Decision **REVISED PROPOSED DECISION OF ALJ DEBERRY**
(Mailed 12/9/2003)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) for Authority to Recover Capital Additions to its Fossil Generating Facilities Made Between January 1, 1997 and March 31, 1998 or the Date of Divestiture for Those Generating Facilities Divested by July 8, 1998 and Related Substantive and Procedural Relief.	Application 99-04-024 (Filed April 19, 1999)

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OPINION REGARDING CAPITAL ADDITIONS

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OPINION REGARDING CAPITAL ADDITIONS

I. Summary

This decision adopts capital additions of $31,782,000 for Southern California Edison Company (Edison) for non-nuclear generation plant added to rate base in 1997 through March 31, 1998, for non-divested generation plant, and through July 8, 1998, for divested and retained generation plant. This amount represents capital additions for environmental, regulatory, and safety purposes and for Federal Energy Regulatory Commission (FERC) relicensing purposes. Capital addition costs of $20,434,000 for divested non-nuclear generation plant between 1997 and July 8, 1998, to maintain plant through December 2001, are also approved. This decision also prohibits potential double recovery of divested plant capital additions from ratepayers. Capital additions for divested plant have already been recovered from ratepayers either through gain on sale in the market or by amortization over the transition period and should not be recovered a second time. An additional $30,937,000 in capital additions to retained non-nuclear generation plant will be addressed in Application (A.) 02-05-004, Edison's Test Year 2003 General Rate Case. This decision further provides that the divested plant capital addition costs should not be included in Edison's going forward memorandum accounts and should not be recovered a second time from ratepayers.

As a result of this decision, Edison is authorized to recover in future rates the return and taxes on capital additions considered in this proceeding, which are recorded in the Non-Nuclear Generation-related Capital Additions Memorandum Account (NGCAMA). This amount is approximately $1.5 million.

II. Procedural Background

In Decision (D.) 97-09-048, issued in the electric industry restructuring rulemaking (R.) 94-04-031, the Commission established the approach for evaluating the appropriateness of the utilities' recovery of capital additions made to non-nuclear generating plant (hereinafter referred to as "capital additions") to determine compliance with § 367[1] during the transition period. For capital additions made during 1996 and 1997, the period before the Power Exchange (PX) and Independent System Operator (ISO) were scheduled to begin operations, the Commission provided for recovery based on an after-the-fact reasonableness review of recorded expenditures. The after-the-fact reasonableness review was subsequently extended to capital expenditures incurred in 1998 prior to the opening of the ISO and PX on April 1, 1998. (D.98-03-054.)[2] The after-the-fact reasonableness review mechanism allowed the utility to make timely business decisions without prior resolution of ratemaking treatment. A market control approach[3] was adopted for recovery of capital additions made during the rest of the transition period.

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[1] All references are to the California Public Utilities Code unless otherwise noted.

[2] The decision allowed recovery of reasonable and necessary capital additions made prior to March 31, 2001 for plants that were not divested, and for reasonable and necessary capital additions made through the date of divestiture, which was required to be completed within 90 days of the beginning of ISO/PX operations (June 30, 1998). Subsequently, the Commission also issued an Order Modifying Decision 97-09-048 To Correct A Typographical Error, and Denying Rehearing of the Decision, as Modified, reiterating the principles set forth in the original decision. (D.99-03-061.)

[3] The market control approach adopted in D.97-09-048 provides that capital additions occurring after January 1, 1998 to a must-run plant would be recovered from payments under ISO call contracts (ISO call contracts refer to the eventual reliability contracts between the ISO and the utilities), or through the PX, and the costs of additions

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Edison filed this application on April 19, 1999.[4] The Office of Ratepayer Advocates (ORA) and The Utility Reform Network (TURN) filed protests to the application. A prehearing conference (PHC) was held on July 1, 1999, with Commissioner Bilas in attendance. ORA and TURN subsequently submitted testimony. Edison submitted rebuttal testimony and made several rounds of revisions to its testimony.

The Commission held five days of hearings regarding Edison's application on February 7-11, 2000. During the evidentiary hearings, Edison offered, for the first time, direct testimony of a witness that contradicted both its prepared written testimony and the oral testimony of its other witnesses on a central issue. Accordingly, the parties were given an opportunity to conduct more discovery and to submit further evidence and the evidentiary hearing was continued to March 10, 2000. The parties filed opening briefs on March 31, 2000 and reply briefs on April 14, 2000. Additional evidence was submitted, pursuant to Administrative Law Judge (ALJ) request, on July 6, 2000, and March 6, 2001.

On January 18, 2001, Assembly Bill X1 6 (ABX1 6) amended § 377 to require that utilities retain electric generation plant not yet divested, and prohibited the disposal of retained generation plant until January 1, 2006. Retained generation plant is subject to continued regulation by this Commission. A September 7, 2001, ruling by the assigned ALJ set aside submission of the proceeding and

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occurring after January 1, 1998, to a non-must-run plant would be entirely recovered from PX prices. See D.97-09-048, 2 CPUC 2d 437, pp. 439-440.

[4] D.97-09-048 required the application to be filed within 30 days after recorded data is available. Edison states that recorded data was available on January 12, 1999 but that it was granted an extension and allowed to file its application within 30 days after issuance of the Commission's decision on its 1996 capital additions. D.99-03-055 was issued on March 18, 1999.

provided parties an opportunity for comments and reply comments on the effects of amended § 377. Comments were filed by Edison, TURN, and ORA on September 28, 2001, and reply comments by TURN on October 12, 2001.

