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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U338E) Regarding the Distribution of SO₂ Allowance Sale Proceeds Related to the Suspended Operation of Mohave Generating Station.

Application 06-12-022
(Filed December 20, 2006)

**ADMINISTRATIVE LAW JUDGE'S RULING
ON TREATMENT OF PROCEEDS FROM SULFUR DIOXIDE ALLOWANCE
SALES BY SOUTHERN CALIFORNIA EDISON COMPANY**

1. Summary

This ruling concludes that the Commission may, but is not obligated to, require Southern California Edison Company (SCE) to give directly to ratepayers the proceeds of the sale of federal allowances for the emission of sulfur dioxide associated with the closed Mohave Generating Station. The Commission may choose other legally available options for disposition of the allowance proceeds, including but not limited to requiring SCE to use the allowance sale proceeds to procure renewable energy that is generated on land of the Hopi Tribe and/or Navajo Nation; or requiring SCE to donate the allowances to a tax-exempt entity that would then retire the allowances. Other options for disposition of the allowance sale proceeds may also be considered by the Commission, so long as they are consistent with the principles set out in this ruling.

2. Procedural Background

On December 20, 2006, Southern California Edison Company (SCE) filed an application regarding the distribution of the sale proceeds from the sale of sulfur dioxide emission allowances (SO₂ allowances, or allowances) related to the suspension of operation on December 31, 2005 of the Mohave Generating Station (Mohave), in Laughlin, Nevada. Protests were filed by the Hopi Tribe, The Utility Reform Network (TURN), and the Just Transition Coalition (Just Transition).¹ SCE filed a reply to the protests on February 13, 2007.

In response to the Administrative Law Judge's (ALJ) Ruling Requesting Proposals for Treatment of Proceeds from Sale of SO₂ Allowances and Scheduling Workshop and Prehearing Conference (February 8, 2007), in March 2007, the Navajo Nation; Coalition of California Utility Employees (CUE) and TURN (jointly; collectively, CUE/TURN); Just Transition; and Californians for Renewable Energy (CARE) filed proposals on how the sale proceeds should be distributed. With the permission of the ALJ, Vernon Masayesva filed comments.

On September 21, 2007, the Scoping Memo and Ruling of Assigned Commissioner (Scoping Memo) confirmed the preliminary determination of the category of the proceeding as ratesetting. The Scoping Memo determined that a hearing was necessary.²

¹ TURN and Just Transition filed their protests on January 22, 2007; the Hopi Tribe filed its protest on January 31, 2007.

² Although the Scoping Memo characterized this determination as a change to the preliminary determination, Resolution ALJ 176-3185 (January 11, 2007) preliminarily determined that a hearing was needed. This determination has been carried through all the scoping memos in this proceeding.

The Scoping Memo was issued while the parties were working on a possible settlement of this proceeding. Following a prehearing conference (PHC) and workshop on March 20, 2007, the parties requested the services of a Commission mediator. During the following year, the parties were actively involved in the mediation process, but did not reach a settlement.

After the mediation concluded, an Amended Scoping Memo and Assigned Commissioner's Ruling Scheduling a Prehearing Conference and Establishing Schedule for Testimony (Amended Scoping Memo) was issued on May 16, 2008. The Amended Scoping Memo maintained the determinations that this is a ratesetting proceeding and that hearings are necessary. SCE served updated testimony and reply testimony and other parties served testimony and reply testimony.³

A second PHC was held on October 7, 2008. At the PHC, parties discussed the Commission's legal authority to undertake a variety of actions proposed by the parties with respect to the SO₂ allowance proceeds. The ALJ's Ruling Establishing Briefing Schedule (October 14, 2008) set out the questions to be

³ SCE served Update Testimony on May 30, 2008. Served on August 1 2008 were: Direct Testimony of the Division of Ratepayer Advocates; Direct Testimony of Charles J. Cicchetti, Ph.D., Arbin Mitchell, and Arvin S. Trujillo on behalf of the Navajo Nation; Prepared Testimony of Just Transition Coalition; Opening Testimony of Californians for Renewable Energy, Inc. (CARE); Testimony of David Marcus on behalf of the Coalition of California Utility Employees; and Prepared Testimony of Robert Finkelstein (TURN). Served on September 19, 2008 were: Reply Testimony of SCE; Reply Testimony of the Division of Ratepayer Advocates; Rebuttal Testimony of Charles J. Cicchetti, Ph.D. and Arvin S. Trujillo on behalf of the Navajo Nation; Prepared Rebuttal Testimony of Just Transition Coalition; and Reply Testimony of David Marcus on behalf of the Coalition of California Utility Employees.

addressed and the timing for filing briefs.⁴ Briefs were filed in November 2008 and reply briefs were filed in December 2008.⁵

In its monthly status report⁶ on Mohave submitted June 10, 2009, SCE stated that the Mohave owners had decided to decommission the power plant and remove the generating facility from the site. In the wake of this report, an Administrative Law Judge's (ALJ) Ruling Requesting Additional Testimony (July 9, 2009) sought updated testimony from SCE on a range of issues in light of the announcement that Mohave would be closed. SCE served supplemental

⁴ The issues set out in the ruling are:

1. Must the gain-on-sale from the sale of SO₂ credits from Mohave by SCE, in proportion to SCE's ownership interest in Mohave, be returned to the SCE ratepayers?
2. Is there legal authority supporting the use of the proceeds from the sale of the SO₂ credits to support the development of renewable resources on land belonging to the Hopi Tribe and the Navajo Nation?
3. Is there legal authority supporting the use of the proceeds from the sale of the SO₂ credits to support an equitable distribution of the proceeds from the sale of SO₂ credits to the Hopi Tribe and/or the Navajo Nation?
4. Is there legal and factual support for the proposals to donate the SO₂ credits, for a tax benefit to SCE ratepayers, or to retire the SO₂ credits?

