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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE

STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) for a Commission Finding that its Procurement-Related and Other Operations for the Record Period January 1 Through December 31, 2010 Complied with its Adopted Procurement Plan; for Verification of its Entries in the Energy Resource Recovery Account and Other Regulatory Accounts; and for Recovery of $25.613 Million Recorded in Three Memorandum Accounts.	)	Application No. 11-04-001 (Filed April 1, 2011)

SOUTHERN CALIFORNIA EDISON COMPANY'S (U 338-E) REPLY BRIEF – PUBLIC VERSION

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Pursuant to Rule 13.11 of the Commission's Rules of Practice and Procedure, Southern California Edison Company (SCE) respectfully submits this Reply Brief in support of its Application in the instant proceeding.

I.

INTRODUCTION

In many cases, the Division of Ratepayer Advocates' (DRA) Opening Brief simply repeats arguments it set forth in its written Report. SCE has already addressed these arguments in its Opening Brief. Although SCE disagrees with the accuracy of DRA's arguments, for the sake of brevity SCE will not repeat positions it has previously briefed. Instead, SCE's Reply Brief focuses on new or modified arguments and issues raised by DRA in its Opening Brief. SCE's silence in this Reply Brief on any issue should not be taken in any way as acquiescence to the arguments made in DRA's Opening Brief or Report.

Fundamentally, DRA's disallowance recommendations seek to hold SCE to standards of conduct that DRA prefers, and not the standards of conduct that governed the 2010 Record Period. DRA's attempt to argue that because its recommendations are connected to "ERRA entries" and that therefore any associated disallowance is fair game in this proceeding is unconvincing. DRA's Opening Brief misinterprets the purpose and scope of this ERRA review proceeding. The Commission should reject DRA's disallowance recommendations.

II.

THE CORRECT APPLICABLE LEGAL STANDARDS

DRA and SCE agree that SCE has the ultimate burden of proof in this proceeding. But DRA's characterization of this burden as one requiring "clear and convincing evidence" is wrong. DRA cites D.06-05-016 (the 2006 SCE GRC Decision) and other, earlier decisions as support for this standard,[1] but the Commission has subsequently clarified that DRA's articulation of the standard is incorrect. In its decision in SCE's 2009 GRC, the Commission clarified that the burden of proof, which had previously been described as "clear and convincing evidence," was actually a "preponderance of evidence," as correctly articulated in SCE's Opening Brief:

> With the burden of proof placed on the applicant in rate cases, the Commission has held that the standard of proof the applicant must meet is that of a preponderance of evidence, which the Commission has, at times, <u>incorrectly</u> referred to as "clear and convincing" evidence."[2]

The clarification in SCE's 2009 GRC decision that the correct standard is the "preponderance of evidence" conformed the Commission's practice to California law: "except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence."[3] In a 2008 decision, the Commission discussed the origin of the mistaken citations to a "clear and convincing" standard:

> Our own research indicates that the Commission first appeared to require clear and convincing evidence in D.44923, where in the course of its review of a motion to dismiss a telephone utility's application for a rate increase, the Commission stated:
>
> "We must keep in mind that this is not an adversary proceeding in the sense that, as in an ordinary civil case, only a prima facie case must be shown. This is a legislative proceed[ing] in which the burden of proof rests most heavily upon applicant to prove by clear and convincing evidence that the present rates of which it complains work a confiscation of its property."
>
> However, it is unclear from the discussion in D.44923 whether the Commission used the words "clear and convincing" in a lay sense only, or whether it was adopting a specific legal standard.[4]

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1 DRA Opening Brief, pp. 7-8.

2 *Re Southern California Edison Co.*, D.09-03-025, p. 8 (emphasis added).

3 Cal. Evid. Code § 115. As the Commission has also noted: "The preponderance of the evidence is generally the default standard in civil and administrative law cases." *Re San Diego Gas & Elec. Co*., D.08-12-058, p. 19 (citing California Administrative Hearing Practice, 2nd Ed. (2005) at 365).

4 *Re San Diego Gas & Elec. Co*., D.08-12-058, pp. 18-19, footnote 28 (internal citations omitted).

The "preponderance" standard was also adopted in the Commission's decision on Pacific Gas and Electric's (PG&E) 2011 GRC.[5] It is understandable why DRA does not like this correct standard; however, it is indefensible that it fails to cite it. Moreover, DRA's Opening Brief does not even address DRA's burden to produce sufficient evidence to support its disallowance recommendations.[6] DRA cannot meet this burden and its disallowance recommendations should be rejected.

III.

SCE'S 2010 RECORD PERIOD ACTIVITY FULLY COMPLIED WITH LEAST-COST DISPATCH MANDATES

The arguments in DRA's Opening Brief on Least Cost Dispatch (LCD) are conclusory and unsupported. DRA's recommendations are generally not supported by objective evidence, but instead cite to incorrect opinions, unfounded speculation, and illogical theories.

A. SCE Appropriately Self-Scheduled Mountainview During The Record Period

Much like in its Report and during evidentiary hearings, DRA's Opening Brief stresses that "self-scheduling" utility resources is permissible in the California Independent System Operator's (CAISO) post-Market Redesign and Technology Upgrade (MRTU) markets. SCE agrees with that and SCE did self-schedule Mountainview during the Record Period when appropriate.[7] DRA reiterates that its "primary message" is that SCE should have self-scheduled Mountainview "more."[8] DRA never defines how much "more," except that SCE should have

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5 *Re Pacific Gas and Elec. Co.,* D.11-05-018, p. 68. This discussion on the standard of proof addressed the contested issue of the rate of return on legacy electromechanical meters, not on the issues addressed in the settlement submitted in that proceeding.

