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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION **RESOLUTION E-4313**
June 24, 2010

R E S O L U T I O N

Resolution E-4313. Approves Southern California Edison (SCE) request to modify its Reliability Investment Incentive Mechanism (RIIM).

PROPOSED OUTCOME: SCE will escalate its 2009 RIIM capital expenditures and additions by 4.25% to derive its 2010 RIIM capital expenditures and additions, and will escalate the 2010 results by 4.35% for 2011.

ESTIMATED COST: No increase in ratepayer cost results, because overall rates for the period 2009-2011 were adopted in D.09-03-025; up to $70 million could be returned to ratepayers at the end of the three-year period if SCE chooses not to spend it under RIIM.

By Advice Letter 2408-E Filed on November 20, 2009.

SUMMARY

Southern California Edison Company (SCE) may escalate expenditures under its Reliability Investment Incentive Mechanism (RIIM) for 2010 and 2011 by the same escalation factors that were adopted for the revenue requirement in SCE's 2009 General Rate Case (GRC) decision.
Adopting lower escalation rates for RIIM projects in this Resolution would not reduce ratepayer costs because SCE's overall revenue requirement escalation rates were set in D.09-03-025. At this point in the rate case cycle only SCE can reduce the costs at issue by choosing to not invest in RIIM, in which case SCE must return unused RIIM funds to ratepayers.

Conversely adopting lower escalation rates for RIIM investments would only cap the Commission's intent under RIIM to invest in reliability and thereby shifting the approved revenues to investments made at SCE's discretion.

Escalation rates for costs related to capital that are reflected in the revenue requirement, such as rate base, income taxes and depreciation may be higher than escalation rates for capital costs alone, but again, the RIIM escalation rate does not affect the fixed revenue requirement.

BACKGROUND

Southern California Edison (SCE) rates have included reliability incentive mechanisms since 1997.
The first mechanism adopted by the Commission, in D.96-09-092, imposed rewards or penalties based on the frequency and duration of interruptions (SAIDI and SAIFI metrics). The Commission later modified it in D.04-07-022 in SCE's 2003 General Rate Case (GRC).

In SCE's 2006 GRC decision D.06-05-016, the Commission approved a stipulation between the Coalition of California Utility Employees (CUE) and The Utility Reform Network (TURN) to establish a RIIM. RIIM replaced the benchmark-based reliability incentive mechanism with reliability-related capital expenditures and workforce increases. Under RIIM, funds may flow to higher priority requirements as circumstances dictate, and SCE returns unspent funds to ratepayers at the end of the rate case cycle.

In SCE's 2009 GRC SCE and CUE filed a Joint Motion which the Commission then approved in D.09-03-025 with the following features:

- RIIM capital expenditures are to be tracked on a recorded basis from January 1, 2009 to December 31, 2011;
- About one-third of total capital expenditures are classified as high-priority items related to new service connections, storms, and breakdown replacement ;
- The remaining capital expenditures preserve long-term electric service reliability and include spending for distribution infrastructure replacement, preventive maintenance, load growth, and substation infrastructure replacement;
- Operating expenses if filled are granted for a cumulative total of 150 line positions added to SCE's workforce during 2009-2011.

NOTICE

Notice of AL 2408-E was made by publication in the Commission's Daily Calendar. Southern California Edison (SCE) states that a copy of the Advice Letter was mailed and distributed in accordance with Section 3.14 of General Order 96-B.

PROTESTS

SCE's Advice Letter AL 2408-E was timely protested by The Utility Reform Network (TURN) on December 10, 2009.

SCE responded to TURN's protest on December 17, 2009.

DISCUSSION

Energy Division staff reviewed SCE's Advice Letter, TURN's protest and SCE's reply comments.

SCE's Advice Letter (AL) involves capital expenditures and capital additions as shown in Table 1 *RIIM Capital Expense*.
These two accounting categories are related as described in this paragraph and discussion of capital escalation factors in this Resolution applies equally to both. Capital expenditures on multi-year RIIM projects do not add to rate base immediately. Only when complete do they become capital additions to rate base and earn a return. RIIM projects include for example the physical relocation and electrical re-configuration of transmission and sub-transmission line equipment, and additional transformers, and Energy Management System upgrades.

SCE filed this AL because the 2009 decision did not quantify the RIIM increases that SCE should use for 2010 and 2011.