Parties supporting distribution to the Hopi Tribe and/or the Navajo Nation were also instructed to discuss whether the distribution of funds must have a benefit to SCE ratepayers and how the distribution proposal directly benefits SCE ratepayers.

Finally, SCE was asked to clarify how many SO₂ credits would actually be available.

⁵ Opening briefs were filed November 18, 2008 by CARE, CUE/TURN, Division of Ratepayer Advocates (DRA), Hopi Tribe, Just Transition, Navajo Nation, and SCE. Reply briefs were filed on December 12, 2008 by CARE, CUE/TURN, DRA, Just Transition, Navajo Nation, and SCE.

⁶ Decision (D.) 04-12-016 requires SCE to submit monthly status reports on Mohave to Energy Division.

testimony on July 29, 2009 and other parties served reply testimony in accordance with the ALJ's ruling.⁷

A third PHC was held on September 14, 2009. Prior to the PHC, several parties filed PHC Statements in response the ALJ's Ruling Setting Prehearing Conference (August 21, 2009).⁸ Most parties expressed strong interest in receiving a ruling on the legal issues identified in the ALJ's October 2008 ruling prior to addressing possible evidentiary hearing issues. At the PHC, parties reaffirmed their support for a ruling on the previously identified issues.

The Third Amended Scoping Memo and Assigned Commissioner's Ruling (December 6, 2010) set a new schedule for the remainder of this proceeding.

3. Factual Background

3.1. Mohave Generating Station

Mohave is a two-unit coal-fired power plant in Laughlin, Nevada with a capacity of 1580 MW. Mohave is owned jointly by four utilities, with SCE having the majority (56%) of the shares.⁹ It commenced operation in 1971 and ceased operations at the end of 2005.

Mohave obtained all of its coal supply from the Black Mesa Mine, operated by Peabody Western Coal Company and located in northeast Arizona on the

⁷ CARE, DRA, and Just Transition served supplemental reply testimony on August 18, 2009. With permission of the ALJ, Navajo Nation served its Supplemental Rebuttal Testimony of Charles J. Cicchetti, Ph.D. on August 19, 2009.

⁸ PHC statements were filed and served on September 10, 2009 by CARE, CUE, DRA, Hopi Tribe, Just Transition, Navajo Nation, SCE, and TURN.

⁹ The remainder of the ownership shares are: Salt River Project Agricultural Improvement and Power District, 20%; Nevada Power Company, 14%; and Los Angeles Department of Water and Power, 10%.

lands of the Hopi Tribe and the Navajo Nation. All of Mohave's coal supply was delivered from the mine to Mohave using a coal slurry pipeline, taking the water required for the coal slurring operation from groundwater wells located on the lands leased by Peabody under its coal leases.¹⁰ The coal mine provided jobs to Hopi and Navajo people. The leases for the coal and the water necessary for the slurring operation provided revenue to both tribal governments.

Mohave was a significant source of air pollution, including SO₂ and nitrogen oxides. The Grand Canyon Trust and the Sierra Club initiated a federal lawsuit alleging that Mohave's owners had violated the federal Clean Air Act by not installing appropriate pollution controls. The lawsuit was settled in 1999. The Mohave owners agreed in a consent decree to install controls by December 2005 in order to continue operating Mohave. (D.04-12-016 at 3.)

Rather than install the pollution controls mandated by the consent decree, SCE and the other owners of Mohave chose the other option given by the consent decree, and ceased all generation operations on December 31, 2005. In June 2006, SCE concluded that it would not support efforts to resume operation of Mohave. In June 2009, SCE notified the Commission that all the owners of Mohave had decided to decommission the plant and dismantle the generating facility.

3.2. SO₂ Allowances

Mohave receives an annual allocation of allowances for the emission of SO₂ under the federal acid rain program, which was created under Title IV of the

¹⁰ The water was taken from an aquifer commonly referred to as the Navajo Aquifer or N-Aquifer.

federal Clean Air Act (codified at 42 United States Code (U.S.C.) § 7651 *et seq.* “Title IV of the Clean Air Act aims to reduce acid rain deposition nationwide, and in doing so creates a cap-and-trade program for SO₂ emitted by fossil fuel-fired combustion devices.” *North Carolina v. EPA*, 531 F.3d 896, 903 (D.C. Cir. 2008).

The federal Environmental Protection Agency (EPA) allocates SO₂ allowances to all qualified units at no cost. An allowance authorizes a utility or industrial source to emit one ton of SO₂ during a given year or any year thereafter. (42 U.S.C. § 7651b(f).) A facility must operate within its allowances, or reduce its emissions to balance with its allowances, or buy allowances from another facility. (42 U.S.C. § 7651b(a).) At the end of each year, the source must hold an amount of allowances at least equal to its annual emissions, *i.e.*, a source that emits 5,000 tons of SO₂ must hold at least 5,000 allowances that are usable in that year. (42 U.S.C. § 7651b(g).) If not needed for its own emissions, the source may sell or otherwise transfer any allowances that it does not need, or it may bank them for future use or sale. A source with insufficient allowances to cover its SO₂ emissions may buy allowances to cover its obligations.

