Citizens' Oversight Projects (COPs)

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April 7, 2015

To: Asm. Anthony Rendon, Chair, Assembly Committee on Utilities and Commerce

Members:

Asm. Anthony Rendon (Chair)	Asm. Brian Dahle	Asm. Jay Obernolte
Asm. Jim Patterson (Vice Chair)	Asm. Susan Talamantes Eggman	Asm. Bill Quirk
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Re: April 1, 2015 Letter from CPUC President Michael Picker

Dear Chair Rendon:

Welcome home from your trip to the utility-industry sponsored event in Singapore through the shell utility lobbying organization CFEE. I only hope that you are able to maintain your independence as you conduct your oversight duties regarding the CPUC and disregard the largess of a free “fact finding” trip.

I have to be honest. It is very disturbing to read the response of CPUC President Michael Picker, dated April 1, 2015, to your letter of March 19, 2015. Unfortunately, we can't write this off as an “April Fool's” joke, but a sign of a governmental regulatory agency run amok.

Perhaps most importantly, we must note that Picker avoided the most significant question of all – that is, how the meeting of former CPUC President Michael Peevey with the Chief General Counsel Pickett of SCE at the Bristol Hotel in Warsaw, Poland on March 26, 2013, (at a CFEE-sponsored event) can be squared with the concept that the settlement is fair and in the best interests of rate payers, a settlement which was officially kicked off on March 27, 2014, but which met behind closed doors and without inviting all parties, for months. This question was completely avoided by Picker, as he enumerated – at length – the various steps completed as the settlement was pushed through. The sad reality is that the formal process, including all the steps taken before and after the release of the settlement were only a sham to cover the deal made by Peevey in Poland, a deal that also covered the improper provisional rates approved in the RSG project decision.

“Transparency”

Picker says “This reliance on an evidentiary record developed through a public process that is open for all to view — transparent — is our primary source of information for formal Commission decisions,” and then he defines a new meaning for the term “transparent” which is unique to the CPUC. Unfortunately, the process was not transparent when it includes a private meeting in Warsaw, which was not disclosed for nearly three years. It is not transparent when it includes months of secret negotiations without even informing all the parties that the negotiations were in process. It is not transparent when

most of the meat of the proceeding was never made part of the record, and the phase 3 prudency review scuttled.

Settlements are Appropriate?
Picker says: “The Commission accepts — and as a matter of policy often encourages — settlements as a means of resolving difficult issues and avoiding harm or cost to ratepayers from long protracted litigation.”

The idea of settlements in civil disputes is well understood. But this does not map directly into administrative law and a regulatory agency. First of all, in a typical civil case, the parties can settle even before they ever get in the courtroom if they want to. The result of the settlement is that one party pays the other a sum they both feel is appropriate, so both parties have the same stake in the outcome. The courts can play a very disinterested role in the whole proceeding. As long as the parties are happy, justice has been done.

Now, let's compare that to what might happen at the CPUC. First, of all, you can't settle the case before it even starts because it is necessary to first fully characterize the interest that ratepayers have in the case as they are to be represented by advocates. Second, the parties don't have the same interest in the case. The utilities have billions at stake while intervenors might collectively make $1 million, if they are lucky.

In civil cases, there is the assumption that the free market will set reasonable prices, and if you don't like what you get, then you can go somewhere else. Not so with the utilities, where ratepayers are a captive customer base, and have no choice but to pay the exceptionally high rates we have here in California. In theory, the CPUC plays the role of the free market. Setting up opposing sides with courtroom procedures is supposed to simulate what might otherwise happen in a free competitive marketplace.

Can settlements help to shortcut the process and still provide viable results? It's hard to imagine going to settlement before the case for the ratepayers has been fully described. Plus, the concept of settlements makes little sense in the case of an investigation into a failure, such as what occurred at San Onofre. There are really two aspects to this.

First, it is clear that design mistakes were made by Southern California Edison, as the party responsible for the project. They like to blame these errors on Mitsubishi Heavy Industries (MHI), their subcontractor who designed and built the steam generators. But since they did not seek the required license amendment for the new design, and since SCE admitted that the design was not like-for-like in the “Nunn letter,” they were also acting imprudently. And since they did not seek the license amendment from the NRC as they should have, they were shouldering the entire liability.

This is indeed a black eye for SCE and it is one they did not want to belabor any more than necessary. But they are not the only party that wanted to sweep this under the rug.