On October 2, 2001, the Commission and Edison entered into a Settlement Agreement (Settlement Agreement). In accordance with the Settlement Agreement, Edison filed Advice Letter (A.L.) 1586-E to establish the associated ratemaking structure and the Procurement Related Obligations Account (PROACT).[5] On January 23, 2002, the Commission adopted Resolution E-3765 approving the structure and operation of the PROACT. On April 4, 2002, the Commission adopted D.02-04-016,[6] and directed Edison to file an advice letter detailing its rate base consistent with terms of the Settlement Agreement.[7] D.02-04-016 also adopted revenue requirements and balancing accounts for the recovery of reasonable costs. These balancing accounts[8] were established in

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[5] PROACT tracked the procurement related obligations, plus interest. D.03-07-029, adopted July 10, 2003, determined that the PROACT balance was recovered, and PROACT was eliminated.

[6] Opinion Adopting Revenue Requirements for Utility Retained Generation.

[7] D.02-04-016, *mimeo*, Ordering Paragraph 11, p. 99.

[8] The three balancing accounts are: (1) Native Load Balancing Account (NLBA), (2) Purchased Power Balancing Account (PPBA), (3) Independent System Operator Balancing Account(ISOBA). The NLBA records Edison's actual operating expenses and actual capital-related expenses for its ownership share of fossil, hydro and nuclear generating facilities. In addition, the NLBA tracks the difference between: (1) recorded operating expense and capital-related expense; and (2) the interim 2002 authorized revenue requirement for operating expenses and capital-related expenses. The PPBA records Edison's actual purchased power expenses. In addition, the PPBA tracks the difference between: (1) recorded purchased power expenses; and (2) the interim revenue requirement for purchased power expenses. The ISOBA records: (1) Edison's actual ISO payments for ancillary services and uplift charges, and (2) Reliability Must Run revenue and ancillary services revenue. The ISOBA also tracks the difference

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A.L. 1614-E. In further response to D.02-04-016, Edison filed A.L. 1618-E on May 5, 2002. A.L. 1618-E modifies the Settlement Rates Balancing Account (SRBA). Edison transfers activities in the NLBA, PPBA, and ISOBA to the SRBA on a monthly basis. A.L. 1618-E states that this proceeding remains as one of three generation-related proceedings currently pending before the Commission. Furthermore, A.L. 1618-E (p. 7) states that in compliance with D.02-04-016, Edison has included the 1997 and 1998 capital additions in its recorded rate base in determination of both Utility Retained Generation and General Rate Case revenue requirements, and that the return and taxes calculated through December 31, 2001, on the 1997 and 1998 capital additions at issue in this proceeding are included in the NGCAMA. The amount in NGCAMA related to return and taxes on 1997 and 1998 capital additions at issue in this proceeding as of January 2000 is approximately $1.5 million.[9]

On September 9, 2002, the assigned ALJs in this proceeding and in A.02-05-004, issued a joint ruling requesting Edison to provide testimony on capital additions made in 1997 and 1998 for reliability and obsolescence projects in A.02-05-004 (Joint Ruling). Attachment A to the Joint Ruling listed those projects to be removed from this proceeding and to be addressed in A.02-05-004. A letter from Edison on September 18, 2002, clarified that the projects and amounts for capital additions in retained plants under $100,000 are in coal and hydro plants. The total amount of reliability and obsolescence projects to be considered in A.02-05-004 is $30,937,000, and the capital additions to be

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between: (1) actual ISO expenses and revenue, and (2) the authorized interim 2002 ISO revenue requirement. (A. L. 1614-E).

[9] A.00-03-047, Edison Exhibit 1. This amount has not been included in rates.

considered in this proceeding are $52,216,000. The proceeding was submitted on September 19, 2002, following receipt of this information.

III. Background

Section 367, adopted as a part of AB 1890, which guides the implementation of electric restructuring, provides the standard and requirements for an electric utility to receive cost recovery through the competition transition charge (CTC) for capital additions incurred after 1995. Section 367 provides, in pertinent part:

> The Commission shall identify and determine those costs and categories of costs for generation-related assets and obligations, consisting of generation facilities . . . and the appropriate costs incurred after December 20, 1995, for capital additions to generating facilities existing as of December 20, 1995, that the Commission determines are reasonable and should be recovered provided that these additions are necessary to maintain the facilities through December 31, 2001.

To implement § 367, D.97-09-048 stated that we would consider "the following criteria, *among others*, in determining the reasonableness of 1996 and 1997 recorded expenditures on a case-by-case basis:

1. Consistency with recent capital budgets and expenditures for respective power plants;

2. The need for compliance with other regulatory requirements;

3. Cost effectiveness; and

4. The impact of the capital addition on the unit's heat rate and output." (*Emphasis* in original.) (*Id.*, *mimeo*, at p. 19.)

Capital additions that are found to be reasonable and necessary to maintain the facilities through December 31, 2001 would then be included in the

Transition Cost Balancing Account (TCBA)[10] for recovery from all ratepayers through the CTC.

We reviewed Edison's application for recovery of its 1996 capital additions (A.97-10-024) using the criteria described above and, in D.99-03-055, resolved several issues regarding the components Edison used to demonstrate the cost effectiveness of its projects. We adopted a capacity value of $962/MW/day, rejected use of a forced outage factor, and, for 1996 capital additions only, adopted a 20-year payback period. In D.99-03-055, we also determined that it was appropriate for Edison to group together projects costing under $100,000 without providing detailed information for our review.

In D.99-03-055, we explained the core purpose of our review:

> "our scrutiny of these generating costs is critical because our approval of them means they will be recoverable by way of the competitive transition charge (CTC), a surcharge which may not be bypassed by customers. The implication is that non-generation customers will assume certain costs of generation after the initiation of direct access. Edison's competitors are affected because they may not pass along such costs to Edison's nongeneration customers. The recovery of the costs anticipated in § 367 thereby creates a competitive advantage for Edison. In assessing the reasonableness of Edison's 1996 capital additions, therefore, we must consider two competing concerns: the need to satisfy the requirements of § 367 and the effects on competition and captive customers of including such costs in the CTC." (D.99-03-055, at p. 3.)