Allowances are allocated to Mohave and other eligible sources 30 years in advance, so that today, Mohave has allowances allocated through 2041. Mohave’s annual SO₂ allowance allocation from 2000 through 2009 was 53,216 per year, declining to 52,224 per year in 2010. SCE’s share of the allowances is 56%, corresponding to its Mohave ownership share. For the years prior to 2010, SCE's share of the allowances is 29,801 annually. For 2010 and future years, SCE's share of the allowances is 29,245 annually. All parties agree that SCE owns the allowances allocated to it.

4. Proposals of the Parties

4.1. Treatment of Proposals in this Ruling

All parties have made proposals for the disposition of the proceeds from the SO₂ allowance sales. SCE's proposal appears in its application. Other parties made initial proposals in their protests to the application, or in response to the ALJ's ruling requesting proposals. Proposals were elaborated and refined in the testimony served as directed in the Amended Scoping Memo. In their briefs, filed in late 2008, several parties revisited and refined their own proposals, in addition to addressing the proposals of other parties.¹¹

In view of the development and refinement of the parties' proposals over time, this ruling will address the proposals as they have been articulated and defended in the briefs filed by the parties. This approach allows consideration of the salient aspects of the proposals, without requiring an examination and evaluation of the details of each proposal presented in the parties' testimony, which is not appropriate at this point in this proceeding.

4.2. Proposals on Disposition of Proceeds of Sales of Allowances

4.2.1. SCE

In its application, SCE asserts that the Mohave SO₂ allowances are "effectively 'ratepayer assets'" and proposes to "credit all of the net proceeds from

¹¹ In the Ruling Establishing Briefing Schedule, at 2, the ALJ allowed the parties to:

refer to any testimony, including their own, that has been submitted in this proceeding... Testimony has not yet been subject to cross-examination so parties are to frame their legal arguments in the context of 'assuming the testimony is correct' for purposes of this briefing. Parties will not have waived their right to cross-examine or challenge the testimony later in the proceeding.

any sale of SO₂ allowances from Mohave] directly to SCE's customers." (SCE Application at 2.) SCE has maintained this position throughout this proceeding to date.

4.2.2. DRA

DRA supports SCE's position. (DRA Opening Brief at 5-6.)

4.2.3. Hopi Tribe

The Hopi Tribe presents its proposals in the alternative. Its primary proposal is that "some or all of SCE's Mohave SO₂ emission credit sales proceeds should be invested in Hopi and Navajo energy or other projects on Hopi and Navajo land." (Hopi Tribe Brief at 10.) The details of such a disposition would be negotiated between representatives of the Hopi Tribe, the Commission and "other interested persons." (*Id.* at 14.)¹²

As an alternative, the Hopi Tribe proposes that "a fund should be established to hold the sales proceeds of SCE's Mohave SO₂ emission credits." (*Id.* at 10.) During the proposed 15-year life of the fund, proceeds could be used to fund energy or other projects sited on Hopi and/or Navajo tribal land and approved by the Commission and the relevant tribal government. At the end of

¹² In its protest, the Hopi Tribe identifies "financing for feasibility studies, design, siting, permitting, and construction of an advanced, 50 to 75 MW, utility-scale community based sustainable power technology system for the Hopi reservation that will generate approximately 45 to 70 MW of certifiable green power..." as one among a number of possible projects to be financed in part with proceeds from the Mohave SO₂ allowances. (at 5-6.) Because the Protest does not indicate whether this specific project is the highest priority proposal for use of proceeds from the Mohave SO₂ credits, this ruling will consider the more general proposal advanced in the Hopi Tribe Brief, above. However, more detail about the proposal may be relevant at a later point of this proceeding.

the 15-year period, any balance in the fund and/or any Mohave SO₂ allowances not yet sold by SCE would be disposed of at the Commission's direction. (*Id.* at 10-11.)

4.2.4. Navajo Nation

The overarching goal of the proposal of the Navajo Nation is for the Commission to “use the proceeds from the sale of the SO₂ credits in a manner that will mitigate the harm caused by the closure of Mohave to the Navajo Nation.” (Navajo Nation Opening Brief at 3.)

The Navajo Nation puts forward two variants of its proposal. The first proposal is based on requiring SCE to purchase power from renewable energy facilities¹³ located on Navajo Nation land and approved by the Navajo Nation. Additional requirements for the SCE power purchase would be:

- The RPS-eligible renewable generation facilities “must benefit the Navajo Nation and provide local community benefits.” (Navajo Nation Opening Brief at 4.)

¹³ The Navajo Nation, as well as other parties, refers to “renewable generation.” In California, utilities must procure sufficient renewable energy resources to meet the requirements of the renewables portfolio standard (RPS), Pub. Util. Code §§ 399.11-399.20. In order for renewable procurement to count for RPS purposes, the generation facility must be certified as RPS-eligible by the California Energy Commission (CEC). (See CEC's *Renewables Portfolio Standard Eligibility Guidebook*, 4th ed. (Dec. 2010).) Various other RPS requirements set by statute and this Commission must also be met. In order to realize full value for California utilities and ratepayers, procurement of renewable resources must be consistent with RPS requirements. Therefore, this ruling departs from the parties' description of “renewable generation” and uses “RPS-eligible” to describe the renewable resources discussed by the parties, meaning “renewable generation resources that comply with California's regulatory requirements for the RPS program.”