But there is a second dimension. When the Replacement Steam Generator (RSG) Project was initially approved in 2005, there was no settlement or shortcut there. The RSG Project was approved, unfortunately using very high prices for natural gas, which has been far from what we see today. The project was tenuous. Even San Diego Gas & Electric disagreed, and they pushed the position that it was best to run the existing steam generators until they reached their plugging limit, predicted in 2016. (In fact SDG&E wanted no part of the project, but then were added in later.) SCE pushed to remove the old steam generators BEFORE they had reached their plugging limit, and they did. The Commission

violated traditional ratemaking doctrine which does not allow any inclusion in rates for capital expenditures until the infrastructure becomes used and useful. Instead, it allowed SCE to charge ratepayers for the project BEFORE it was even done, shown to be used and useful, and before the reasonableness review of the project, which was supposed to occur within six months after they were in use.

So the Commission was caught with its pants down too. Now it was clear that ratepayers were already paying for the faulty steam generators and they had already failed. It could be that Peevey had a habit of pre-negotiating deals with utilities before they were ever processed through their "only for show" courtroom procedures. But in this case, he had an additional incentive: to cover up the fact that the RSG project violated the traditional "it must run before we pay you" policy.

In commercial contract law, there is a concept of an "Implied Warranty: Merchantability," that is, the product that you purchased must meet basic requirements of operation. In the case of steam generators, no one really knows how well they are holding up (unless there is a catastrophic failure, as there was in this case) until they have been run at least through one fuel cycle, and in the next refueling outage (RFO) the tube wear is measured, and then checked against the acceptance threshold. You can't check for wear during operation because the water inside the steam generator tubes is under high pressure, very hot, and radioactive to boot.

Unfortunately, in the RSG project approved in 2005, there was no detailed threshold for approval of the quality of the work performed, just that it was completed under the maximum cost threshold, and they started and ran for six months (only about half to a quarter of the 18-to-24-month fuel cycle period).

It turns out that the original steam generators would have – according to experts hired by SCE – run at least until 2016 before reaching their plugging limit, without spending a penny on the RSG project. It is hardly fair to have ratepayers pay for any of SCE's failed RSG project, since they got no value out of it at all. (And it is also the case the most of the capital expenditures in recent years was to allow the plant to operate with the new steam generators for some time to come, such as new high-pressure turbine rotors, new control room, etc.)

Not only that, but their imprudent decision-making resulted in the demise of the entire plant and the loss of all capital expenditures in recent years. Not that I am against shutting down the nuclear plant, I am happy that is gone, as it has generated 3.6 million pounds of waste we have trouble safeguarding and the plants are notorious financial losers, at least from the ratepayer standpoint. (From the utility stand point, they love them as they require constant capital investment to the tune of about $120 million a year, and the utilities get very high guaranteed returns.)

But unfortunately, none of the facts described above were ever part of the record in the investigation, and so it was really not feasible for the Commission to effectively weigh the merits of the position of the ratepayers, who had no say in any of the faulty decisions.

It is our position that when such a failure occurs, an investigation into the reason why mistakes were made should be completed, even if there is eventually a settlement in terms of the money involved. The utilities know their position, but he position of the ratepayers is not fully known to the commission unless a complete record is created – and it wasn't. Worst of all, there is no lessons learned from this whole experience. No lessons learned means it can happen again.

Settlement Process

Picker says, “The Commission has formally adopted standards on how the Commission reviews settlements that are brought before it in Rule 12 of the Commission's Rules of Practice and Procedure. These rules, which were reviewed and approved by the State's Office of Administrative Law, provide due process, notice and opportunity to the parties and ensure that only settlements that are lawful and in the public interest are adopted.”

We don't agree that the settlement process is well defined at all, and it allows the utilities free-reign to do almost anything they want to do, in secret, and without even informing all the parties that settlement negotiations are in process.

There is frequent talk of the “settling parties.” Those settling parties are the ones selected by the utilities who are the most pliable to their point of view, and leave out the rest. The fact that ORA joined in the secret negotiations, and even made written proposals without informing other parties not included in their secret meetings is inexcusable[1]. As ratepayer advocates, we were excluded from all settlement negotiations. We were never provided an opportunity to put an alternative solution on the table. Even if we moved the needle by only 1%, which I cannot believe is not possible, that would be a $33 million benefit to ratepayers. They argue that the settlement process is good to conserve resources, but if the proceeding were to be litigated to its full extent, it is likely that ratepayers would have benefited by far more than 1%, and that would easily pay for any costs of a proceeding, which ratepayers pay for as well.

We believe that a plain reading of the Commission's rules requires that before settlement negotiations can begin in earnest, a settlement conference is to be held with all parties having an opportunity to participate. However, the way this rule has been perturbed over time, negotiations are conducted in secret, and once a settlement is set in cement, it is then provided *fait accompli* to the other parties, who can only decide to join the settlement or not, with the stigma of possibly not getting intervenor compensation if you decide to go against the utility position.

