BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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Application of Southern California Edison Company (U 338-E) for Approval of Agreement to Sell its Interest in Four Corners Generating Station.	Application 10-11-010 (Filed November 15, 2010)

OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES

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Application of Southern California Edison Company (U 338-E) for Approval of Agreement to Sell its Interest in Four Corners Generating Station.	Application 10-11-010 (Filed November 15, 2010)

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I. INTRODUCTION

Pursuant to Rule 13.11 of the Commission's Rules of Practice and Procedure and to the *Assigned Commissioner's Scoping Memo and Ruling* issued February 8, 2011, the Division of Ratepayer Advocates (DRA) submits this Opening Brief regarding Southern California Edison Company's (SCE) above-captioned Application for approval to sell its interest in Four Corners Generation Station to Arizona Public Service Company (APS).

DRA has a neutral position at this time regarding the Commission's ultimate determination of whether to authorize SCE's divestiture of its interest in Four Corners pursuant to the Purchase and Sale Agreement negotiated with APS. However, as discussed below, DRA emphasizes that the reasonableness of any transaction has a lifespan. Based on the forecasts in SCE's valuation study and SCE's negotiated crediting mechanism for sale price adjustments dependent on closing date, it is in SCE's ratepayers' interest to close the transaction on or before the October 1, 2012 scheduled closing date. The reasonableness of the negotiated price of $294 million as well as the assumptions and cost forecasts used by SCE to create its valuation should be viewed by the Commission as imprecise and subject to reconsideration should the Commission's disposition of SCE's application extend beyond March 31, 2012.[1]

II. DISCUSSION

A. Scope of Proceeding Includes Reasonableness of Valuation Methodology and Negotiated Value of Agreement

Pursuant to the *Assigned Commissioner's Scoping Memo and Ruling* issued February 8, 2011, the following issue is to be determined in this proceeding:

> 3. Is the divestiture pursuant to the Purchase and Sale Agreement reasonable? This issue includes consideration of whether the value of the agreement is reasonable….[2]

DRA notes that the Commission's determination regarding the reasonableness of the final negotiated price in the agreement should depend heavily on an examination of the reasonableness of the valuation methodology SCE used for purposes of negotiating the agreement price.

B. SCE's Valuation Methodology

SCE claims that its valuation methodology for negotiating the purchase price with APS for Four Corners Units 4 and 5 "was to hold SCE ratepayers <u>economically indifferent</u> to a sale before the expiration of the current Operating Agreement [July 2016]."[3] According to SCE, its valuation of its ownership in Four Corners "keeps SCE customers whole or indifferent to [the] sale" because the negotiated price of $294 million "compensates ratepayers for the estimated benefits that they otherwise would have received from operating through the end of the current Operating Agreement."[4]

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[1] As discussed below, APS has the option to terminate the Sale Agreement if final Commission approval is not authorized by March 31, 2012. (Exh. 1 [SCE's Testimony], p. 10, fn. 11.)

[2] *Assigned Commissioner's Scoping Memo and Ruling*, p. 3.

[3] Exh. 1 [SCE's Testimony], p. 27, emphasis added.

[4] Exh. 1 [SCE's Testimony], p. 28.

Specifically, SCE describes its valuation modeling runs for four operating costs scenarios as follows:[5]

(1) SCE Cost Forecast: SCE's forecast of costs assuming the plant continues to be maintained in a manner consistent with historic practice, through the remaining duration of the ownership agreement (July 2016). Under this scenario, SCE would have an incentive to minimize investments in the plant, while the other co-owners would have an incentive to increase spending to extend the life of the plant beyond July 2016.

(2) SCE Cost Forecast + GHG Impact: SCE Cost Forecast, taking into account forecast of greenhouse gas (GHG) costs.

(3) Harvest Study Cost Forecast: Based on a reduced stream of costs as identified in the APS Harvest Study, which reflects a reduced stream of investments by all co-owners, leading to an early shutdown of Four Corners in July 2016.

(4) Harvest Study Forecast + GHG Impact: Harvest Study Cost Forecast, taking into account forecast of GHG costs.

