



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

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Application of Pacific Gas and Electric Company for Approval and Recovery of Costs Associated with its Fuel Cell Project.

Application 09-02-013

Application of Southern California Edison Company for Authority to Implement and Recover in Rates the Cost of its Proposed Fuel Cell Installation Program.

Application 09-04-018

**REPLY BRIEF OF THE UTILITY REFORM NETWORK
CONCERNING THE FUEL CELL APPLICATIONS
OF PG&E AND SCE**



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January 13, 2010

REPLY BRIEF OF THE UTILITY REFORM NETWORK CONCERNING THE FUEL CELL APPLICATIONS OF PG&E AND SCE

Pursuant to Rule 13.11 and the schedule adopted by ALJ Duda the Utility Reform Network (TURN) respectfully submits this reply brief in the consolidated applications of Southern California Edison Company (SCE) and Pacific Gas and Electric Company (PG&E) for authority to recover the costs of six proposed fuel cell installation projects. TURN submitted an opening brief on December 30, 2009.

TURN addressed all the substantive arguments advanced by the utilities in our opening brief. Thus, in this reply brief we only address certain comments made by PG&E and SCE concerning the proper contingency rate to use for forecasting installed capital costs.

Definition and Purpose of Contingency

PG&E in its brief states that the purpose of a contingency is to cover risk for “scope modifications that may occur during the development, engineering, construction and start-up of the Project,” and further states that “any material change in scope of work will require coordination and consent of the host universities.” (PG&E Opening Brief, p. 10).

SCE extends this argument even more, emphasizing that the purpose of a contingency is to protect against changes in the scope of work:

The contingency represents costs that SCE is likely to incur due to scope modifications made during the final development and engineering of the Fuel Cell Program but cannot categorize or define at this time.

SCE’s cost estimate for the Fuel Cell Program is based upon a conceptual design and studies performed one year ago. Therefore, the contingency is **necessary** to cover scope modifications required during the final development and engineering phase of the Fuel Cell Program, and accommodate site specific construction and design requirements before SCE installs the fuels cells at the host university sites. (SCE Opening Brief, p. 14, footnotes omitted, emphasis in original.)

The utilities are not presenting a consistent message concerning the ratemaking purpose of the contingency allowance. TURN requests that the ALJ take official notice of PG&E's comments on the proposed decision in A.09-02-022, filed on January 11, 2010, or less than two weeks after the opening brief in this proceeding. In response to the proposed decision in that case disallowing any contingency based on the opportunity for future reasonableness review of any cost overruns, PG&E explained that the contingency is specifically meant to cover cost overruns for work within the "defined project scope":

The record supports including the contingency component in the authorized revenue requirement. "PG&E's implementation of a dynamic pricing rate design for default PDP is a multifaceted, large-scale project that will impact numerous inter-related work streams and systems." (PG&E, Ex. 3, p. 1-12, lines 14 to 16.) "[U]ncertainties and risks in complex projects are normal. Typically, project estimates will include risk-based allowances or contingencies to provide for the uncertainties and risks in project cost estimates **for a defined project scope**. The purpose of including a risk-based allowance or contingency in a project estimate is to provide an allowance for **unforeseeable factors that adversely affect the estimated cost of in-scope project work**." (*Id.*, p. 1-13, lines 12 to 18.) "a contingency is not a 'cushion,' a 'safety net,' or a 'free pass.' Rather it is an integral part of an estimate used by estimators to create a total estimate value that reflects the best representation of what the **defined project scope** will ultimately cost." (PG&E, Ex. 8, p. 2-2, lines 18 to 22.)¹

TURN suggests that the utilities' arguments on this issue highlight a fundamental ratemaking problem, and the Commission should either give little weight to these complaints or else order the utilities to refile their applications when the scope of work is more defined.

Simply speaking, the utilities' ratemaking proposal in this case represents a relatively new process for this Commission. Unlike traditional reasonableness reviews which occur after a project has been completed and placed into service, the utilities are here requesting the pre-approval of a specific amount as a reasonable cost that would *not* be subject to any *ex post* reasonableness review. However, if actual costs exceed the pre-

¹ PG&E's Comments on the Proposed Decision of ALJ Fukutome, A.09-02-022, January 11, 2010, p. 4 (emphasis added).

approved forecast, the utility can still seek full cost recovery subject to a reasonableness review of the overruns.

