance measures will be contained in testimony that will be issued on December 6, 2002.

V. CONCLUSIONS

Post test year plant additions should be based on historic data and possibly estimates for 2002 and 2003 that have been scrutinized in the GRC process. The exclusive use of a budget derived in 2000 to estimate plant additions for 2004 and 2005 is not practical considering, in this case, the inaccuracy of that budget in estimating even 2001 and 2002 plant additions. Based on its test year 2003 estimates and modifications (plant additions and updated escalation) to SCE's proposed PTYR mechanism, ORA recommends post test year rate changes amounting to a decrease of $108,815,000 for 2004 compared to 2003 levels and an increase of $44,432,000 for 2005 compared to 2004 levels.

Regarding SCE's proposed incentives to maintain service quality, at this time ORA recommends that the employee safety incentives be penalty only. ORA will address electric system reliability and customer satisfaction in the December 6, 2002 mailing.