- SCE and the Navajo Nation would conclude an agreement that would require SCE to purchase a minimum of \$50,000,000 per year of wholesale electricity from RPS-eligible generation projects located on Navajo Nation lands.
 - The Navajo Nation would receive at least \$10,000,000 per year in royalties, taxes, and other revenues associated with the power purchases by SCE;
 - Local Navajo Nation communities would benefit through employment opportunities and community benefits agreements related to the projects;
 - If there are insufficient generation projects meeting these criteria to generate \$50,000,000 per year of wholesale sales of electricity to SCE, “SCE would be expected to build its own facilities to make up the differences.” (*Id.* at 4.)

The second Navajo Nation proposal would require the Commission to “enter into an intergovernmental agreement with the Navajo Nation for the distribution of the credit proceeds through the Navajo Nation’s own procurement process.” (*Id.*) The Navajo Nation would select and fund renewable energy generation projects on Navajo Nation land, from which SCE would be required to purchase at least \$50,000,000 per year of electricity.¹⁴

The Navajo Nation characterizes the first proposal as its preferred choice. (*Id.*)

4.2.5. Just Transition

In its brief, Just Transition presents a simplified version of the proposal developed in its testimony. Just Transition proposes that the SO₂ allowance

¹⁴ As noted above, the renewable generation facilities would have to be RPS-eligible.

proceeds be used to benefit Hopi Tribe and Navajo Nation communities through development of renewable energy resources (solar and wind) on land of the Hopi Tribe and the Navajo Nation. Just Transition asserts that its proposal shares "four common principles" with the Navajo Nation's position:

1. proceeds from the SO₂ allowance sales should be used to benefit the impacted Native American communities;
2. the revenues should be used to develop renewable energy;
3. the renewable energy should be located on Native American land;
4. the eligibility of these projects could be determined through SCE's procurement process.

(Just Transition Opening Brief at 12.)

Renewable energy projects would be developed and renewable resources would be procured through SCE's procurement process.¹⁵ Just Transition proposes that specific implementation steps for its proposal (such as timing and scope of allowance sales, management of proceeds from allowance sales, and use of the funds if no qualifying renewable energy is available to SCE) should be addressed after a determination about the viability of the current proposals has been made.

4.2.6. CARE

The goal of CARE's proposal is to obtain:

an equitable distribution of the proceeds from the sale of SO₂ credits to the Hopi and Navajo communities adversely affected by 35 years

¹⁵ As noted above, such resources would have to be RPS-eligible for SCE to count energy produced by those generation resources toward its RPS obligations.

of Mohave operations, and the adverse socioeconomic impacts of the plant's closure in 2005.

(CARE Opening Brief at 14.) CARE proposes that a non-profit organization in Arizona determine how best to distribute the allowance sale proceeds to communities of the Hopi Tribe and Navajo Nation. (*Id.* at 15.)

4.2.7. CUE/TURN

The CUE/TURN proposal takes a fundamentally different approach from the other proposals. These two parties propose that SCE be required to donate all the Mohave SO₂ allowances to a tax-exempt organization, which would retire the allowances.

All direct monetary value gained as a result of the savings in SCE's federal and state income taxes would be credited to SCE ratepayers. The environmental value of the avoided emissions would also accrue to ratepayers.

(CUE/TURN Opening Brief at 2.) CUE/TURN also propose that the Commission require SCE to study converting the Mohave site to solar power generation, with a direction to SCE to make the conversion "or show cause why it should not." (*Id.*)

5. Discussion

5.1. Quantity of Allowances Available

In its testimony and briefs, SCE argues that the proceeds from only a fraction of the SO₂ allowances available to it as a result of the shut-down of Mohave should be considered in this proceeding. SCE asserts that proceeds from

the sale of only about 16.5% of the available allowances should be considered.¹⁶ SCE supports this assertion by arguing that if Mohave had continued operating beyond 2005, the SO₂ scrubbers required to comply with the consent decree would have been installed. SCE claims that the scrubbers would have reduced the SO₂ emissions from Mohave by about 83.5% from prior levels, making approximately 83.5% of the SO₂ allowances surplus at that time. Thus, SCE urges, the only allowances that are truly attributable to the shutdown of Mohave are the "incremental" 16.5% that would not have been surplus if the plant had continued to operate.

No other party supports SCE's position that only the proceeds from 16.5% of the SO₂ allowances are subject to disposition in this proceeding.¹⁷ SCE's position is based on a surmise that is contrary to the existing facts. SCE's estimate of how many SO₂ allowances would have been needed to operate Mohave in accordance with the consent decree is hypothetical. Mohave was never operated with the pollution controls required by the consent decree. Instead, its owners (led by SCE) shut the plant down. In fact, none of Mohave's SO₂ allowances from 2006 forward have been needed, or used, for operation of the plant. SCE's entire share of all of those allowances is therefore surplus and

¹⁶ SCE calculates that its share of the Mohave SO₂ allowances is 29,801 per year through 2009, and 29,245 per year for each year thereafter. Thus, SCE is proposing that this proceeding address the disposition of the proceeds from the sale of approximately 4800-4900 allowances annually.

¹⁷ The Hopi Tribe, CUE/TURN, and Just Transition expressly oppose SCE's position. Further, as Just Transition points out, DRA assumes that all of SCE's share of the Mohave allowances should be distributed. (Just Transition Reply Brief at 14; DRA Opening Brief at 17.) The Navajo Nation asserts that SCE has provided too little information on the number and value of SO₂ allowances at issue.

available to be sold, and the proceeds subject to disposition as determined in this proceeding.