We learned later that the settlement deal was conceived by Peevey in the Warsaw meeting. Thus even these settlement negotiations were probably just an act to make it appear to TURN and ORA that legitimate negotiations were occurring. Putting these huge decisions on the backs of just one outside ratepayer advocate, and thus on the back of one staff attorney (Matthew Freedman of TURN) is putting far too much pressure on one individual to maintain clarity of mind while in staged settlement negotiations against multibillion dollar corporations.

Incomplete Record

Picker says he asks himself, “Did the Assigned Commissioner or the Administrative Law Judges ask the correct questions in order to get all pertinent testimony from the parties to the proceeding, and thus to build the record?” Unfortunately, he also knows the answer to that question, because SCE President Ron Litzinger testified – under oath – that there was nothing in the record to evaluate the settlement regarding the claim of ratepayers, that claim being that SCE acted imprudently in the RSG project. This information SHOULD have been in the record for the settlement to be evaluated. It is not. But what is in the record is the admission that the record is so incomplete that a fair evaluation of the settlement could not be made.

It is interesting that Picker asks this question rhetorically and does not attempt to answer it, or make a claim that “all pertinent testimony from the parties of the proceeding” was made part of the record,

1 On 2/26/2014, ORA and Matt Freedman of TURN met and discussed an alternative settlement proposal, according to time logs submitted by TURN. On 2/27/2014, this alternative proposal was submitted to the utilities without informing the other parties of the proceeding.

because it was not, and he knows it.

Not good for ratepayers
Picker says, "The Settlement avoided years of additional uncertainty, offered ratepayers relief from ongoing costs much more immediately than an extended and uncertain litigation, was based on evidence offered in the record that I reviewed, and, when taken as a whole, was a good outcome."

First, "avoided years of additional uncertainty" is not something that is factual. There is no way to predict how easily a full proceeding would have been completed, and arguably, it could have been completed just as quickly as the extended settlement processing time, and all the additional litigation that is still pending. Is it better to reach a conclusion that is incorrect but reached quickly, or is it better to spend a little more time (if that were the case) and get it right? We hope you agree that justice is not served if a bad decision is made quickly, just because you want it over with.

Second, "offered ratepayers relief from ongoing costs more immediately" is really a ridiculous notion. The only reason ratepayers were paying for the RSGs before the reasonableness review is because the Commission violated the traditional "used and useful before putting in rates" policy, and instead got ratepayers on the hook before the steam generators proved themselves.

But even if we assume that putting the RSGs in rate on a provisional basis was a mistake already made, the Commission was asked by ORA and other parties to immediately cease the provisional rate treatment, and were ignored. So this logic is a complete sham. There is no reason a settlement would have been any better than litigation in terms of the ratepayers paying for "ongoing costs."

The "based on evidence offered in the record" has already been dealt with in the prior section, and it is clear that the record was incomplete – and intentionally so.

Settlement Big Picture
The big picture of this settlement is that ratepayers are being asked to cover the vast majority of any losses, while SCE comes out unscathed. And ratepayers also pay for replacement power. And the net asset value of the plant was boosted in 2002 an additional $500 million with no associated capital expenditures. SCE is attempting to get their subcontractor MHI and their insurance company NEIL to cover those same losses in litigation. Of course, the attorney's fees are taken off the top, and then the net is split 50/50 between shareholders and ratepayers. Questions were asked at the recent CPUC hearing, why is it that the shareholders receive anything at all, if ratepayers are covering the losses up front? It is a good question.

Citizens' Oversight would rather have seen the deal turned around the other way, with ratepayers not covering the losses up front, and allowing SCE to pursue their own subcontractor and insurance company and keeping whatever they get, minus the attorney's fees, which are under their control. Ratepayers have no way to manage this process, limit attorney's fees, no say in what sort of insurance was purchased or what sort of deal was struck with MHI to begin with. Ratepayers are kept out of any say in the matter when SCE runs their business until SCE makes a big mistake, and then ratepayers are expected to save the day.

We were the only party that dug into the history of what the CPUC has done in situations when plants close or engineering projects fail. There are really two cases: 1) early retirement due to regulatory or legal changes which are not under the control of the utility, and 2) failure due to imprudent management or technical mistakes. In the former case, the utility typically is allowed to recover their net asset value

with 0% return on investment. In the latter case, historically, the Commission does not do anything to help the utility out of their own mess. (Details of our analysis is in our comments to the settlement deal).

This case, we believe, falls in the latter category, and so we believe the ratepayer should not be bailing the company out, paying for replacement power, and then letting them additionally pursue essentially double payment from their insurance and subcontractor (who they are suing for some $4 billion). Even if they were prudent and the plant was retired for not fault of their own, they would get the net asset value plus 0% return. In this case, it is clear that they were not faultless, and thus should not get the net asset value, nor a return. Getting the net asset value and a 3% return is a hard slap in ratepayer's faces. (Plus, we assert that the net asset value was inflated by $500 million in 2002 when the license was extended to 2022).