[10] However, as a result of the Settlement Agreement, amounts in the TCBA no longer affect rates, except to the extent the CPUC authorizes the recovery after such date of costs previously recorded in the TCBA.

IV. Edison's 1997 and 1998 Capital Additions Budgets

Edison seeks recovery of $83.153 million[11] in capital additions for 1997 and through March 31, 1998 for non-divested non-nuclear generation plants, and through the date of divestiture, not later than July 8, 1998, for divested generation plants.[12] (Revised Jt. Exh. 400B.) $52.718 million in capital additions were made to fossil generating plants while $30.435 million in capital additions were made to hydroelectric plants.

Edison segregates its capital additions projects into six categories: (1) replacement of broken or obsolete components (reliability or obsolescence projects); (2) compliance with regulatory (e.g., environmental) requirements; (3) maintenance of a safe working environment; (4) compliance with FERC's hydroelectric generation relicensing requirements; (5) metering projects to enable participation in the new market structure; and (6) projects required for divestiture of fossil-fired generation facilities. Edison contends that each of these projects was appropriate, reasonable, and necessary to maintain the facilities through December 31, 2001, considering the circumstances and information

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[11] In its application, Edison sought recovery for $83.9 million in capital addition costs. Edison withdrew its requests related to three Work Orders (WO), totaling $695,000 (WOs 1413-0402, 3398-0440, and 1320-0546) and reduced the amount requested for two other WOs (2314-0428 and 2314-0429) by $85,000.

[12] D.98-03-054 provides for recovery of capital additions made to divested plants through the date of divestiture, which were required to be completed by 90 days after the beginning of ISO/PX operations. (*Id.*, *mimeo*, at p. 4, Ordering Paragraph 2.) Edison seeks recovery of capital additions made to its Ormond Beach fossil generation plant through July 8, 1998, 98 days after the start of ISO/PX operation. Edison asserts, however, that it should be permitted to recover these costs because the Commission was not able to approve the divestiture until this date. No party has objected to Edison's recovery of these capital additions on this basis. Under the circumstances, we believe that this minimal delay was reasonable and permit Edison to continue with its claim.

available at the time the decisions to go forward with the projects were made. It argues that all of its capital additions meet the criteria set forth in D.97-09-048 in that its costs were at levels below recent capital expenditures, that many were for compliance with regulatory requirements, that they were cost effective based on reasonable assumptions, and that any impact on the unit's heat rate was an incidental result of a project required to maintain system reliability.

ORA proposes to disallow $44.659 million of the gross capital additions while TURN proposes to disallow $24.315 million of Edison's total requested $83.153 million. (Jt. Exh. 400B.)[13] Some, but not all, of ORA's and TURN's proposed disallowances overlap. If we were to adopt all of TURN's and ORA's proposed disallowances, the total amount disallowed would equal $47.912 million, about 60% of Edison's proposed recovery in this proceeding and A.02-05-004.

For the capital additions in this proceeding, ORA proposes to disallow $14.150 million of the $52.216 million in gross capital additions, while TURN proposes to disallow $13.323 million. If we were to adopt all of ORA's and TURN's proposed disallowances, including those that overlap, the total amount would equal $16.287 million, or about 31% of the capital additions considered in this proceeding.

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[13] Joint Comparison Exhibit 400B identifies the work orders challenged by TURN and ORA together with the reasons for seeking disallowance of the associated costs. TURN and ORA originally challenged many more work orders. However, after Edison provided further information documenting the claims, both in discovery and at the evidentiary hearing, TURN and ORA withdrew many of their objections. Joint Comparison Exhibit 400B has been updated to reflect the total work orders challenged by TURN and ORA in this proceeding. Significantly, TURN withdrew its objection to Edison's transmission metering projects based upon evidence not submitted until the hearing.

The bulk of TURN's and ORA's cost recovery objections pertain to the costs associated with investments Edison contends were made to improve reliability or to forestall obsolescence. TURN's objections are limited to projects at the fossil fuel-fired plants while ORA's objections also encompass projects at the hydroelectric plants. TURN and ORA also oppose recovery of the cost of spare parts purportedly incurred for divestiture of fossil fuel-fired generation plants and ORA opposes CTC cost recovery of revenue metering projects installed to enable participation in the new market structure at Edison's retained coal and hydroelectric plants. TURN and ORA generally do not oppose Edison's investments in projects required to fulfill safety or environmental standards or regulatory or hydroelectric relicensing requirements.

With respect to the projects for which they seek disallowance, TURN and ORA contend that the projects were not necessary to maintain the plants through 2001 and were unreasonably incurred. They challenge Edison's cost effectiveness calculations, including the selected payback periods, the fuel savings or heat rate assumptions, the catastrophic event calculations, and other factors that are project-specific, as well as the timing of the projects. ORA and TURN also challenge projects where the actual costs varied greatly from the cost estimates used in the cost effectiveness calculations. TURN asks us to analyze Edison's capital additions on a project-by-project basis instead of adopting general criteria for Edison to apply, as we did with respect to Edison's 1996 capital additions in D.99-03-055. TURN also seeks a ruling prohibiting Edison from recovering costs disallowed because they are unreasonable either directly or indirectly through the sunk cost balances recorded in the TCBA.