5.2. Disposition of Proceeds of Allowance Sales

5.2.1. Framework

The California Supreme Court has described the Commission as

'a state agency of constitutional origin with far-reaching duties, functions and power' whose 'power to fix rates [and] establish rules' has been 'liberally construed.'

Southern California Edison Co. v. Peevey, 31 Cal.4th 781, 800 (2003) (internal citations omitted). As stated in Pub. Util. Code § 701:

The Commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction.¹⁸

The Commission's formidable powers are not, however, unlimited. The Legislature may augment them or subject them to explicit directions in legislation. More important for this proceeding, the Commission's powers are granted and exercised for the regulation of California public utilities. The Commission's role as a utility regulatory agency is therefore the touchstone in evaluating the parties' proposals for disposition of the SO₂ allowance proceeds.

Therefore, as set forth in more detail below, the Commission's options for allocating the SO₂ allowance proceeds are limited to those that are connected to the Commission's ongoing regulation of California public utilities and that may

¹⁸ Unless otherwise noted, all further references to sections are to the Public Utilities Code.

be implemented under the Commission's supervision. The parties' proposals are evaluated in light of these criteria.

5.2.2. SCE/DRA Proposal

DRA argues that the sale proceeds are, or should be considered, rate refunds governed by § 453.5, and thus must be returned to ratepayers.¹⁹ SCE asserts that the sale proceeds are "indistinguishable" from rate refunds and thus must be credited to ratepayers.

No other party agrees with this "rate refund" analysis.²⁰ The opponents' arguments are persuasive that the proceeds of the sale of the Mohave SO₂ allowances do not fall into the legal category of "rate refund."

A rate refund under §453.5, as interpreted by the California Supreme Court in *California Manufacturers Association v. Public Utilities Commission*, 24 Cal.3d 836 (1979) and *Assembly v. Public Utilities Commission*, 12 Cal.4th 87 (1995), has three specific characteristics.

¹⁹ Section 453.5 provides:

Whenever the commission orders rate refunds to be distributed, the commission shall require public utilities to pay refunds to all current utility customers, and, when practicable, to prior customers, on an equitable pro rata basis without regard as to whether or not the customer is classifiable as a residential or commercial tenant, landlord, homeowner, business, industrial, educational, governmental, nonprofit, agricultural, or any other type of entity.

For the purposes of this section, "equitable pro rata basis" shall mean in proportion to the amount originally paid for the utility service involved, or in proportion to the amount of such utility service actually received.

Nothing in this section shall prevent the commission from authorizing refunds to residential and other small customers to be based on current usage.

²⁰ See, e.g., CUE/TURN Opening Brief at 9; Hopi Tribe Opening Brief at 2-7; Just Transition Opening Brief at 16-17; Navajo Nation Opening Brief at 22-23.

1. The funds to be refunded were previously collected in rates from ratepayers. In *California Mfrs. Assn.*, the California utilities had collected rates on natural gas provided to their industrial customers based on the charges the utilities paid to their natural gas suppliers. (24 Cal.3d at 839-40.) In *Assembly*, the telephone utility had collected rates from retail telephone customers that were used in part to fund research and development of cellular telephone technology. (12 Cal. 4th at 91.)

2. The funds were previously ordered to be refunded to customers by a regulatory agency. In *California Mfrs. Assn.*, this Commission had authorized the gas rates on the condition that, if the Federal Power Commission (FPC)²¹ concluded that the gas suppliers had overcharged the utilities, the overcharges would be refunded to utility customers. The FPC did find that the supplier rates were excessive and required that the gas suppliers rebate the excess charges to the utilities. (24 Cal.3d 840.) In *Assembly*, the Commission had determined that ratepayers of Pacific Bell were entitled to refunds for certain cellular technology research and development charge in rates that the Federal Communications Commission had ordered passed on to Pacific Bell, but that Pacific Bell had never sent back to customers. (12 Cal.4th at 91-92.)

3. The refunds are to be made, to the extent practicable, to the customers who paid the excessive rates. This is a statutory requirement. In *California Mfrs. Assn.*, the Supreme Court held that the Commission's assignment of the gas overcharge rebates to balancing accounts for the affected utilities was not consistent with that requirement. (24 Cal.3d at 848.) In *Assembly*, the court agreed with the

²¹ This is the predecessor agency to the present Federal Energy Regulatory Commission.

Commission that it was impractical to try to make refunds to prior customers, but found that the Commission was required to refund the entire amount of principal and interest to current customers, rather than assigning part of the interest to another public purpose.

(12 Cal.4th at 100-01.)

None of these three central characteristics is present in the sales of the Mohave SO2 allowances.

1. Ratepayers did not previously pay excessive rates for the allowances, because nobody paid for the allowances at all. Under the federal Clean Air Act, SO2 allowances are distributed to power plant owners without charge.

2. Neither this Commission nor any other regulatory body has previously made an order about the disposition of the SO2 allowance proceeds; indeed, it is in *this* proceeding that such an order is supposed to be made.²²

3. Refunds cannot be made to customers who paid the excessive rates, because there were no charges in rates for the SO2 allowances.