6 *Re Pacific Bell*, D.87-12-067, 27 CPUC2d 1, 22. *See also Universal Studios Inc. v. Southern California Edison Co*., D.04-04-074, pp. 31-32, 2004 Cal. PUC LEXIS 173; *Re Golden State Water Co*., D.07-11-037, 2007 Cal. PUC LEXIS 648.

7 Exhibit SCE-6C, pp. 5-12.

8 DRA Opening Brief, p. 13. DRA sometimes defines this as a "larger portion of Mountainview". *See, e.g.*, *id.* at p. 25.

pursued this self-scheduling strategy to achieve a higher capacity factor at Mountainview. SCE has already explained in detail why targeting a specific minimum capacity factor is meaningless (and counterproductive) in evaluating LCD compliance. SCE has also demonstrated why DRA's insistence that Mountainview should have "performed" at the same capacity factor in 2010 that it did in 2008 is erroneous.[9] In sum, DRA continues to rely on years-old, obsolete planning assumptions regarding Mountainview's forecast future use. As SCE has demonstrated, this comparison is meaningless given the comprehensive market changes implemented since that time.

Moreover, SCE has already demonstrated how self-scheduling "more," without regard to economics, is harmful to SCE's customers, and only provides the "certainty" of achieving a sub-optimal outcome for those customers.[10] DRA claims that SCE's example in its rebuttal testimony demonstrating this result (SCE-6C, Table II-1) is overly "simplified" and that SCE "fails to 'show' what the expected revenue would be if SCE failed to receive CAISO bid awards; i.e., $0."[11] This is not true; SCE's example shows exactly why self-scheduling without regard to price is inappropriate. The "simplified" nature of SCE's example is based on the fact that the concept of LCD is simple; resources should operate only when they can recover their variable operating expenses. DRA is clinging to its assertion that SCE bid Mountainview at above-cost prices (and thus purportedly did not receive market awards that it otherwise would have), which DRA cannot demonstrate by providing any objective evidence.

DRA's Opening Brief then re-states the incorrect claim its witness made during evidentiary hearings that "[t]here's ways to self-schedule to make sure you recover variable cost."[12] DRA provides no support for this claim, and it is absolutely incorrect. A self-schedule

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9 SCE Opening Brief, pp. 18-19.

10 DRA continues to be confused about the CAISO's Integrated Forward Market (IFM) and the Real-Time (RT) market. As SCE has explained, if SCE does not self-schedule, and instead submits a cost-based bid that does not clear the IFM, that means that other, lower-cost resources in the IFM were chosen to serve SCE's load. DRA's references to the RT market are irrelevant. *See, e.g.*, DRA's Opening Brief, p. 18.

11 DRA Opening Brief, p. 25.

12 DRA Opening Brief, p. 28 (quoting 1/18/12 Evidentiary Hearing Tr., Stueve).

is, by definition, a price taker action it is therefore impossible to guarantee cost recovery with a self-schedule. If the resource is run uneconomically and does not recover its cost in the market, customers still pay the cost of operating the resource. DRA's misinformed claims cannot change that simple fact. By self-scheduling, if a bidder estimates the market-clearing price correctly the best outcome a bidder can hope to achieve is breaking even compared to bidding a resource at its true variable cost.[13] But if the bidder estimates incorrectly it will run an uneconomic resource "out of the money;" *i.e.*, the bidder will be running a resource that is not recovering its variable cost.

Similarly, DRA claims (without presenting any evidence) that Mountainview was not running during certain "peak hours or peak seasons."[14] By SCE submitting cost-based bids, the market ensures that Mountainview runs only when there is not lower-priced energy to serve SCE's load. It is irrelevant during which season or hours that occurs. For example, if during a peak afternoon hour in August market prices are $40 per MW/hr, but Mountainview's variable costs are $50 per MW/hr, then Mountainview should not run. By bidding Mountainview at cost in the Integrated Forward Market (IFM), if market prices do "double or triple"[15] as DRA fears, the result would be that the market would "pick" Mountainview based on its cost-based bid and it would run, because it would be cost-effective. Choosing to self-schedule only because of the possibility of market price spikes is a downside proposition.

Finally, DRA makes the new argument that Standard of Conduct No. 4 (SOC 4) only prohibits utilities from exhibiting "inappropriate" preferences for utility-retained generation (URG) resources. The unspoken premise in DRA's argument is that some amount of preference for URG resources is somehow "appropriate." SCE disagrees, and the Commission has noted that under SOC 4 "[p]rohibited utility conduct under this standard includes <u>any</u> action that results

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[13] *See* SCE-6C, p. 9.
[14] DRA Opening Brief, p. 28.
[15] *Id.*

in preference to URG resources … ."[16] DRA's own citation does not support its argument: "[U]nder certain circumstances, economic dispatch will mean supplying incremental power from lower-cost utility generating assets to customers."[17] That is exactly what SCE does by bidding Mountainview at cost: When Mountainview is "lower-cost" than other market resources, it is dispatched by the CAISO.