V. Discussion

Because capital additions in retained plants ($30,937,000) will be addressed in A.02-05-004, we need not consider them here. The capital additions have been

recorded in the Generation Memorandum Accounts. We separate the remaining capital additions ($52,216,000) into three categories, listed in Appendices A, B, and C:[14]

1. Capital additions for environmental, regulatory, and safety purposes and FERC relicensing requirements in divested and retained plants (Appendix A—$31,782,000);

2. Capital additions for oil and gas plants divested at a gain (Appendix B—$10,528,000); and

3. Capital additions for oil and gas plants divested at a loss (Appendix C—$9,906,000).

A. Environmental, Regulatory, Safety and FERC Relicensing Capital Additions

We will allow Edison to recover its costs associated with capital additions in retained plants and divested plants that were made for regulatory, environmental, and safety purposes as well as to meet FERC relicensing requirements. These costs total approximately $31.8 million of the $52.2 million, at issue in this proceeding. TURN and ORA have fully reviewed these expenditures, and as shown in the comparison exhibit[15] did not disagree with the reasonableness of these capital expenditures. Because of the nature of these costs, they are deemed necessary to maintain the facilities through December 31, 2001. The costs allowed on this basis are set forth in Appendix A, attached to this decision. Capital additions for regulatory, environmental, and safety purposes, and FERC relicensing requirements have already been recovered in rates;

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[14] Allocations of capital additions are based on Revised Joint Comparison Exhibit 400B.

[15] Revised Joint Comparison Exhibit 400B for 1997-1998 Capital Additions.

therefore, our adoption of these costs as reasonable means that Edison is authorized to recover the interest and taxes included in the NGCAMA in rates. We will devote the remainder of this decision to the remaining costs incurred for those investments incurred for plant that has been divested.

B. Treatment of Divested Plant Capital Additions

Edison argues that each capital addition in divested plant meets the test of reasonableness as demonstrated by the benefit-to-cost ratios, all of which exceed 1.0.[16] Edison notes that it removed from its application any capital additions that had benefit-to-cost ratios less than 1.0. TURN and ORA apply different economic criteria including a shortened payback period, and conclude the opposite. TURN and ORA also argue that Edison has failed to justify certain of its capital additions.

We have previously stated that the test of whether a capital addition is reasonable is not whether the associated plant may be sold at levels above book value. The test is whether it adds to the value of the plant.[17] In assessing the added value to plant, we have reviewed the different economic criteria proposed by TURN and ORA, including the shortened payback periods. While the shortened payback periods might result in rejecting certain capital additions, it is unclear when Edison should have applied this new standard and concluded that a shortened payback period should have been used in determining the cost effectiveness of the capital additions.[18] In D.99-03-055, we rejected similar shorter

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[16] See Exhibit 1, Table III-15, p. 54; and Table III-18, p. 58; Exhibit 2, Table II-2, p. 30.

[17] D.99-03-055, *mimeo*, p. 6.

[18] TURN argues that the Preferred Policy Decision in December 1995 should have been an indication that the criteria for capital additions was about to change, although § 367 was not enacted until 1996.

payback periods for 1996 capital additions, although D.99-03-055 provides for the consideration of shorter payback periods in other capital additions proceedings.

In this proceeding, Edison stated it applied a 10-year payback period for many of its oil and gas plants in cost effectiveness calculations a period somewhat longer than the seven-year period proposed by TURN and the six-year period proposed by ORA.[19] As shown on Exhibits 1[20] and 2,[21] the cost-to-benefit ratios exceed 1.0, and for some capital additions the cost-to-benefit ratios are as high as 22.0, as calculated by Edison. Despite TURN's and ORA's arguments to the contrary, we do not agree with reducing the payback periods to determine new cost-to-benefit ratios. As Edison points out, initially these projects were calculated using a 20-year payback period,[22] however, given the changes anticipated as a result of electric industry restructuring, beginning in May 1996, Edison applied a 10-year life in its fossil fired capital addition payback calculations. Edison argues that the 10-year period reflects the economic life of the capital additions. Application of the 10-year payback period to projects calculated using the 20-year payback period resulted in Edison withdrawing two projects from its requested capital additions.[23]

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[19] Eight projects were evaluated using 15 or 20 years (Exhibit 2, p. 16).

[20] P.58.

[21] Pp. 16-17, p. 30.

[22] D.99-03-055 concludes that a 20-year payback period is generally consistent with approach the Commission has taken in general rate cases. (p. 9)

[23] Work Orders 1413-0402 (Alamitos Units 3&4 reconductor), and 3398-0440 (Cool Water Units 3&4 transition)

TURN and ORA argue that a shorter payback period of either 6 or 7 years reflects the anticipated CTC recovery period. However, this is information that was not available to Edison at the time it made its decision to go forward with its capital additions, and does not reflect the economic life of these projects. Applying shorter payback periods would not be reasonable as the decisions to go forward with the capital additions were made before the enactment of AB 1890 in September 1996, which set December 2001 as the end of the rate freeze. After considering the arguments for different payback periods and Edison's cost-to-benefit ratios, we have determined that Edison's capital additions to divested plants meet the standard of cost effectiveness adopted by D.99-03-055, and therefore are reasonable. While we do not adopt TURN and ORA's position in this decision, their case-by-case analysis of Edison's capital additions was invaluable to the Commission in reaching this decision. While we choose to adopt Edison's blanket 10 year payback period for the capital additions at stake here, we could not have understood the impact on reliability of each of these projects without the analysis provided by TURN and ORA.

We must also ask whether the capital additions were necessary to maintain the plants through December 2001. In D.97-09-048, the Commission stated its concern over the issue of capital additions, and the potential for an unfair playing field for market participants.[24] This concern was clarified in D.99-03-055, which explains how Edison would receive dollar-for-dollar recovery of capital costs that might, in turn, unfairly lower operational and maintenance costs in a competitive market environment.[25] Although the Commission

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[24] 75 CPUC 2d, 442.

[25] *Mimeo*, pp. 9-10.

expressed its concern over these potentially abusive capital additions, it also expressed the need for utilities to recover capital additions that will maintain the reliability of the electric system.[26] The purpose of these concerns was to place Edison at risk for unreasonable capital additions in the deregulated marketplace expected after plant divestment.