A total revenue requirement for 2009 was adopted in D.09-03-025 along with a RIIM total and components as shown in **Table 1 *RIIM Capital Expense*.** The only indicators however, of Commission intent for 2010 and 2011 were not for RIIM or other expenses but only for revenue requirement. SCE proposes in this AL to use as RIIM escalation factors the same figures of 4.25% for 2010, and 4.35% for 2011 that the Commission adopted for revenue requirement for those years.

TABLE 1
RIIM Capital Expense
(Millions)

Authorized RIIM Capital Expenditures	2009	2010	2011
RIIM Expenditures	$765.6	$798.1	$832.8
RIIM - High Priority Exceptions Expenditures	$313.6	$326.9	$341.1
Total Expenditures	$1079.2	$1125	$1173.9

Authorized RIIM Capital Additions Booked	2009	2010	2011
RIIM Capital Additions	$752.1	$784	$818.1
RIIM - High Priority Exceptions Capital Additions	$284.2	$296.2	$309.1
Total Additions Booked	$1036.3	$1080.2	$1127.2

The following information also was provided in the AL although these details are not at issue:

- Ordering paragraph 25 of D.09-03-025 requires SCE to track the difference between the actual (adjusted-recorded) and authorized RIIM capital additions from 2009 through 2011, and the number of RIIM Employee Targets I and II positions.

- RIIM will track the net increase in SCE's Targets I and II employee levels. SCE is required to fully implement its reliability-related capital spending, and add a net increase of 125 Target I positions and 150 Target II positions based on the employee level at the end of 2008.

    - For a net shortfall of less than 30 RIIM employee target positions, SCE will return $16,500 per position.
    - For a net shortfall of more than 30 RIIM employee target positions, SCE will return $495,000 plus $77,500 for each position greater than 30 to customers.

- SCE also is obligated to refund to customers when the authorized reliability-related capital additions is greater than the actual (record-adjusted) capital additions.

TURN's Protest urges the Commission to adopt lower RIIM escalation rates in order to prevent overspending on RIIM.

TURN's protest stated that: 1) SCE has not described "expenditure priorities, nor explained how the relief sought by SCE is consistent with those purported priorities, 2) SCE and CUE's agreed approach inappropriately conflates two very different concepts of revenue requirement increase and capital expenditure increase, and 3) SCE's request would result in the utility getting larger increases than the utility had originally requested in the 2009 GRC in its "budget-based" capital forecasts for 2010 and 2011. SCE's original forecasts of changes in total reliability-related and high priority capital expenditures were 1.2% increase from 2009 to 2010, and a 3.5% decrease from 2010 to 2011.

TURN concludes that for 2011, SCE's approach in this AL produces a total RIIM request of $832.8 million. This amount exceeds SCE's original GRC request of $813 million despite Commission disallowances in D.09-03-025. The 4.35% increase in 2011 would allow SCE to spend $138 million more in 2011 for load growth projects under RIIM than SCE had proposed in its GRC testimony.

TURN believes that RIIM fails to protect ratepayers from unreasonable levels of capital expenditures in 2010 and 2011 because it would encourage SCE to overspend on reliability capital projects beyond what the Commission deemed appropriate and what the settlement recommended.

TURN suggested that if the Commission does grant escalation in this Resolution that it develop a proxy based on treatment of this issue in D.06-05-016, SCE's Test Year 2006 GRC. The proxy would yield a capital escalation rate of 2.15% to 2.78% for 2010 and 2.2% to 2.84% for 2011.

SCE's Reply indicated that lower escalation rates mean that more of the total authorized revenue requirement is left to SCE's discretion.

SCE replied that SCE and CUE are obligated to propose an agreed upon calculation method under the terms of the Commission-approved RIIM settlement.

SCE continued that TURN's protest of the total capital expenditure amount of $3.75 billion over the three-year 2009-2011 period has not accounted for the substantial reductions made by the Commission.

SCE stated that the calculated 2010 and 2011 RIIM spending must come out of the total authorized post-test year revenue requirements. The higher the escalation rates used to determine RIIM capital, the greater the risk SCE will under-spend in RIIM categories, which would trigger the obligation to return the funds to ratepayers. Conversely, lower escalation rates mean more of the total authorized amount is left subject to SCE's discretion, with no obligation to refund revenues associated with this under-spending.

SCE also pointed out in its reply that the factors from SCE's 2006 GRC should not be applied to 2010-2011 post-test years because these factors are not part of the 2009 GRC evidentiary record, and the post-test year formulae in these two decisions are different.