DRA's repeated arguments regarding stranded resources and bid cost recovery (BCR) are also wrong.[18] DRA continues an illogical claim that Mountainview is "stranded" when not running. By this logic, any dispatchable resource not running is also "stranded," when in fact the reason that available dispatchable resources are not committed in the CAISO IFM is that they are not needed. It is common knowledge that not all dispatchable resources run every day. DRA disregards basic economic principles by claiming that Mountainview should be force-run by self-scheduling "more" just because it is an SCE customer asset. In addition, DRA continues to mischaracterize BCR as costs that customers would not otherwise bear if the affected units (*e.g.*, Mountainview) were self-scheduled instead of bid. BCR is simply a mechanism to recover a resource's cost if CAISO commits the resource and market revenues are insufficient to cover the cost of operating the resource. Interestingly, DRA disregards the fact that BCR is a cost that is socialized across all the CAISO-area load-serving entities. By self-scheduling, BCR does not indeed apply, but SCE's customers and only SCE's customers then pay the entire cost of running the resource, even if it is uneconomic. Put another way, the resource cost does not change, only who pays it.

DRA's repeated arguments about only "extremely high" levels of self-scheduling potentially impacting the market are wrong.[19] Self-scheduling any resource "out of the money"

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[16] D.02-12-069, pp. 62-63 (emphasis added); *see also* D.03-06-067, p. 7.

[17] DRA Opening Brief, p. 27 (quoting D.02-09-053, p. 41). This partial citation is also misleading. In that case, the Commission was instructing the utilities to dispose of (*i.e.*, sell on the market) higher cost DWR contracts if their own URG resources were lower cost.

[18] DRA Opening Brief, p. 19.

[19] DRA Opening Brief, p. 17.

is by definition a reduction in market efficiency and congestion can occur on any path irrespective of how "high" the system-wide self-scheduled quantities may be.[20] This is one of the primary reasons the MRTU environment exists, and is also why the market is nodal (*i.e.*, the recognized need for the day-ahead market to simultaneously consider transmission system capabilities; this produces locational marginal prices (LMPs) reflecting system constraints).[21]

B. **<u>SCE Appropriately Submitted "True Cost-Based" Bids for Mountainview During The Record Period.</u>**

DRA's Opening Brief now claims that the second LCD option (other than self-scheduling) for utility resources is to bid them at "true" cost.[22] In the hours during the Record Period when SCE did not self-schedule Mountainview, SCE did bid the resource at its "true" cost. SCE's rebuttal testimony and Opening Brief discuss the two available CAISO mechanisms ("proxy" or "registered") for declaring resource start-up and hourly minimum load costs. [redacted] SCE explained that most of its dispatchable natural gas resources have [redacted]

DRA's Opening Brief now claims that the "true" cost of Mountainview was approximately \$37.40/MWh during the Record Period.[23] SCE has conclusively demonstrated

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[20] DRA also completely misinterprets the 2010 CAISO statement quoted on page 29 of DRA's Opening Brief. In that statement, CAISO noted that because load-serving entities served a high proportion of their load in the day-ahead market, *i.e.*, the IFM, instead of in the real-time (RT) market, that generators' ability and incentive to increase prices in RT has been reduced. That is true. But that does <u>not</u> equate to a CAISO preference for IOU self-scheduling instead of bidding their resources into the IFM at variable cost. The CAISO was simply referencing the effects of serving a high proportion of load through the IFM instead of the RT market.

[21] *See* D.07-12-052 at p. 262 ("There is no doubt that MRTU will greatly impact the CAISO's markets. We note that this is precisely the point of this endeavor. As a result of the redesign effort there are a number of elements of MRTU that may impact the procurement practices or costs of the IOUs.")

[22] DRA Opening Brief, p. 11.

[23] DRA Opening Brief, p. 11, footnote 29 and p. 12.

that evaluating the average annual price for Mountainview's output is meaningless in a market that values resources on an hourly basis.

[redacted]

DRA has provided no evidence that it understands Mountainview's "true" costs at all, much less that it understands them better than SCE's team of professionals whose full-time job it is to calculate SCE's resource portfolio costs. More fundamentally, DRA does not present any actual evidence that [redacted]

[redacted] There are two kinds of "fixed" costs. There are those fixed costs that do not vary with Mountainview's output, number of start-ups or annual run time. Those fixed costs, such as capital costs, are irrelevant to LCD. As SCE has stated many times before, those costs are unavoidable, because SCE's shareholders have paid for them, and SCE's customers will reimburse them, over the life of Mountainview irrespective of how often Mountainview runs.

The second category of "fixed" costs are, on the other hand, avoidable and therefore relevant to LCD. SCE's customers will only incur these costs only if, and to the extent that, Mountainview runs. [redacted] The "true" cost to run Mountainview includes these costs, and they are only "fixed" to the extent that they are static and do not vary with fuel price fluctuations. That does not make them any less relevant for LCD purposes. The essential question that SCE's planners must answer when crafting Mountainview's bid is: "How much will it cost to run the unit?" [redacted]

Perversely, DRA argues that the Commission should consider the sunk, unavoidable, "fixed" costs of Mountainview (*i.e.*, capital costs, or what DRA refers to as "stranded" costs),[24] but not the incremental, avoidable "fixed" costs (*i.e.*, non-fuel start-up costs) in evaluating SCE's compliance with LCD. This flies in the face of basic economic theory, and is contrary to clear Commission precedent:

> Economic dispatch entails analysis of the marginal costs of the available energy and dispatching the least-cost incremental resource. An important element of least cost dispatch is that the fixed costs associated with resources are considered sunk for dispatch purposes. Variable costs are the only ones that are incurred or avoided as a result of operating decisions. … [T]o achieve economic dispatch the operating utility needs only to see the variable cost … of any … resource in its portfolio. … [LCD] [d]ispatch does not require the … consideration of total costs to dispatch [utilities'] own utility retained generation.[25]

C. SCE Did Not Engage In "Market Revenue-Based" Bidding For Mountainview

Despite SCE's repeated, clear explanations, DRA continues to cling to the argument that SCE engaged in "market revenue-based" bidding for Mountainview during the Record Period. That is simply not true. SCE's Opening Brief (as well as its rebuttal testimony) conclusively refuted this misrepresentation.[26]

DRA continues to ignore SCE's repeated explanation (in SCE's rebuttal testimony, through discovery responses, through in-person and telephonic meet-and-confer sessions, and at the Evidentiary Hearings) regarding the Mountainview "profit margin" calculation, and represents that SCE "conditioned availability" of Mountainview based on the calculation of projected market revenues. DRA still has not produced any evidence that SCE bid

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24 DRA Opening Brief, p. 18.
25 D.02-09-053 at p. 39 (emphasis added, internal citations omitted).
26 SCE Opening Brief, pp. 10-11; SCE-6C, pp. 5-7.

Mountainview inappropriately.[27] [redacted]

D. DRA's "Damages" Calculation Is Arbitrary And Capricious And Must Be Rejected

DRA claims that it took a "conservative approach" when it calculated its recommended LCD damages of approximately $10.2 million for the Record Period. A "conservative" approach is not the same as a legally-defensible, non-arbitrary approach. SCE's Opening Brief demonstrated why the Commission must reject DRA's damage calculation - because it is not based on any rational analysis. Specifically, DRA picked an arbitrary number ($20/MWh) and multiplied it by the number of fewer hours Mountainview ran in 2010 compared to 2008. Crucially, DRA did not compare how much SCE's customers should have paid for power with what they actually paid for power.

DRA attempts to shift this burden to SCE, noting that "SCE did not present any alternative calculation in its Rebuttal Testimony … ."[29] But it is indisputably DRA's burden to support its disallowance recommendation, not SCE's to provide DRA with an "alternative." For years, SCE has provided DRA with, among other things, all its daily resource plans and the traditional, three detailed "deep dive" sample days from the relevant Record Period to support its LCD showing. That has always been sufficient for DRA, and for the Commission. Now, DRA claims that SCE "provided DRA with everything except what is needed to analyze their

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[27] DRA's assertion in its Opening Brief that "SCE's Mountainview strategy influenced heat rate" is absurd. There is no relationship between performing a simple calculation to determine whether a resource is likely to recover its costs and "influencing" a resource's heat rate.

[28] Exhibit SCE-6C, pp. 5-7.

[29] DRA Opening Brief, p. 44.

achievement of least-cost dispatch."[30] This is flatly contradicted by DRA witness Stueve's testimony during evidentiary hearings:

> ALJ ROSCOW: So do you have are there still outstanding data responses that you haven't received responses to?
>
> DRA WITNESS: We have all the responses fully now, I believe, some with objections, and we revised some due to objections. But we have the full -- all the responses, I believe.[31]

DRA has presented no evidence that SCE did not achieve LCD during the Record Period, and its recommended damage calculation is arbitrary and not legally-defensible.

Moreover, the "after-the-fact" LCD-compliance analysis DRA requests is unprecedented and inappropriate. DRA witness Stueve's claim that SCE could do an after-the-fact compliance analysis for a full annual Record Period in "a week or two" is unfounded speculation and untrue. In any event, the ERRA compliance review proceeding is appropriately not a forecasting-accuracy contest. As explained in length in SCE's Opening Brief, this proceeding is appropriately about whether or not SCE acted consistent with its Commission-approved Long-Term Procurement Plan. DRA has never claimed that SCE did not.

E. SCE's Record Period CAISO Charges Should Be Approved

DRA's Opening Brief essentially sets forth no new arguments on this issue, and SCE respectfully directs the Commission to SCE's Opening Brief. One point merits further discussion: DRA claims that if SCE had self-scheduled "more," then it would have avoided some CAISO charges for energy SCE purchased in the market.[32] That is by definition true, although most definitely not $204 million less. But of course SCE would have incurred additional, more-than-offsetting costs for running its own generation instead of buying the less-costly CAISO market energy. Because SCE has demonstrated that it ran its own generation

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30 *Id.*
31 1/18/12 Evidentiary Hearing, Stueve, p. 67:1-8.
32 DRA Opening Brief, p. 31.

when it was economical to do so, and purchased CAISO energy when it was cheaper, DRA's argument is true but meaningless.

IV.

SCE IS ENTITLED TO RETURN ON ITS INVESTMENT IN MOHAVE

A. DRA's Recommended Disallowance Is Beyond The Scope Of ERRA, Will Potentially Conflict With SCE's 2012 GRC Decision, And Constitutes Retroactive Ratemaking

As DRA's Opening Brief did not raise any new issues addressing SCE's arguments, SCE will not repeat those arguments here. Instead, SCE respectfully directs the Commission to SCE's Opening Brief and SCE's November 15, 2011 Motion to Strike.