TURN and ORA assert that certain of the capital additions were primarily for improving heat rate, a purpose that does not meet the "necessary to maintain" standard. However, Edison believes it made a reasonable case that each capital addition provided some additional reliability to Edison's electric system in order to maintain generation plant through the end of 2001. We have reviewed each of the disputed capital additions, and believe that each made some contribution to the reliability and maintenance of Edison's electric system through December 2001. Therefore, we find that the capital additions in divested plants were both reasonable and necessary to maintain plant through December 2001.

Furthermore, while we have not considered the effects of capital additions on plants sold after divesture, it is reasonable that these capital additions contributed to plant reliability, and system reliability, and will do so in the future, thus benefiting ratepayers with a more reliable system.

We are concerned that the adopted capital additions not be recovered twice from ratepayers, and therefore we consider the mechanisms by which Edison recovers the costs of capital additions in divested plants.

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[26] D.97-09-048, 75 CPUC 2d, 442.

1. Divested Plants Sold at a Gain

Edison seeks recovery for capital additions both to divested plants and to those that were not divested. Of the divested plants, several were sold for substantially over book value, and four were sold for less than book value as follows:

Plant	Book Value	Sale Price
Alamitos, Huntington, & Redondo:	$229 mil.	$781 mil.
Cool Water Generating Station:	$79 mil.	$186 mil.
El Segundo Generating Station:	$71 mil.	$87.75 mil.
Mandalay:	$15 mil.	$41 mil.
San Bernardino & Highgrove:	$6 mil.	$9.5 mil.
Subtotals	$400 mil.	$1,105.25 mil.
Ormand Beach	$125 mil.	$40 mil.
Long Beach	$100 mil.	$30 mil.
Etiwanda and Ellwood	$32 mil.	$10 mil.
Totals:	$657 mil.	$1,185.25 mil.

(A.96-11-046, D.97-12-106, D.98-03-077, D.98-07-030, and D.98-07-077.)

In D.97-09-048, we provided that the utilities' ability to recover reasonable and necessary capital additions occurring prior to divestiture of the plants, using the after-the-fact review mechanism, "will cease the earlier of (1) when the plant is sold or (2) March 31, 1998[27] and should only apply to capital additions not otherwise recovered through the marketplace." (*Id.*, at p. 3.)

Edison's Revenue and Tariffs Division supervisor testified to the accounting treatment of capital additions associated with divested non-nuclear generating facilities. He testified that, if these capital additions were found to be reasonable, no adjustment to the TCBA would be necessary because "the

[27] As discussed above, this date was later extended to June 30, 1998.

applicable capital addition would have already been included in the gain or loss on sale calculation, and included in the operation of the TCBA."[28]

Given Mr. Durgin's testimony, for the plants that sold for over book value, it would seem that the capital additions have already been "recovered through the marketplace," at least to the extent that the undepreciated cost of the capital additions was less than the sale price. To the extent that these capital additions already were recovered through the sale price by reducing the credit to the TCBA, they should not be recovered again. This finding is also consistent with the overall statutory scheme that provides only for the recovery of *uneconomic* costs. Section 367 provides for the recovery of costs for generation-related assets and obligations that:

> were being collected in commission-approved rates on December 20, 1995, and that may become uneconomic as a result of a competitive generation market, in that these costs may not be recoverable in market prices in a competitive market.

The total cost of the capital additions to Edison's divested oil/gas-fired generating stations—Alamitos, Huntington, Redondo, Cool Water, El Segundo, Mandalay, San Bernardino, and Highgrove—were substantially less than the sum of their respective sale prices; thus, we find that the capital additions to these plants are not recoverable a second time through the

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[28] We interpret Mr. Durgin's testimony to mean that Edison recouped the original plant investment (book value) plus the capital additions from the sale proceedings and credited the remainder to the TCBA as a gain available to ratepayers. For example, assume that the plant sold for $200 million, the book value before the capital additions was $100 million, and the cost of the capital additions was $10 million. In this example, we assume, based on Mr. Durgin's testimony, that Edison credited $90 million to the TCBA for the benefit of ratepayers.

NGCAMA or any other accounting mechanism. These divested plant capital addition costs that are found reasonable and necessary to maintain plant through December 2001, have already been recovered and are set forth in Appendix B.

In our decision regarding Edison's 1996 capital additions (D.99-03-055) we rejected Edison's argument that capital additions for plants that were sold above book value were necessarily economic and reasonable because the "test of whether a cap ad is reasonable is not whether the associated plant may be sold at levels above book value" but whether it "adds value to the plant."[29] However, the only issue that was posed and that we addressed in that case concerned cost effectiveness. That is, we were asked simply to evaluate whether we could presume that a capital investment was cost effective and reasonable by the mere fact that the plant sold for greater than book value. And, we concluded that we could not. We did not address the issue we face today, that is, whether Edison's specific capital additions in plants divested at a gain were reasonable in those particular instances. We conclude that the entire $10,528,000 in capital additions to divested plant was reasonable and necessary to maintain that plant through December 2001. Furthermore, we also conclude that Edison has been compensated for these capital additions as the sale price exceeded the book value plus the undepreciated cost of the capital additions and therefore no further cost recovery is warranted.

2. Divested Plants Sold at a Loss

Four divested plants were sold at a loss, Long Beach, Ormand Beach, Etiwanda and Ellwood. We have determined that capital additions in divested plants were reasonable and necessary to maintain plant through

[29] See D.99-03-055, p. 6.