The secondary argument advanced by DRA and SCE for treating the SO2 allowance proceeds as rate refunds is based on their assertions that ratepayers are paying more for electricity because the shutdown of Mohave incurs costs and also requires the acquisition of more expensive (because less polluting) power in place of the power previously provided by Mohave. The additional costs to ratepayers for Mohave's shut-down and for electricity purchases, they argue, are sufficiently similar to the overpayments in the rate refund cases to require the same treatment. However, neither DRA nor SCE provides any basis to believe

²² This point is noted in the Navajo Nation Opening Brief at 22.

that ratepayers are being unreasonably overcharged for these ordinary operational changes, so that the SO₂ allowance proceeds must be used to make up the overcharges.

In addition to being weakly connected to the facts of this application, this argument is too broad. Any change in utility operations may cause costs for ratepayers to increase or decrease. Changes in utilities' costs are handled through the ordinary ratemaking process; they do not trigger the special statutory treatment for rate refunds.

In sum, the Commission's treatment of the proceeds from SCE's sale of the SO₂ allowances available because Mohave has been shut down is not governed by § 453.5.

DRA also argues that parties and the Commission have in past cases treated emissions allowances for various air pollutants, used for ongoing operations of utility-owned generation, as functionally property of the utility. DRA's cited cases are of limited value, however.²³ No party in this proceeding suggests that the SO₂ allowances are *not owned* by SCE. Rather, the issue to be decided in this proceeding is the *disposition* of the Mohave SO₂ allowance proceeds. On that issue, the cases cited by DRA provide neither direct authority nor particularly helpful guidance. The emissions allowances discussed in those cases were used for ongoing operations of utility-owned generation facilities, not

²³ DRA cites two settlements of energy cost adjustment clause proceedings for Pacific Gas and Electric Company (PG&E) and San Diego Gas & Electric Company, D.95-12-051 and D.97-11-074, respectively. As the Navajo Nation points out, settlements are not to be considered as precedent under the Commission's rules. (Rule 12.5, Rules of Practice and Procedure.) The litigated case cited by DRA, D.97-11-074, is an order issued as part of the electric restructuring process of the late 1990s addressing which utility costs would be eligible for transition cost treatment.

surplus allowances still being allocated by the federal EPA to a facility that the utility has shut down.

Nevertheless, the Commission has ample authority under § 701 to direct SCE to pass the proceeds of the SO₂ allowance sales on to ratepayers through rates. Even if not mandated by § 453.5, or compelled by past ratemaking treatment of other air pollution allowances, the Commission can, in its discretion, decide that the preferred outcome for ratepayers is for SCE ratepayers to receive a small reduction in their rates, corresponding to the proceeds realized by SCE from the Mohave SO₂ allowance sales. As discussed further below, this is one, but not the only, course available to the Commission in allocating the SO₂ allowance proceeds.

5.2.3. Hopi Tribe Proposal

The Hopi Tribe's primary proposal seeks to have some or all of the allowance sale proceeds invested in projects on Hopi and Navajo land. The proposal suggests a preference for, but does not require, that the projects provide energy. The proposal contemplates that projects would be implemented by a range of entities, and does not restrict the kinds of entities that would be making the investments in the projects (for example, SCE, the governments of the Hopi Tribe and the Navajo Nation, private developers). The funding of this proposal, unlike the program sketched out in the Hopi Tribe's protest, is limited to the proceeds of SCE's allowance sales.

By limiting the available funding to the SO₂ allowance sale proceeds, the Hopi Tribe proposal is within the scope of this proceeding, whose purpose is to allocate the allowance sale proceeds. However, because it does not limit the nature of the projects to be developed on Hopi and Navajo land, or the identities of the developers, the proposal goes beyond the range of the Commission's

regulatory role. The Hopi Tribe cites no authority to support the Commission allocating the SO₂ allowance sale proceeds to a developer for any project of any kind (e.g., a clothing factory) that might be built on Hopi or Navajo land. Nor is there any authority provided for the Commission to allocate the proceeds directly to the governments of the Hopi Tribe and/or the Navajo Nation, to be used for purposes determined solely by those governments.

In its alternative proposal, the Hopi Tribe suggests a more limited approach. The allowance sale proceeds would be held in a fund to be expended for energy projects or other types of projects on Hopi Tribe and Navajo Nation land. The projects would require approval by the Commission and the Hopi and Navajo tribal governments. The Hopi Tribe suggests that, if the money in the fund is not fully spent within 15 years, the Commission would direct the disposition of any remaining funds.

This alternative proposal has the advantage that it would require the Commission to approve the specific projects on which the funds are spent. It also provides a reasonable limit on the duration of the funding obligation. As proposed, however, this alternative still leaves open the possibility that the Commission would be asked to approve the expenditure of some of the allowance proceeds on projects that do not provide energy or other benefits to California utility customers, and indeed that may have no connection with California at all. This would be beyond the Commission's jurisdiction and its mission.

5.2.4. Navajo Nation Proposal

The Navajo Nation's first proposal requires SCE to purchase power from renewable energy facilities located on Navajo Nation land and approved by the Navajo Nation. That basic mandate is accompanied by a number of conditions.

The Navajo Nation proposes that SCE be required to spend a minimum of \$50,000,000 to purchase wholesale electricity from RPS-eligible projects on Navajo Nation land, or to build its own RPS-eligible generation if that amount of RPS-eligible electricity is not available. Whatever other merits or deficiencies this element of the proposal may have, it has no connection to the monetary amount of the proceeds from the sale of the Mohave SO₂ allowances. The allowance proceeds are the subject of this proceeding. In this proceeding, the Commission will not order SCE to spend money in an amount greater than the amount of the proceeds of the allowance sales. SCE may or may not realize \$50,000,000 per year from the allowance sales; but since it is not possible to determine in advance the sum SCE will ultimately realize from the allowance sales each year, it is not reasonable to require SCE to spend a fixed amount of money on the assumption that such a sum will be available from the allowance sale proceeds. A less restrictive direction to SCE to purchase RPS-eligible energy from RPS-eligible facilities on Navajo Nation land could, however, be fashioned and implemented by the Commission. The current Navajo Nation proposal, however, does not provide for such flexibility.