B. SCE Acted Diligently In Maintaining Flexibility At Mohave For The Benefit Of Customers And Is Entitled To A Return

To date, it has been undisputed that SCE acted reasonably and in accord with the Commission's wishes regarding Mohave.[33] DRA now claims for the first time that the return embedded in Mohave Balancing Account (MBA) entries for post-shutdown years is a "difficult problem created by SCE … by not securing adequate supplies to run the plant through 2016."[34] DRA goes on to claim that SCE "fail[ed] to properly manage" Mohave. DRA cites no evidence to support this unfounded accusation, and has never before claimed that SCE did not do everything in its power to keep its options open at Mohave. In fact, SCE has submitted extensive evidence demonstrating that it went to extraordinary lengths, both before and after Mohave's shutdown, to maintain the maximum value of the plant for the benefit of customers. *See*

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[33] SCE-6C, pp. 27-29.

[34] DRA Opening Brief, p. 62.

generally SCE-01, Ch. XVI; SCE-06, pp. 27-29; 1/18/12 Evidentiary Hearing Tr., Phelan, pp. 100-104.[35]

1. DRA's Misstates The Law Regarding the "Used and Useful Test"

As discussed in SCE's Opening Brief and Motion to Strike, it is inappropriate for the Commission to retroactively re-examine SCE's return on investment on Mohave in this proceeding, as opposed to prospectively dealing with that issue in SCE's pending 2012 GRC. Even if such an inquiry was appropriate here, DRA's arguments about the "used and useful" test misstate the law. In Mohave's case, the Commission determined that Mohave was used and useful when it went into service in the early 1970s, and Mohave was accordingly put into rate base, with an original amortization schedule through 2006. The Commission accepted that original amortization schedule, and a subsequent revised amortization schedule, which depreciated Mohave through 2016.

The revised amortization schedule was confirmed by D.06-05-016 (the 2006 GRC Decision) and D.09-03-025 (the 2009 GRC Decision). The Commission in the 2006 GRC Decision, which was issued after Mohave had ceased generating electricity, but when it still might have been re-started, did not remove Mohave from rate base and permitted SCE to earn a rate of return on the plant through 2016. The Commission in the 2009 GRC Decision, which was issued after Mohave had ceased delivering electricity, and ***after*** SCE informed the Commission that it was never going to be restarted, did not remove Mohave from rate base, and permitted SCE to earn a rate of return on the plant's remaining book value through 2016. The Commission noted that SCE was "proceeding with … physical decommissioning of the plant"

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35 This is another reason that SCE earning a return on Mohave after it was out of service is reasonable. The Commission ordered SCE to keep its options open at Mohave. This necessitated SCE spending capital at the plant, which represents some of the AFUDC at issue. SCE is entitled to a return on all of its capital investment at Mohave, which was made at the Commission's direction and for the benefit of SCE's customers.

yet still allowed SCE to earn a return on its remaining plant investment going forward through 2016.[36]

DRA's citation to Public Utilities Code §455.5, which applies to utility assets taken out of service, is unavailing. That section reads:

> (a) In establishing rates for any electrical …corporation, the commission may eliminate consideration of the value of any portion of any electric … generation or production facility which, after having been placed in service, remains out of service for nine or more consecutive months, and may disallow any expenses related to that facility. …
> (b) Every electrical … corporation shall periodically, as required by the commission, report to the commission on the status of any portion of any electric … generation or production facility which is out of service and shall immediately notify the commission when any portion of the facility has been out of service for nine consecutive months.
> (c) Within 45 days of receiving the notification specified in subdivision (b), the commission shall institute an investigation to determine whether to reduce the rates of the corporation to reflect the portion of the electric … generation of production facility which is out of service.[37]

In Mohave's case, SCE notified the Commission after Mohave had been out of service for nine consecutive months. At that point it was up to the Commission's discretion ("may," not "must") to consider whether to disallow costs related to Mohave, and "whether to reduce rates" accordingly. The Commission did consider that question in SCE's 2006 and 2009 GRCs, and decided not to reduce rates accordingly, even though the Commission knew Mohave was out of service. *See also* D.95-12-063 ("Utility property, such as a generation asset, that has received revenue recovery through rates is used and useful in the performance of its duties to the public until such time as the Commission determines otherwise.")[38]

The Commission's decision to not remove Mohave from rate base was completely appropriate given the circumstances. DRA overstates the "used and useful" test as an almost absolute prerequisite for rate recovery of invested capital. DRA cites a series of cases regarding

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[36] D.09-03-025, p. 18.
[37] P.U.C. §455.5 (a-c) (emphasis added).
[38] D.95-12-063 (as modified by D.96-01-009) at Conclusion of Law No. 33.

utility property that has never been used and useful,[39] and discusses two exceptions to the rule (Plant Held for Future Use and "abandoned plant") that similarly relate to utility property that has never been placed in service. But Mohave was "used and useful" and in service to SCE's customers for approximately 35 years. The more relevant benchmarks are situations where utility resources have been used and useful, and have then been subsequently removed from service.