December 2001, including those capital additions in plants sold at a loss. In D.97-11-074, we directed that any loss associated with sale of assets should be amortized over the transition period[30] from January 1998 through December 2001.[31] Pursuant to this direction, Edison amortized the losses from plants sold at a loss (Long Beach, Ormand Beach, Etiwanda and Ellwood), including the capital additions in these plants prior to the Settlement Agreement. At this point in time, § 2.8 of the Settlement Agreement[32] then directed Edison to continue the amortization of losses through December 2001. Pursuant to this direction, Edison filed A.L. 1623-E, pursuant to which the losses, including the related capital additions, have already been amortized and are listed in Appendix C. The amount of capital additions in plants sold at a loss is $9,906,000.

The return and taxes[33] on capital additions included in NGCAMA have not yet been included in rates. Our adoption of the $52.216 million in capital additions in this proceeding means that Edison is authorized to recover that portion of the return and taxes recorded in NGCAMA associated with this $52.216 million in capital additions.

VI. Comments by Parties to Proposed Decision

A proposed decision of ALJ DeBerry in this matter was mailed to the parties on July 22, 2003, and comments and reply comments were received from

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[30] Finding of Fact 21, p. 746, 2nd CPUC, Vol. 76.

[31] D.97-06-060.

[32] The California Supreme Court affirmed that the Settlement Agreement did not violate California law, *mimeo*, August 21, 2003.

[33] $14.6 million as of January 2000.

Edison, TURN, and ORA. The comments and reply comments raised a number of significant issues and therefore a revised proposed decision was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure on December 9, 2003. Comments on the Revised Proposed Decision (RPD) were jointly filed by TURN and ORA on January 5, 2004. Edison filed reply comments on January 12, 2004.

TURN and ORA recommend that the RPD be either abandoned or substantially revised. TURN and ORA argue that the RPD allows recovery by Edison of 1997-98 capital additions without a determination that costs were reasonable. TURN and ORA contend that the RPD does not meet the standard in Pub. Util. Code § 1705 requiring Findings of Facts (FOF) and Conclusions of Law (COL) material to the decision. TURN and ORA allege the RPD is inadequate, and unlawful, as it does not address reliability and obsolescence issues that are affected by shorter payback periods and the expected economic lives of capital additions. TURN and ORA further assert that the RPD evaluation of the "necessary to maintain" standard is inconsistent with the record, and does not make sense. TURN and ORA assert that it is insufficient for the RPD to conclude that each capital addition made some contribution to reliability and maintenance based merely on a belief, rather than record evidence supporting the belief. TURN and ORA point to certain individual plant additions and conclude that these do not meet the "necessary to maintain" standard. In addition, TURN and ORA believe that the RPD must discuss other project specific criticisms, including fuel savings, catastrophic events and timing. Finally, TURN and ORA argue that the RPD should not allow Edison to recover the costs of any unreasonable projects from plant sales, including the Alamitos and Cool Water projects that were withdrawn from Edison's application.

In response, Edison takes significant exception to the TURN and ORA arguments. Edison contends that the TURN and ORA arguments are rife with errors, and Edison insists that the RPD is consistent with applicable California law and the evidentiary record. Furthermore, Edison asserts that the RPD includes the necessary FOF and COL that satisfy Pub. Util. Code § 1705. Edison argues that nothing in Pub. Util. Code § 1705 requires specific FOF or COL on each project, and that the Commission in many instances, reviews categories of capital additions. Edison also contends that the RPD payback assumptions are supported by the record and that the physical lives of assets are the expected recovery period for economic assets. Edison explains that the CTC recovery of stranded costs did not necessarily change the expected physical life of an economic capital addition.

Edison argues that the RPD appropriately determines that the capital additions were necessary to maintain generating facilities, and reliable system operation. Edison adds that contrary to assertions by TURN and ORA, Edison has not recovered all costs associated with capital additions in this proceeding, as interest and taxes in NGCAMA have yet to be recovered.

In response to these comments, we have made modifications to language that remove a finding of cost-effectiveness for environmental, regulatory, safety and relicensing projects, and clarified that environmental, regulatory, safety and relicensing capital additions have been recovered either through gain on sale, or amortized for plants sold at a loss. Similarly, we have modified language to clarify that Edison has recovered its capital additions costs for divested plants,[34] and on Edison's payback periods used in some projects.

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[34] Only interest and taxes on capital additions included in NGCAMA (approximately $1.5 million) have not yet been recovered in rates.

VII. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Bruce DeBerry is the assigned ALJ in this proceeding.

Findings of Fact

1. ABX1 6 signed January 18, 2001, modifying Pub. Util. Code § 377, requires that utilities retain all generation plant not divested until January 1, 2006.

2. The return and taxes on 1997-98 capital additions costs are recorded in the NGCAMA and this account has not yet been recovered in rates by Edison.

3. Given the nature of the costs, the complete review made by TURN and ORA, and as TURN and ORA do not recommend disallowance of capital additions made for regulatory, environmental, and safety projects and FERC relicensing in divested and retained plants, it is reasonable to deem that these capital additions were necessary to maintain the facilities through 2001, and are reasonable. The amounts for regulatory, environmental, and safety projects and FERC relicensing in divested and retained plants is $31,782,000.

4. The Alamitos, Huntington, Redondo, Cool Water, El Segundo, Mandalay, San Bernardino, and Highgrove plants were sold for substantially over their book values.

5. Edison has recovered the costs of the capital additions incurred at the Alamitos, Huntington, Redondo, Cool Water, El Segundo, Mandalay, San Bernardino, and Highgrove plants through the gain on sale in the marketplace by reducing the credit to the TCBA associated with the sale.

6. It is reasonable to deny recovery, through the NGCAMA, or other accounting mechanism, of costs of capital additions already recovered through the gain on sale in the marketplace.

7. The Long Beach, Ormand Beach, Etiwanda, and Ellwood plants were sold below book value, and the losses from these sales have already been amortized.