The Navajo Nation also proposes that any plan for SCE to procure RPS-eligible energy from projects located on Navajo Nation land should provide the Navajo Nation with \$10 million per year in royalties, taxes, and other revenues. Fulfillment of this requirement is fundamentally in the hands of the Navajo Nation, not SCE or the Commission. It is the Navajo Nation, not SCE or the Commission, that would enter into leases or royalty agreements with generation developers. It is the Navajo Nation that would govern the methods by which other revenue would be generated. The Commission cannot hold SCE responsible for whether or not generation projects provide a particular amount in

revenue to the Navajo Nation, since the decisions governing the generation of those revenues to the Navajo Nation would be largely independent of SCE's actions and outside its control.

The Navajo Nation's alternative proposal would have the proceeds of the SO₂ allowance sales given to the Navajo Nation, which would use the funds in the development of renewable energy generation projects on Navajo Nation land. SCE would again be required to purchase at least \$50,000,000 per year of electricity from these facilities.

The Navajo Nation's alternative proposal rests on an overly expansive reading of what is often referred to as the Commission's "equitable jurisdiction." (See, e.g., *Consumers Lobby Against Monopolies v. Public Utilities Commission*, 25 Cal.3d 891, 906.) This is not the broad jurisdiction of a court exercising its wide-ranging equitable authority. Rather, "[t]he Commission often exercises equitable jurisdiction as an incident to its express duties and authority." (*Id.*) Such equitable actions may be extensive and undertaken in many different contexts, as summarized by the Navajo Nation. (Opening Brief at 8-11.) But these actions are always incident to the Commission's regulation of California public utilities.

Even though the Navajo Nation's alternative proposal contemplates that RPS-eligible energy will ultimately result, it would not allow the Commission to exercise its own regulatory responsibilities.²⁴ Turning over the SO₂ allowance proceeds to the Navajo Nation, a sovereign entity not located in California, over

²⁴ In view of this analysis, it is unnecessary to address the further question of whether the Commission has the legal authority to enter into an agreement with the Navajo Nation disposing of the allowance proceeds.

which the Commission has no jurisdiction, does not allow the Commission to exercise any supervision over the implementation of the plan set out in the alternative proposal. This lack of connection to the Commission's core responsibilities is not resolved by the second prong of the proposal, the requirement that SCE buy \$50,000,000 of electricity annually from the generation facilities to be constructed on Navajo Nation Land. In the alternative proposal, this sum is completely unrelated to the amount of the allowance proceeds, which would already have been transferred to the Navajo Nation. The Commission's duties and powers simply do not stretch as far as the alternative proposal would require.

5.2.5. CARE Proposal

CARE proposes that a non-profit organization in Arizona decide how to allocate the SO₂ allowance proceeds to Hopi and Navajo communities. CARE envisions that the allowance proceeds would go directly to Hopi Tribe and Navajo Nation communities because they have been "adversely affected by 35 years of Mohave operations, and the adverse socioeconomic impacts of the plant's closure in 2005." (CARE Opening Brief at 5.)

This proposal is even further beyond the core responsibilities of the Commission than the Navajo Nation alternative proposal discussed above. It has no connection to California utilities or ratepayers, other than using the SO₂ allowance proceeds as the source of funds.²⁵ CARE argues that no such

²⁵ CARE's reliance on the Commission's decision accepting the PG&E bankruptcy settlement, D.03-12-035, is not persuasive. As a settlement, that decision is not precedential. Moreover, the provisions cited by CARE relate to land and activities owned by PG&E in California and/or in its service territory, not to communities in other jurisdictions located in other states.

connection is needed, because important norms of equal protection²⁶ and international human rights²⁷ are implicated by the situation of the Hopi Tribe and the Navajo Nation. CARE does not, however, provide any argument to demonstrate that those high-level principles obligate the Commission to take the particular action of requiring SCE to give the SO₂ allowance proceeds to Hopi Tribe and/or Navajo Nation communities.

As CARE and other parties note, the Commission has consistently acknowledged the existence of negative impacts from Mohave's closure, and its concern for the people impacted. The Commission's constitutionally and legislatively mandated responsibilities do not, however, include providing compensatory funds without conditions to residents of sovereign entities not located in California.

5.2.6. Just Transition Proposal

Just Transition proposes that the SO₂ allowance proceeds be used by SCE to procure electricity from renewable (i.e., RPS-eligible) generation projects to be developed on land of the Hopi Tribe and/or Navajo Nation. Just Transition asserts that the details of making its proposal work (which are significant) could be addressed once it is determined that, in principle, the proposal is viable.

The three elements of this proposal are:

1. SCE holds the SO₂ allowance proceeds in a special fund;
2. SCE uses the proceeds as part of its procurement of RPS-eligible generation;

²⁶ United States Constitution, amend. XIV.

²⁷ See, e.g., the Universal Declaration of Human Rights, <http://www.un.org/en/documents/udhr/index.shtml>.