Each of the above modeling runs produced a "Net Benefit" value which, according to SCE, represents the estimated difference between selling SCE's share of Four Corners Units 4 and 5 in 2012 (forecasted replacement capacity and energy costs) and maintaining ownership though the end of the current Operating Agreement in July 2016 (forecasted capital, O&M, fuels costs, etc).[6] Finally, each of the modeling runs produced an ultimate "Otherwise Value" which is the Net Benefit value minus plant decommissioning and mine reclamation costs;[7] in other words, the estimated value SCE would have received if there was no transaction. Significantly, SCE acknowledges that

[5] See Exh. 1 [SCE's Testimony], pp. 27-30; Exh. 10 [SCE's Confidential Workpapers (Public Version)], pp. 85-90.

[6] Exh. 10 [SCE's Confidential Workpapers (Public Version)], pp. 85-88.

[7] SCE's forecast for plant decommissioning and mine reclamation costs = $79.855 million. (Exh. 10 [SCE's Confidential Workpapers (Public Version)], pp. 85-88.)

"[t]he estimated value of the plant to SCE ratepayers is highly dependent on which of these scenarios is assumed."[8]

In addition, SCE's valuation assumed a transaction closing date of October 1, 2012, and SCE negotiated a crediting mechanism whereby the sale price would be decreased by $7.5 million for each month thereafter that the sale does not close, or increased by $7.5 million for each month prior to October 1, 2012 that the sale closes early. According to SCE, this crediting mechanism makes SCE ratepayers economically indifferent to delays or accelerations in the actual closing date.[9]

Tables 1 and 2 below summarize SCE's valuation methodology and provide values derived directly from SCE's Workpapers and Testimony:[10]

Table 1
Valuation per Month[11]
($ millions, present value revenue requirement)

Scenario	Otherwise Value[12] (a)	Net Benefit[13] (b)	Otherwise Value per Month[14] (c)	Net Benefit per Month[15] (d)
SCE Cost, w/GHC	$90	$170	$2	$3.8
SCE Cost, w/o GHC	$223	$303	$5	$6.7
Harvest Study Cost, w/GHC	$227	$307	$5	$6.8
Harvest Study Cost, w/o GHC	$361	$440	$8	$9.8

[8] Exh. 1 [SCE's Testimony], pp. 28-29.

[9] Exh. 1 [SCE's Testimony], p. 30.

[10] See Exh. 1 [SCE's Testimony], pp. 27-30; Exh. 10 [SCE's Confidential Workpapers (Public Version)], pp. 85-90.

[11] SCE's Valuation studied the period October 1, 2012 through June 30, 2016, or 45 months.

[12] Exh. 1 [SCE's Testimony], p.29. As stated above, Otherwise Value = Net Benefit value minus plant decommissioning and mine reclamation costs.

[13] Exh. 10 [SCE's Confidential Workpapers (Public Version)], pp. 85-88.

[14] (c) = (a)/45

[15] (d) = (b)/45

Table 2
Sales Price per Month Value
($ millions, present value revenue requirement)

Negotiated Sales Price[16] (a)	Sales Price per Month[17] (b)
$294	$6.5

C. The Reasonableness of SCE's Valuation and Negotiated Sale Price

DRA accepts the premise that SCE structured the sale of its share of the Four Corners Generating Station so that SCE's ratepayers would be indifferent to whether SCE maintained its participation in the 50-year operating agreement until the middle of 2016, or divested its interest in the Four Corners plant earlier. Based on this premise, DRA has a neutral position at this time regarding the Commission's ultimate determination of whether to authorize SCE's divestiture of its interest in Four Corners pursuant to the Purchase and Sale Agreement negotiated with APS.

However, DRA emphasizes that:

1. Based on the forecasts in SCE's valuation study and SCE's negotiated crediting mechanism for sale price adjustments dependent on closing date, it is in SCE's ratepayers' interest to close the transaction on or before the October 1, 2012 scheduled closing date; and
2. The reasonableness of the negotiated price of $294 million as well as the assumptions and cost forecasts used by SCE to create its valuation should be viewed by the Commission as imprecise and subject to reconsideration should the Commission's disposition of SCE's application be delayed.

[16] Exh. 1 [SCE's Testimony], p. 5.