Conclusions of Law

1. Edison should be allowed to recover the cost of capital additions projects made for regulatory, environmental, and safety and FERC relicensing projects in its divested and retained plants. These are approved costs, previously recovered, and are delineated in Appendix A.

2. The cost of capital additions projects made in 1997 through July 8, 1998, for divested plants as shown in Appendices B and C were previously recovered or amortized and should not be recovered again. No adjustment to recorded rate base or NGCAMA is necessary.

3. Edison should not be allowed to recover the costs of capital additions projects made to the Alamitos, Huntington, Redondo, Cool Water, El Segundo, Etiwanda, Ellwood, Mandalay, San Bernardino, Long Beach, Ormand Beach, and Highgrove plants a second time through the NGCAMA or other accounting mechanism.

4. In order to resolve these issues without further delay, today's decision should be made effective immediately.

O R D E R

IT IS ORDERED that:

1. The application of Southern California Edison Company (Edison) for recovery of certain capital additions pursuant to Section 367 of the Public Utilities Code is granted to the extent set forth herein and consistent with Appendices A, B, and C.

2. Edison is authorized to file an advice letter, which includes supporting documentation, to recover the return and taxes recorded in the Non-nuclear Generation-related Capital Additions Memorandum Account, for those capital additions adopted in this decision.

3. Application 99-04-024 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX A: APPROVED COSTS[1]

Environmental, Regulatory, and Safety Purposes and FERC Relicensing

Work Order	Description	Gross Additions ($000)
1320-0544	MOGS – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	270
2211-8002	BIG CREEK NO. 1 – INSTALL SURFACE WATER FILTRATION SYSTEM	116
2211-8011	BIG CREEK NO. 1 – INSTALL 20, 000 GALLON DOMESTIC WATER TANK	124
2211-8016	BIG CREEK NO. 1 – WASTE WATER TREATMENT PLANT TANK/WEIR INSTALLATION	213
2230-8006	BIG CREEK NO. 3 – REPLACE DOMESTIC &WASTE WATER SYSTEMS (INCLUDING INSTALLING WELL)	299
2314-0428	ERSKINE FLUME – SEISMIC UPGRADE TO FLUME STRUCTURE	1,322
2314-0429	BODFISH FLUE – SEISMIC UPGRADE	2,266
2202-0301	BIG CREEK CANYON – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	1,324
2301-0305	SANTA ANA RIVER & MILL CREEK CANYON – REVE METERING REQ TO PARTICIPATE IN WEPEX	305
2305-0303	KERN RIVER CANYON – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	519
2307-0303	KAWEAII RIVER CANYON – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	412
2309-0301	SAN GORGONIO CANYON – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	135
2331-0346	ONTARIO NO. 1 – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	155
2501-0318	BISHOP CREEK CANYON – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	528
2503-0306	MONO BASIN – REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	145
2328-0434	KERN RIVER NO. 3 – COSTS ASSOCIATED WITH RELICENSING EXISTING FEDERAL PROJECTS	4,912
2503-0302	LEE VINING – COSTS ASSOCIATED WITH RELICENSING EXISTING FEDERAL PROJECT	1,431
2503-0303	RUSH CREEK – COSTS ASSOCIATED WITH RELICENSING EXISTING FEDERAL PROJECTS	1,515
1211-0337	REDONDO G/S - UNIT 5 ASBESTOS ABATEMENT	826
1211-0338	REDONDO G/S - UNIT 6 ASBESTOS ABATEMENT	1,943
1211-4200	REDONDO G/S - UNIT 5 ASBESTOS ABATEMENT	540
1214-0983	REDONDO G/S - UNIT 7 ASBESTOS ABATEMENT	378
1219-0340	REDONDO G/S - PLANT 1 REPLACE SERVICE WATER TANK AND FOUNDATION	699
1310-8055	ETIWANDA G/S - REPLACE OIL SKIMMER FACILITY	130
1311-4214	ETIWANDA G/S - UNITS 1&2 ASBESTOS ABATEMENT	577
1313-4215	ETIWANDA G/S - UNITS 3&4 ASBESTOS ABATEMENT	1,005

[1] Revised Joint Comparison Exhibit 400 B for 1997-1998 Capital Additions.

3245-7720	ALAMITOS PEAKER - STATION FUEL STORAGE TANKS UPGRADE	104
1513-0846	EL SEGUNDO G/S - REPLACE UNIT 4 STEAM COOLED FRONT WALL BOILER TUBES	197
1513-0847	EL SEGUNDO G/S - REPLACE UNIT 3 TURBINE SPV SYSTEM	339
1513-4218	EL SEGUNDO G/S - REPLACE INSULATION UNIT 3 ASBESTOS ABATEMENT BOILER PIPING AND DUCTS	580
1612-0628	HUNTINGTON BEACH G/S - REPLACE UNITS 1&2 CHEM LAB MONITORING SYSTEM	230
3265-7705	HUNTINGTON BEACH PEAKER - DISTILLATE FUEL STORAGE TANK UPGRADE	155
1712-0524	MANDALAY G/S - REPLACE UNIT 1 INSULATION CONTAINING ASBESTOS	480
1712-0525	MANDALAY G/S - REPLACE UNIT 2 INSULATION CONTAINING ASBESTOS	403
1712-6001	MANDALAY G/S - UNIT 1 ENGINEER, DESIGN AND CONSTRUCT SCRS FOR REDUCTION OF NOX	143
1712-6002	MANDALAY G/S - UNIT 2 ENGINEER, DESIGN AND CONSTRUCT SCRS FOR REDUCTION OF NOX	227
3270-0044	MANDALAY PEAKER - SPARE PARTS BLANKET	121
3393-6025	COOLWATER COMBINED CYCLE - CEM'S FOR PART 75	105
1216-0358	RGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	706
1316-0812	ETGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	364
1416-0401	ALGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	897
1516-0854	ELGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	346
1616-0631	HBGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	414
1716-0551	MAGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	245
1936-0436	CWGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	143
1936-0438	CWGS - ADD 115KV CIRCUIT BREAKERS FOR THE DIVESTITURE SWITCHRACKS ON GENERATOR UNITS	465
1966-0365	HIGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	207
1996-0372	SBGS - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	130
1996-0373	SBGS - ADD 115KV CIRCUIT BREAKERS FOR DIVESTITURE SWITCHRACKS ON GENERATOR UNITS	494
3025-0311	ELWOOD PEAKER - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	114
3398-0437	CWCC - PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	257
9575-9730	NOR - SLIGER 95 VARIOUS INSTALL. PROTECTION EQUIPMENT FOR GROUND POTENTIAL RISE	137
9585-9714	WES – TESSAMA 95 VARIOUS SCENET INDOOR INFRASTRUCTURE	132
1727-4205	ORMOND BEACH G/S – REPLACE ASBESTOS INSULATION ON UNIT 1 TURBINE	253
3316-0493	LONG BEACH G/S - REPLACE COMBUSTION TURBINE HEAT RECOVERY BOILER TRANSITION DUCTS CT1	305
1726-0559	OBGS – PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	420
3316-0500	LBGS – PROVIDE REVENUE METERING REQUIRED TO PARTICIPATE IN WEPEX	580
	Total	=$31,782