DRA does cite some cases that are relevant to this inquiry, but its discussion of those cases is incomplete. In D.85-08-046, a PG&E prospective rate-setting proceeding, the Commission examined how to handle the ratemaking treatment of PG&E's Humboldt Bay plant after it had gone out of service in 1976, but before the end of its expected useful life. In that case, the Commission decided to remove the plant from rate base on December 19, 1979 (in D.91107), more than three years after the plant had been removed from service. In D.85-08-046, the Commission ruled that PG&E was not entitled to a return on the net plant balance or recovery of Allowance for Funds Used During Construction (AFUDC) from December 19, 1979 <u>forward</u>, *i.e.*, after the plant had been removed from rate base:

> We should point out that our disallowance of this portion of AFUDC affects only for the time after our decision to remove Unit 3 from rate base. … PG&E has already recovered a return on the undepreciated plant, which includes the original AFUDC, from the start of commercial operation through December 19, 1979, when we removed the plant from rate base. PG&E thus continued to earn a rate of return on its original investment and associated AFUDC for over three years after the plant ceased operating.[40]

This decision is analogous to a potential Commission decision in SCE's 2012 GRC removing Mohave from rate base, which would allow SCE to earn a return on Mohave from 2006 to 2012, but not from 2012 forward. D.85-08-046 does <u>not</u> stand for the proposition that a

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[39] DRA cites the following cases, all of which deal with the ratemaking treatment of utility plant before it goes into service: *San Jose v. Pacific Tel. & Tel. Co.*, 3 R.R.C. 720 (1913); *Application of the Southern California Tel. Co. for an Order Authorizing Exchange Areas in the Territory Served*, 25 R.R.C. 721 (1924); *Re Southern California Gas Co.*, D.84-09-089, 16 CPUC 2d 205 (1984); D.05-07-021; D.05-01-047; D.06-11-050.

[40] D.85-08-046, p. 17.

plant can be retroactively removed from rate base and earned return retroactively disallowed, which is what DRA proposes in this proceeding.

DRA's discussion of D.85-12-108 is similarly incomplete. In that case, a San Diego Gas and Electric Company (SDG&E) GRC, the utility requested continued rate base treatment for certain "stored" generation facilities that had been removed from service. The Commission allowed continued rate base treatment (*i.e.*, SDG&E continued to earn a rate of return) for one such plant (South Bay 3), because of the potential unreliability of SDG&E's resource plan and because the plant was useful as a "'yardstick' in bargaining for firm purchased power."[41] By analogy, the Commission essentially ordered SCE to keep its options open at Mohave as a "yardstick," to maintain the most flexibility and value for SCE's customers. In any event, there is no suggestion in D.85-12-108 that the Commission ordered the other SDG&E plants to be retroactively removed from rate base; instead, additional return was prospectively prohibited in a GRC.[42]

Moreover, DRA simply ignores other relevant Commission decisions that undermine its arguments regarding the "used and useful" test:

In D.92-08-036, the Commission adopted a settlement between DRA and SCE/SDG&E that allowed a four-year amortization for the utilities' remaining investment in San Onofre Nuclear Generating Station (SONGS) Unit 1. The utilities were allowed to earn a rate of return for the four-year amortization period, even though SONGS Unit 1 had been removed from service.

In D.95-12-063, the Commission allowed transition cost recovery during electric industry restructuring at a reduced rate of return, even though the utilities' generation assets were no longer used and useful. Similarly, in D.97-11-074, regarding electric restructuring, the

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41 D.85-12-108 at p. 35. The Commission ordered that South Bay 3 be treated as Plant Held for Future Use and the other plants removed from rate base unless and until they were returned to service.

42 *See also* D.92-12-057, p. 216 (in PG&E's 1992 GRC, prospectively removing from rate base PG&E's Geysers 15 geothermal plant, which had been out of service since 1989).

Commission held: "In allowing the recovery of generation plant-related transition costs, we have, in effect allowed the utilities to recover costs of plants that may no longer be used and useful in the new competitive marketplace."[43]

In D.83-08-031, the Commission considered the ratemaking treatment regarding the early retirement of Pacific Telephone & Telegraph Company's capital equipment. The Commission allowed rate base treatment for some of those assets, even after they had been removed from service and were no longer used and useful:

> Whether the [retirements have] been caused by the economic trends of the day, the migration strategy, or, most likely, some combination of the two, does not make a difference. The difference lies in how costs are allocated between Pacific's shareholders and ratepayers. That portion not resulting from the migration strategy [*i.e.*, the portion due to economic trends of the day] should be paid by ratepayers.[44]

Finally, in D.84-05-100, the Commission allowed PG&E to recover AFUDC for the abandoned Montezuma coal plant, even though it did not produce electricity. The Commission's reasoning was that the abandonment of the plant resulted in a net gain for ratepayers because PG&E was able to sell the plant to a third party:

> We allow the carrying costs because ratepayers derived substantial benefits from the project, in the form of profits from the sale, even though the project never produced electricity. Thus, PG&E is entitled to its carrying costs…[45]

The common thread in all of these cases is that the "used and useful" test is applied on a going-forward basis, it is not an absolute prerequisite to rate recovery, and it is fact- and situation-specific. In fact, in D.92497 the Commission noted that in addition to concerns about customer costs regarding utility assets that were not used and useful, the Commission was:

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[43] D.97-11-074, p. 174.
[44] D.83-08-031, p. 7.
[45] D.84-05-100, p. 7.