[17] (b) = a/45 (ignoring time value of money)

2. SCE's Ratepayers Will Benefit from a Transaction Closing Date on or Before October 1, 2012

Based on the forecasts in SCE's valuation study and negotiated crediting mechanism, it is in SCE's ratepayer's interest to close the transaction on or before the October 1, 2012 scheduled closing date. As demonstrated above, SCE negotiated a sale price of $294 million while SCE's valuation model estimated the "Otherwise Value" of the transaction to range from $90 million to $361 million. Again, SCE acknowledges that "[t]he estimated value of the plant to SCE ratepayers is highly dependent on which of [the modeling] scenarios is assumed."[18] In addition, the negotiated monthly sales price credit adjustment of $7.5 million per month is near the high end of SCE's valuation study scenarios, which range from $8.0 million per month to $2.0 million per month during the course of the 45 month study period.[19]

If the Commission were to assume that the negotiated sales price of $294 million was the best estimate of the value of SCE's share of Four Corners, SCE will lose $1 million in value for each month that the transaction closes after October 1, 2012, based on the negotiated sales price divided into SCE's 45 month study period. ($294/45 = $6.5). Accordingly, based on SCE's valuation study, the negotiated $7.5 million per month credit for a pre-October 1, 2012 transaction close will bring more value to SCE's ratepayers than a post-October, 2012 transaction close.[20]

For the above stated reasons, while DRA has a neutral position at this time regarding the Commission's ultimate determination of whether to authorize SCE's sale of its interest in Four Corners, DRA respectfully encourages a timely disposition of SCE's instant application.

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[18] Exh. 1 [SCE's Testimony], pp. 28-29.

[19] The actual value, of course, will fluctuate depending on market prices, replacement power, and other supply/demand issues.

[20] Again, DRA notes that the value of maintaining access to the power after October 1, 2012 may be as low as $2.0 million per month based on SCE's valuation study.

3. The Reasonableness of SCE's Valuation and Negotiated Price Should be Viewed in Context of the Timing of the Commission's Disposition of the Instant Application

DRA does not at this time seek to challenge the reasonableness of the assumptions, models, or forecasts used by SCE to calculate the above described valuation; nor does DRA at this time challenge the reasonableness of the negotiated $294 million value of the agreement Moreover, DRA recognizes that SCE's forecasted inputs of, for example, Replacement Energy and Replacement Capacity costs, were created near the time SCE negotiated its deal with APS and may still be reasonable in the context of current market conditions.

However, the reasonableness of any transaction has a lifespan. Therefore, the reasonableness of the negotiated sale price of $294 million, as well as the reasonableness of the assumptions and cost forecasts used by SCE to create its valuation, should be viewed by the Commission as imprecise. Again, SCE's valuation study estimated the value of the transaction between $90 million and $361 million. Whether this same valuation range and the $294 million negotiated sale price would be reasonable after an extended period of time is debatable. The timing of the Commission's disposition of the instant application is uncertain, and the potential for delay already exists since the Commission's Energy Division has not yet issued the result of its environmental review of the sale pursuant to CEQA. Moreover, DRA notes that APS has the option to terminate the Sale Agreement if final Commission approval is not authorized by March 31, 2012.[21]

Accordingly, DRA respectfully requests that the parties be allowed an opportunity to reevaluate the reasonableness of the proposed transaction if the Commission does not issue a decision in a timely manner. For example, DRA would support a Commission determination that, if a Commission decision is not issued by APS's option date of March 31, 2012, parties be allowed to submit comments on any impact a delay may have on the reasonableness of the valuation modeling currently in the record. In addition, or

[21] Exh. 1 [SCE's Testimony], p. 10, fn. 11.

alternatively, DRA would support a Commission order that SCE submit an update to its valuation if a Commission decision is not issued by March 31, 2012. Regardless of whether the Commission implements the above or similar procedural mechanisms, DRA encourages the Commission to be mindful of the impact of the timing of its decision as it affects the reasonableness of the transaction from the perspective of SCE's ratepayers.

III. CONCLUSION

For the reasons stated herein, DRA emphasizes:

(1) Based on SCE's valuation study and SCE's negotiated crediting mechanism for sale price adjustments dependent on closing date, it is in SCE's ratepayers' interest to close the transaction on or before the October 1, 2012 scheduled closing date. Accordingly, DRA encourages a timely disposition of SCE's instant application; and

(2) The reasonableness of the negotiated price of $294 million as well as the assumptions and cost forecasts used by SCE to create its valuation should be viewed by the Commission as imprecise and subject to reconsideration should the Commission's disposition of SCE's application be delayed beyond March 31, 2012.

Respectfully submitted,

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