Energy Division's analysis of this AL, Protest and Reply led to Table 2 ***Comparison of SCE and TURN Proposed Escalation Factors.*** **Table 2** compares SCE-projected RIIM-related capital expenditures for 2009-2011 with comparable figures for TURN, after disallowances and SCE reductions.

Table 2
Comparison of RIIM Expenditures Resulting from SCE and TURN Proposed Escalation Factors

Category		2009	2010			2011			Total		
		Comm. Approved	SCE[3]	TURN[4]	Difference	SCE[3]	TURN[4]	Difference	SCE[3]	TURN[4]	Difference
RIIM	Distribution Infrastructure Replacement	$133	$139	$136	$3	$145	$139	$6	$416	$408	$9
	Preventive Maintenance	$99	$103	$101	$2	$108	$103	$4	$310	$303	$6
	Load Growth	$435	$453	$444	$9	$473	$454	$19	$1,362	$1,333	$28
	Substation Infrastructure Replacement	$99	$103	$101	$2	$108	$103	$4	$310	$303	$6
	Total	$766	$799	$782	$16	$833	$800	$34	$2,398	$2,348	$50
RIIM - High Priority	New Service	$175	$182	$179	$4	$190	$183	$8	$548	$536	$11
	Storms	$53	$55	$54	$1	$58	$55	$2	$166	$162	$3
	Breakdown Replacement	$86	$90	$88	$2	$94	$90	$4	$269	$264	$6
	Total	$314	$327	$321	$7	$342	$328	$14	$983	$963	$20
	Grand Total	$1,080	$1,126	$1,103	$23	$1,175	$1,127	$47	$3,381	$3,311	$70

Note:
1. Cost in Millions
2. Cost Figures have included disallowances and SCE reductions.
3. SCE proposed escalation rates of 4.25% & 4.35% for 2010 and 2011
4. TURN proposed escalation rates of 2.15% to 2.78% for 2010, and 2.2% to 2.84% for 2011 but this table reflects only the lower figures in order to illustrate the largest possible differences.
5. Rounding errors may cause total and grand Total figures to differ from the sum of individual numbers.

SCE's GRC decision sets base revenues for test year 2009 and revenue escalation rates of 4.25% for 2010 and 4.35% for 2011. Those rates and revenue requirements, which are the actual costs to ratepayers, will not be changed by this AL or Resolution.

RIIM is not a 1-year but a 3-year mechanism. Tracking will be applied only to the total expenditures recorded after the end of the 3-year term, 2009-2011.

However if SCE spends a total RIIM amount over the three-year period that is less than authorized by the escalation factors adopted in this Resolution, then SCE will return the difference to ratepayers as a 1-time event.

TURN's protest is informed and detailed but not balanced in content. It appears to benefit from TURN's involvement in prior RIIM cases and makes numerous plausible assertions such as:

> *Use of the 4.25 and 4.35% escalation factors … would produce unreasonable levels of capital expenditures … subject to RIIM.*

and

> *…RIIM…could encourage SCE to overspend on reliability capital projects beyond what the Commission deemed appropriate as evidenced by its disallowances…*

and

> *a 4.35% increase in 2011 would allow SCE to spend $138 million more in 2011 for load growth than SCE had proposed in its testimony*.

What TURN mentions only briefly however is the overriding role of the fixed total revenue requirement. TURN's extensive protest implies without careful reading that this Commission can lower ratepayer costs by adopting lower escalation rates in this Resolution, even though the Commission has already fixed the level of revenues from rates for all 3 years.

For example, with respect to TURN's third-listed claim above, SCE has been granted the $138 million in rates or revenue escalation factors already and may spend it with no further Commission direction whether on load growth, other reliability-related projects, or elsewhere.

The effect of this Resolution is limited to SCE'S RIIM capital expenses, and in that category to only capping the maximum RIIM expenses not all capital expenses. The scope of the AL does not involve SCE's capital in other areas or other expenses. Amounts not spent on RIIM due to lower escalation rates would not reduce costs and rates but simply be spent on other capital projects or in other SCE areas.

In conclusion, current and future rates already include the $70 million difference between SCE's and TURN's proposals shown in **Table 2** above, independent of the outcome of this Resolution.

Approving the escalation rates proposed by SCE requires investments in RIIM related projects instead of leaving the difference to SCE's discretion. For these reasons the Commission adopts this Advice Letter as filed.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Accordingly, this draft resolution was mailed to parties, and timely comments and replies are discussed following.

On May 25, 2010, the Coalition of California Utility Employees (CUE) and SCE submitted comments supporting Draft Resolution E-4313 and asking the Commission to adopt it.