There are two possibilities. If the utility has properly defined a project, the contingency represents the inherent risk of cost overruns, as explained in PG&E's comments filed in A.09-02-022. Such a contingency should be no higher than normal contingencies for unanticipated risks. TURN has already explained why the appropriate contingency rate should be no higher than the lower of the two rates proposed by SCE and PG&E in this case. There is also a reasonable argument to be made against any contingency, since all reasonable cost overruns would be recoverable in a subsequent reasonableness review. As explained by ALJ Fukutome:

The exclusion of the contingency allowance does not preclude PG&E from recovering reasonable actual costs that are in excess of the forecasted amount. This opportunity to do so is balanced by the fact that although costs are forecasted in this proceeding, only the actual costs (up to the cost cap based on the forecasted costs) and not the forecasted costs are reflected in rates.

By this decision, PG&E can recover costs above the forecasted amounts whether the excess is related to contingency risks or any other reason, as long as PG&E can demonstrate the need for, and the reasonableness of, the additional expenditures in a reasonableness review. This is consistent with our responsibility to ensure just and reasonable rates, and is thus preferable to building in a contingency amount and allowing PG&E to spend that amount without having to justify the need for, or the reasonableness of, the expenditures.²

However, if the contingency is supposed to cover scope changes, as the utilities argue in this proceeding, then it seems inappropriate to submit an application for pre-approval. Pre-approving costs when the scope of a project is not well-defined and thus includes excessive adders sends an improper incentive to the utilities (and vendors) and does not allow the Commission to properly review the project. The incentive to utilities (and their vendors) is to enhance project scope within the limits of the contingencies. And if the project scope changes significantly, then by definition the Commission's review

² Proposed Decision of ALJ Fukutome, A.09-02-022, December 22, 2009, p. 124.

and pre-authorization did not involve a review the project as built for reasonableness of costs.

Thus, the Commission should either authorize a more reasonable contingency level, require the utilities to resubmit their applications when the scope is better defined, or simply allow the utilities to use standard reasonableness review for cost recovery after completion of a project.

Contingency for fixed price fuel cell equipment

SCE maintains that “TURN’s argument that there is no reason to apply a contingency for the cost of the fuel cells mischaracterizes what SCE’s contingency covers,” because:

SCE is not estimating a contingency on a line item basis. Instead, SCE has estimated a contingency based upon the total capital cost of the Fuel Cell Program.⁶⁶ Eliminating contingency on a line item basis will hinder SCE’s ability to cover scope modifications for the project made during final engineering.⁶⁷ In other words, SCE did not estimate a contingency for the cost of the fuel cells and other line item costs such as installation costs. Instead, SCE determined the overall project costs based upon a conceptual design, and then included a contingency to cover scope modification made during final engineering.⁶⁸³

SCE’s argument simply reinforces TURN’s position. The fact that SCE did not estimate a contingency for “line items” is precisely the problem. TURN’s entire argument is that the contingency covers risks that are not associated with the cost of the fuel cell equipment itself. SCE’s opening brief concerning the risks covered by the contingency supports this notion, as it ably explains how the cost risks all relate to the design, engineering and construction associated with the *installation portion* of the project. SCE has not provided one iota of proof or explanation of how any design or scope changes might impact *the cost of the fuel cells themselves*. The fuel cells are packaged boxes. The

³ SCE Opening Brief, p. 14-15 (footnotes omitted).

only difference could be based on the final project size.⁴ But that is not at all a risk factor, since SCE's capital cost forecast covers expected costs "up to" 3 MW.

January 13, 2010

Respectfully submitted,

By: _____/S/_____

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⁴ TURN appreciates that the passage of time could change the price of a fuel cell from the indicative bids used in the cost estimation. TURN for this reason has not opposed a 5% contingency on the fuel cell equipment cost.

CERTIFICATE OF SERVICE

I, Larry Wong, certify under penalty of perjury under the laws of the State of California that the following is true and correct:

On January 13, 2010 I served the attached:

**REPLY BRIEF OF THE UTILITY REFORM NETWORK
CONCERNING THE FUEL CELL APPLICATIONS
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on all eligible parties on the attached lists **A.09-02-013** and **A.09-04-018** by sending said document by electronic mail to each of the parties via electronic mail, as reflected on the attached Service List.

Executed this January 13, 2010, at San Francisco, California.

/S/
Larry Wong

Service List for A.09-02-013 and A.09-04-018

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