3. SCE must use the proceeds on procurement from RPS-eligible generation on Hopi Tribe and/or Navajo Nation land.

Each of these elements is within the Commission's regulatory ambit, because each element involves actions to be taken by SCE as part of its ordinary procurement and accounting processes. The Commission can order SCE to take such actions and can review whether and how SCE has implemented the Commission's instructions. Whether the Commission ultimately determines that one or more of these elements is feasible, as well as desirable for SCE to undertake, will be an issue for subsequent determination in this proceeding.

5.2.7. CUE/TURN Proposal

Taking a different approach, CUE/TURN propose to generate a tax benefit for ratepayers through donation of the Mohave SO₂ allowances to a non-profit organization. SCE could thus, according to CUE/TURN, obtain a deduction for its federal taxes that would save ratepayers money that SCE would otherwise have to pay in federal income tax. The proposal also specifies that the recipient organization would retire the donated allowances, leading to a measurable, though very small, reduction in the SO₂ allowances available to enable power plants nationwide to emit additional SO₂ pollution.

CUE/TURN acknowledge that this proposal is complex and entirely dependent on the approval of such a donation deal by the federal Internal Revenue Service (IRS). Whether the IRS would approve is simply unknown at this time. DRA and the Navajo Nation argue that the proposal is so unlikely to meet IRS requirements for a tax-deductible donation that it should not be considered. At this stage of this proceeding, although there are many questions about the CUE/TURN proposal, it is not possible to say that the proposal is legally or practically impossible. Moreover, no party advances a credible

argument that the Commission is without power to order a regulated utility to deliver the value of a utility-owned asset to ratepayers by means of the value of a tax benefit. The CUE/TURN proposal, though it has many uncertainties, is within the range of actions the Commission could take in ordering the disposition of the SO₂ allowance proceeds.

CUE/TURN also suggest that SCE be required to develop a plan for using the Mohave site for renewable generation. Although this suggestion could be implemented by the Commission, it is outside the scope of this proceeding, because it is independent of the allocation of the SO₂ allowance proceeds.

5.3. Application of D.06-05-041(Gain on Sale of Utility Assets)

Although the ALJ's October 2008 ruling uses the terminology of "gain on sale" in reference to the SO₂ allowance proceeds, parties identify a compelling reason why the Commission's "gain on sale" rules, adopted in D.06-05-041, do not apply to the SO₂ allowance proceeds.²⁸ As CUE/TURN and Just Transition point out, D.06-05-041 applies to the gain upon the sale of a capital asset which was "formerly used to serve utility customers." D.06-05-041 at 2. Because the SO₂ allowances are available for sale precisely because the shutdown of Mohave renders the allowances unnecessary to serve utility customers, the allowance proceeds are not covered by the rules set out in D.06-05-041.

6. Summary of Conclusions

The Commission has a range of options available for allocating the SO₂ allowance proceeds. These options are limited, however, to those that are

²⁸ In filing its application without any reference to D.06-05-041, SCE by implication takes the position that that decision does not apply to the SO₂ allowance sales.

connected to the Commission's ongoing regulation of California public utilities and that may be implemented under the Commission's supervision.

Next Steps

This ruling allows the parties to turn their attention to moving forward in this proceeding. To structure the process for bringing this proceeding to a close, I am issuing a ruling that will:

- require SCE to provide an update of its supplemental testimony dated July 29, 2009;
- set a PHC; and
- request PHC statements, including parties' views on the need for, and scope of, evidentiary hearings.

IT IS RULED that:

1. All of the Mohave Generating Station sulfur dioxide emission allowances allocated to Southern California Edison Company for 2006 and succeeding years are available for sale.
2. The proceeds of the sale of all of the Mohave Generating Station sulfur dioxide emission allowances allocated to Southern California Edison Company for 2006 and succeeding years are subject to disposition in this proceeding.
3. Requiring the expenditure of funds in excess of the actual amount of the proceeds of the sale of Mohave Generating Station sulfur dioxide emission allowances will not be considered further by the Commission in this proceeding.
4. Requiring the administration or distribution of some or all of the proceeds of the sale of Mohave Generating Station sulfur dioxide emission allowances by an entity other than the Commission or Southern California Edison Company will not be considered further by the Commission in this proceeding.

5. Requiring that a specific amount of money must accrue to the Navajo Nation or the Hopi Tribe as a result of the expenditure of the proceeds of the sale of the Mohave Generating Station sulfur dioxide emission allowances will not be considered further in this proceeding.

6. Requiring that some or all of the proceeds of the sale of the Mohave Generating Station sulfur dioxide emission allowances be expended on projects that are not related to developing or acquiring energy resources that would be available for California retail customers will not be considered further in this proceeding.

7. Requiring Southern California Edison Company to take steps to develop renewable generation at the Mohave Generating Station site will not be considered further in this proceeding.

8. Requiring that some or all of the proceeds of the sale of the Mohave Generating Station sulfur dioxide emission allowances be returned to Southern California Edison Company ratepayers through rates may be considered further by the Commission in this proceeding.

9. Requiring that some or all of the proceeds of the sale of the Mohave Generating Station sulfur dioxide emission allowances be expended by Southern California Edison Company on projects that would produce energy resources that could be used to satisfy the California renewables portfolio standard may be considered further by the Commission in this proceeding.

10. Setting a termination date for any plan for the expenditure of the proceeds of the sale of the Mohave Generating Station sulfur dioxide emission allowances may be considered further by the Commission in this proceeding.

11. Requiring Southern California Edison Company to donate the Mohave Generating Station sulfur dioxide emission allowances to a non-profit entity that