> also concerned with the increasing burden being placed on the stockholders who in the past have invested in utility stocks as a reliable income stock with some growth possibilities and very little risk. Although the costs in this case are small in comparison to some abandonment costs … this in itself is not sufficient justification for placing the entire burden either on the stockholder or the ratepayer … . We cannot emphasize too strongly the necessity of examining each case on an individual basis to arrive at an equitable decision.[46]

In the case of Mohave, the "equitable decision" is to leave the current amortization schedule in place, with the corresponding return on investment, through 2016. First, the Commission has already authorized this approach in the 2006 and 2009 GRC Decisions, and any relief to the contrary may only be applied prospectively through the 2012 GRC. Second, the reason that the Commission authorized this approach was to give SCE the appropriate incentives to maintain Mohave's flexibility to maximize its benefits for customers (*e.g.*, through a potential re-start, a sale to a third-party, or re-development with alternative generation technology[47]). In that sense, the case of Mohave is analogous to PG&E's Montezuma plant and SDG&E's South Bay plant. Third, SCE's shareholders should not be punished for the "economic trends of the day," which forced Mohave's premature retirement. Much like Pacific Telephone & Telegraph Company's retired assets, Mohave was removed from service because of conditions beyond SCE's reasonable control before the end of its amortization schedule. It is not equitable to punish SCE's shareholders for those events.

2. SCE Was Under No Obligation To Remove Mohave From Rate Base

DRA claims that SCE should have "immediately removed the plant from rate base when tracked through the MBA immediately after the utility determined to no longer operate the plant."[48] DRA fashions this as SCE's failure "to make the proper adjustment/entry" in the MBA.[49] DRA cites no authority for the proposition that SCE has an obligation to "remove the

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46 D.9297, 4 CPUC2d 725, 1980 CAL.PUC.LEXIS1024, * 115.

47 *See, e.g.*, SCE-06, Appendix K (6/21/06 letter discussing efforts by Mohave co-owner Salt River Project and other co-owners to resume Mohave operations); *id.*, pp. 27-29; D.04-12-016.

48 DRA Opening Brief, p. 52.

49 *Id.*

plant from rate base." As plant is amortized in rates, rate base is reduced. The current amortization schedule remains in place until changed by the Commission. SCE "removes" a generating plant from rate base when fully depreciated, commensurate with the Commission-approved depreciation schedule or when otherwise authorized by the Commission to remove it from rate base. In fact, DRA's argument is belied by the relevant statute, Public Utilities Code Section 455.5, which makes clear that the Commission, may, but does not have to, reduce rates for plants that are no longer in service (*i.e.*, remove them from rate base). The Commission chose not to do so in this case.[50]

As mentioned above, Mohave's original amortization schedule terminated in 2006. But in SCE's 1995 GRC, SCE proposed and the Commission accepted a ten-year extension of the amortization schedule (from 35 years to 45 years) to better align with the then-current estimates of the "life" of SCE's coal and natural gas generating facilities. For Mohave, the revised amortization schedule remains in place to this day. Extending the Mohave amortization schedule resulted in reduced customer rates in the intervening years. DRA claims that "neither D.06-05-016 nor D.09-03-025 state that SCE would be allowed to earn a rate of return through 2016 on the Mohave plant."[51] Those decisions did not remove Mohave from rate base, but instead incorporated the amortization schedules that depreciate Mohave (with a return) through 2016. Moreover, in the 2009 GRC Decision, the Commission ordered SCE to "continue the two-way balancing account to record the ongoing costs associated with Mohave Generating Station."[52]

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[50] SCE gave the Commission every opportunity to do so by sending the notification required by P.U.C. § 455.5(b). *See* SCE-6C, p. 28.
[51] DRA Opening Brief, p. 53.
[52] D.09-03-025, p. 394.

3. DRA's Recommended Disallowance Remedy Would Punish SCE's Customers

DRA calls its recommendation to use "the over-collected balance in the MBA" to allow SCE to recover its remaining capital investments in Mohave (with no return) a "practical solution."[53] SCE respectfully submits that it is not "practical" for the Commission to raise customer rates (because the net over-collections recorded in the MBA during 2006 through 2010 have already been refunded to customers) just to punish SCE for following Commission directions. DRA's Opening Brief does not address this issue.

V.

SCE IS ENTITLED TO RECOVER THE MOUNTAINVIEW AVAILABILITY INCENTIVE AND EMISSIONS CREDITS

A. The Commission Should Reject DRA's Recommendation To Retroactively Disallow Recovery Of $1.2 Million In Earned Mountainview Availability Incentive Awards.

In support of its disallowance recommendation for the $1.2 million availability incentive in the Record Period, the primary argument in DRA's Opening Brief is that the Commission has not actually allowed SCE to revise the formula by which the payment is calculated. As comprehensively demonstrated in SCE's November 15, 2011 Motion to Strike and SCE's Opening Brief, that is false, and SCE will not repeat those arguments here. DRA's secondary argument, that because the incentive is recorded in ERRA that DRA may attack it retroactively, has also been thoroughly addressed in SCE's previous briefing.

DRA's "no waiver" argument, however, does merit further discussion. DRA claims that previous DRA teams' non-opposition to the revision of the incentive formula does not constitute a "waiver" of DRA's ability to attack it now. From a purely technical perspective, it is true that

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[53] DRA Opening Brief, p. 62.

"one DRA team's position or silence on an issue in one proceeding does not bind a future DRA team's right to take a different … position on that issue in a different proceeding."[54] But it is unreasonable for SCE to propose modifications to a formula calculation in one proceeding; have DRA state in that proceeding that it "does not oppose the proposed modifications"; for SCE to then implement the modifications in the next ERRA proceeding (for the 2009 Record Period); for the Commission to accept that revision in the next ERRA proceeding (for the 2009 Record Period); and then for DRA to argue that for the 2010 Record Period SCE's incentive should be disallowed, even though it is undisputed that it was correctly calculated pursuant to the modified formula. Yet that is exactly what DRA's disallowance recommendation would have the Commission do.