On May 25, 2010, TURN also submitted comments, objecting to the draft resolution:

1. An increase in plant in service will cause rates to be higher, all else equal. An increase in plant increases rate base and return on investment at the authorized rate of return. SCE's proposed approach could cause a $70 million higher rate base in SCE's next GRC, all else equal.
2. The Draft Resolution incorrectly links revenue requirement increases with increases in capital spending. SCE's capital spending through 2009 could raise 2010 costs of service even if 2010 capital spending declines, and additional capital investment in any year is not entirely embedded or funded from increased revenues in that year.
3. The Draft Resolution does not address expenditure priorities or demonstrate consistency with the expenditure priorities in the settlement agreement.

On June 1, 2010, SCE and CUE submitted joint reply comments:
TURN's comments repeat arguments it made in protest to AL 2408-E:

1. D.09-03-025 escalates the 2009 revenue requirement to determine 2010 and 2011 levels; therefore, whatever the level of RIIM-eligible plant the Commission approves does not affect the total revenue requirement, either in this rate case cycle or in the future.
2. The $70 million difference shown on Table 2 of the Draft Resolution between what it proposed and what the Draft Resolution would adopt is not supported in the evidentiary record.

3. SCE and CUE did discuss how to implement D.09-03-025 and mutually agreed to the calculations presented in the advice letter, which provide a priority to RIIM-eligible spending. The fact that TURN does not agree with that result does not amount to legal error.

The Commission assessed these comments and replies as follows:
TURN repeats and the Commission agrees that an increase in plant in service will cause rates to be higher, all else equal. TURN looks only at part of the picture, however. The Draft states that SCE's AL deals only with plant subject to RIIM-eligible investment, which if limited by this Resolution still leaves SCE free to escalate nonRIIM-eligible plant. No Commission action on this AL would prevent that outcome.

Secondly TURN states that the Draft Resolution incorrectly links revenue requirement increases with increases in capital spending, and that the Draft fails to address expenditure priorities. The Draft states, however, only that D.09-03-025 already authorized monies which SCE may spend on reliability-related projects, or otherwise. We agree with TURN that revenue increases do not mean there will be similar capital spending increases since the relationship is far more complicated. But by adopting the higher RIIM escalation factors the Commission confirms that it would rather see SCE invest in reliability than in projects solely of SCE's own choosing.

FINDINGS AND CONCLUSIONS

1. D.09-03-025 directed SCE to file an Advice Letter to submit changes to its tariff schedule related to modification of its Reliability Investment Incentive Mechanism (RIIM).
2. RIIM replaced the benchmark-based reliability incentive mechanism with a one-way balancing account for reliability-related capital expenditures and workforce increases.
3. D.09-03-025 allows SCE to escalate the approved 2009 revenue requirement by a factor of 4.25% for 2010, and by 4.35% for 2011.
4. Ordering paragraph 25 of D.09-03-025 requires SCE to track the difference between the actual (adjusted-recorded) and authorized RIIM capital additions from 2009 through 2011, and the number of RIIM Employee Targets I and II positions.

5. RIIM obligates SCE to refund an overcollection of revenue when the authorized reliability-related capital expenditures and additions are greater than the actual (record-adjusted).
6. The 4.35% increase in 2011 would allow SCE to spend $138 million more in 2011 for load growth than SCE had proposed in its testimony.
7. Revenue requirements which are the actual costs to ratepayers for 2009-2011 will remain unchanged regardless of the disposition of this AL.
8. RIIM is not a 1-year but a 3-year mechanism. Total recorded expenditures will be adjusted at the end of the 3-year term, 2009-2011.
9. The Commission should adopt RIIM escalation rates of 4.25% for 2010 and 4.35% for 2011.

THEREFORE IT IS ORDERED THAT:

1. Southern California Edison Company Advice Letter AL 2408-E proposing changes to its Tariff Schedule Preliminary Statement Part LL Reliability Investment Incentive Mechanism (RIIM) is approved as filed.
2. SCE is to escalate the RIIM capital expenditures and additions approved for 2009 in D.09-03-025 by 4.25% to derive RIIM capital expenditures and additions for 2010, and to escalate the resulting RIIM capital expenditures and additions by 4.35% to derive them for 2011.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on June 24, 2010; the following Commissioners voting favorably thereon:

/s/ Paul Clanon
Paul Clanon
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
DIAN M. GRUENEICH
JOHN A. BOHN

TIMOTHY ALAN SIMON
NANCY E. RYAN
Commissioners