APPENDIX B:[1]

APPROVED COSTS

OIL & GAS PLANTS DIVESTED AT A GAIN

Work Order	Description	Gross Additions ($000)
1214-0346	REDONDO G/S - REPLACE U7 FOURTH POINT HEATER	464
1513-0848	EL SEGUNDO G/S - FIRST STAGE BLADING ON U3 HP TURBINE	601
1513-0849	EL SEGUNDO G/S - UNIT 3 STEAM COOLED FRONT WALL	912
1513-0856	EL SEGUNDO G/S - REPLACE UNIT 3 HP/IP/LP TURBINE PACKING	186
1513-0868	EL SEGUNDO G/S - UNIT 3 TURBINE 8TH STAGE	219
1513-0869	EL SEGUNDO G/S - UNIT 3 HP TURBINE 9TH STAGE	146
1513-0871	EL SEGUNDO G/S - UNIT 3 AIR PREHEATER INTERMEDIATE	118
1516-0833	EL SEGUNDO G/S - INSTALL UNIT 1&2 CONTROLS FOR MONITORING PLANT SHUTDOWN UNITS 3&4	166
1710-6025	MANDALAY G/S - MAGS-AUXBANK-PEAKER, POS 3 & POS 7 RECONDUCTOR	114
1712-0535	MANDALAY G/S - ADD ECONOMIZER SECTION SURFACE AREA, UNIT 2	205
3275-0323	MANDALAY PEAKER - INSTALL UNIT 3 PEAKER FUEL GAS PIPE LINE	247
1931-0433	COOLWATER G/S - REPLACE UNIT 1 2ND POINT FEEDWATER HEATER	250
1931-0434	COOLWATER G/S - REPLACE UNIT 2 2ND POINT FEEDWATER HEATER	202
3393-0044	COOLWATER COMBINED CYCLE - SPARE PARTS BLANKET	536
3398-0417	COOLWATER COMBINED CYCLE - INSTALL A NEW ACID TANK AT UNIT 3 & 4 B.O.P.	100
3398-0426	COOLWATER COMBINED CYCLE - REPLACE ROW 2 BLADES (SET 2)	549
3398-0442	COOLWATER COMBINED CYCLE - ROW 1 TURBINE BLADES, PURCHASE (CT31)	632

[1] Revised Joint Comparison Exhibit 400 B for 1997-1998 Capital Additions.

9000-1031	COOLWATER COMBINED CYCLE - SPARE PARTS INVENTORY RECONCILIATION	834
	Production Projects under $100K	2,624
	Transmission Projects under $100K	297
	Site Specific Projects under $100K (Telecommunications Equip.)	672
	Site Specific Projects under $100K (All other)	454
	Total	=$10,528

APPENDIX C:[1]

APPROVED COSTS PREVIOUSLY AMORTIZED

OIL & GAS PLANTS DIVESTED AT A LOSS[2]

Work Order	Description	Gross Additions ($000)
1726-0070	OBGS BLANKET - PERSONAL COMPUTERS AND RELATED EQUIPMENT	115
1727-0544	ORMOND BEACH G/S - REPLACE UNIT 1 SOUTH 4TH POINT HEATER	342
1727-0554	ORMOND BEACH G/S - REPLACE WESTINGHOUSE WDPF SYSTEM ON UNIT 2	897
1727-0555	ORMOND BEACH G/S - REPLACE WESTINGHOUSE WDPF CONTROL SYSTEM ON UNIT 1	954
1727-0557	ORMOND BEACH G/S - REPLACE GE EHC MARK I CONTROL SYSTEM	547
3310-0456	LONG BEACH G/S - REPLACE UNIT #9 THRUST BEARING AND JOURNAL BEARING	485
3316-0480	LONG BEACH G/S - CT#1 PURCHASE NEW TURBINE BLADES, VANES, HEATSHIELDS, AND HARDWARE	5,368
1316-7711	ETIWANDA G/S - CONTROL ROOM INTEGRATION	1,006
3025-0310	ELWOOD PEAKER - UPGRADE THE REMOTE START AND CONTROL SYSTEM AT EESF	192
	Total	=$9,906

[1] Revised Joint Comparison Exhibit 400 B for 1997-1998 Capital Additions.

[2] Ormond Beach and Long Beach Generating Stations.