DRA clearly does not approve of the structure of the revised availability incentive formula. As SCE explained, the incentive, and the formula's corresponding penalties for performance below target, was first approved by the Commission while Mountainview was under construction. As SCE witness Ware explained during hearings, "the historical context was that this incentive somewhat modeled how an independent power plant might make decisions concerning reliability and fuel efficiency" and that the company believed that it was appropriate to continue the incentive (and corresponding penalty structure) after transferring Mountainview cost recovery to base rates in SCE's 2009 GRC.[55]

SCE has proceeded in good faith under the assumption that what made sense then still remains valid today. DRA does not argue that customers would be better served were SCE to revert to an hourly block-loaded schedule for Mountainview, rather than operating Mountainview consistent with the current market structure. Indeed, DRA offers no constructive recommendations on how the incentive mechanism might be better used to encourage a win-win

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[54] DRA Opening Brief, pp. 36-37.

[55] 1/18/12 Evidentiary Hearing Tr., Ware, p. 87. DRA does not dispute that the Commission approved the continuance of the incentive mechanism in SCE's 2009 GRC, but rather DRA focuses on the formula modification that SCE proposed in that proceeding.

for all parties going forward. Instead, DRA claims without any evidentiary support that the incentive "is duplicative of existing incentives within the ERRA process and should be discontinued for as long as the Mountainview plant is owned by SCE."[56]

Essentially, DRA questions why any incentive (irrespective of the specific formula) is necessary to ensure Mountainview reliability, challenging the premise that a "financial incentive" is needed to ensure plant reliability. SCE agrees that its efforts to appropriately manage Mountainview reliability do not strictly require the incentive, although the structure does provide for customer protection in the form of penalties if reliability is not maintained. SCE agrees that the Commission may choose to <u>prospectively</u> abolish the availability incentive. If the Commission adopted that policy, it also should eliminate the corresponding penalty provision should plant availability performance be less than target. That is a policy choice that the Commission may make, after careful consideration, for prospective application. That policy choice should not and indeed cannot be retroactively applied in this ERRA review proceeding. The Commission should not retrospectively reverse an award SCE has already earned, simply because that award is reflected in an ERRA entry.

B. <u>The Commission Should Reject DRA's Recommendation To Defer Recovery Of $0.789 Million In Mountainview Emissions Credits.</u>

SCE's request to recover $0.789 million for Mountainview emissions credits is reasonable. DRA apparently realizes that it was wrong when it asserted that recovery of the $0.789 million would constitute "double recovery" because the Mountainview emissions credits are already recovered through rate base. DRA's Opening Brief essentially claims that SCE has not <u>proven</u> that it made the corresponding reductions to rate base when it expensed the emissions credits. But SCE has sworn testimony demonstrating that it has,[57] DRA has no evidence to the

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[56] DRA Opening Brief, p. 40.
[57] SCE-6C, pp. 23-24.

contrary, and DRA could have propounded a data request in this proceeding if it wanted more "proof." There is no need to defer recovery of the expensing of these emissions credits, and DRA's recommendation should be rejected.[58]

VI.

THE COMMISSION SHOULD NOT ORDER SCE TO PERFORM ADDITIONAL AUDITS OF SONGS AND BIG CREEK

DRA's Opening Brief claims that "the audit records and documents requested by DRA are necessary for proper Commission oversight of SCE and its operations."[59] To be clear, the "audit records" DRA are requesting include an order from the Commission directing SCE to deviate from its internal audit plan by auditing two facilities DRA picks at random,[60] and by allowing DRA to insert itself into what to-date has been an independent process. DRA makes this request despite concluding that it "found no reason to challenge SCE's internal controls" and "that SCE generally intends to use an appropriately risk-based approach to develop its internal audit plant and identify individual audits that are to be performed."[61]

In its Opening Brief, DRA claims it merely wants to be one of the "other stakeholders" to be consulted during audit planning.[62] DRA cites no evidence and SCE is unaware of any that any regulated utility's audit department "consults" with intervenors in regulatory proceedings in developing what is supposed to be an independent and objective audit plan. To do so is both unnecessary (because DRA acknowledges SCE's audit procedures are working correctly), and unjustified (because it would fundamentally alter and delay an independent process that is meant

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58 Moreover, if the Commission wants additional "proof" that SCE has made the appropriate corresponding reductions to rate base, it can view SCE's workpapers in SCE's 2012 GRC at SCE-10, Vol. 2, Ch. IV, workpaper p. 52 (attached hereto as Exhibit A for the Commission's convenience).

59 DRA Opening Brief, p. 63.

60 DRA claims it has "heightened concerns about the SONGS facility (both units) and the Big Creek hydroelectric facilities (all units)", but never states what those "heightened concerns" allegedly are. DRA Opening Brief, p. 65.

61 DRA-1, pp. 3-2 – 3-3.

62 DRA Opening Brief, pp. 64-65.

to be candid, transparent, and self-critical). The Commission should reject DRA's recommendations.

VII.

<u>CONCLUSION</u>

For all the reasons stated above, the Commission should reject DRA's disallowance recommendations in total, as they lack merit.

Respectfully submitted,

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Exhibit A

Mountainview Emission Credits Inventory*

($000, Nominal Average Balances)

Line No.	Item	Recorded 2009	Forecasted 2010	2011	2012	2013	2014
1.	Emission Credits 53/	11,908	11,004	10,148	9,329	8,550	7,713
		6/					