We attempted to present an alternative settlement in our comments to the settlement, but really there was no opportunity to have it considered seriously, as we were not invited to the settlement discussions until the settlement was already done. We proposed a transfer of the nuclear waste operation from shareholders to the decommissioning fund (and thus payment to shareholders by the fund,) aggressive salvaging of the assets of the plant (hard assets, nuclear fuel, etc.), and estimated they might get 25% of what they are claiming in their MHI lawsuit. In that case, they are only $35 million short of where they are with the ratepayer bailout. The big difference is where the incentives lie, and how long it takes to complete.

In their settlement, the company has almost no incentive (5% of the proceeds) to salvage the plant. In our proposal, they get 100%, but are not covered up front. In their proposal, ratepayers cover their third-party losses, and then they share the net (after attorney fees) 50/50. In our proposal, ratepayers do not cover their losses up front, and they get 100% of whatever they can get from their insurance company and subcontractor, MHI. In their settlement proposal, ratepayers are on the hook for ten years. In ours, the case is settled when the case is decided.

With cases decided like this and the need to monitor it for another ten years, we are no longer surprised that the Commission has more work than it can handle.

The regulatory agency is supposed to simulate the free market. The reality is that the free market is much harsher than such a regulatory agency tends to be, particularly when the regulatory agency is headed by a former president of the company being regulated.

We will make a few specific comments about the claims Picker makes about the settlement:

Replacement Power

Picker says in describing the settlement deal that “SDG&E and SCE's ratepayers will pay an estimated $517.2 million for 2012 replacement power costs.” We agree that if nothing else is paid, that ratepayers properly should pay for replacement power. Interestingly, the entirety of Phase 1A of the proceeding, which was to determine how replacement power costs would be calculated, was ignored in the settlement.

However, if ratepayers are covering so many of the other costs (O&M, M&S, etc.) during the outage, it is not fair for ratepayers to also have to pay the full cost of replacement power. In our proposal, we draw the line clearly. Ratepayers pay for replacement power, and for nothing else.

Steam Generator Costs

Picker says that “b. The utilities who owned the San Onofre Nuclear Generating Station will pay $760 million, the costs of the replacement steam generator equipment, except during the period that the plant was operating, from 2011 to January 2012.”

This is a deceptive statement. Of course, they are not “paying” that amount, the are just not getting it. Any margin they had in the work they performed is simply unrealized gains, not payment. The “except during the period that the plant was operating” makes you think that they fairly split up the time the steam generators worked and the part they did not. But payment was front-loaded, so 20% of the costs were paid by ratepayers for less than 4% of the advertised life of the steam generators.

O & M:
Picker says: “SCE and SDG&E ratepayers will pay $970.6 million for the costs of maintenance of the plant not related to the steam generators, including: safeguarding the nuclear fuel that continues to be stored at the San Onofre Nuclear Generating Station; and, the 2012-13 engineering and safety assessments of the potential to restart San Onofre and continue operations while the Nuclear Regulatory Commission was assessing whether the plant could be safely restarted.”

The reality is that in Phase 1 of the proceeding, the proposed decision clearly stated that SCE imprudently pursued the restart of the plant when it was clear that it was dead in the water. The reason they wanted to restart it so desperately is due to PUC code section 455.5 which states that capital costs become used and useful immediately when they are put into service but they take nine months to go out. If they were able to start unit 2 at any level, then the fuel they just reloaded into the core, the new high-pressure turbines, and other improvements would move from CWIP (construction work in progress) to net asset value of the plant, and then get treated with the astronomical returns investors are guaranteed.

The work during 2013 and 2014 was fully paid by ratepayers, and was not even considered in any proceeding to create a record. In fact, in Phase 1, they struggled to limit discussion to only 2012. Then the settlement included everything.

One more point here: The cost of decommissioning the plant is from the decommissioning funds ($4.4 billion) which is not from rates. The operation of the ISFSI and fuel pools is something the utility routinely gets reimbursed from the DOE as the DOE was obligated to pick up spent fuel starting in 1997, and have not. Utility testimony was that they typically get 97% of what they ask for. So yet again, ratepayers are covering their butts when they know that their butts are already covered another way, so they get double what they deserve.

Investigation into the Tainted Settlement
We were astounded to see the Commission stonewall on disclosures to the Assembly Committee: “California Public Utilities Code Section 583(5) sets restrictions on public release of documents provided by the utilities to the Commission which affect our ability to collect and share documents with the Assembly.”

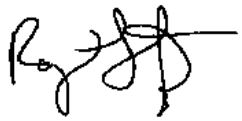
If there really are laws that are restricting your access to this information, then perhaps these should be added to AB-825. From our reading of the PUC 583(5) between your Committee and the Commission, there should be no restriction at all.

We hope these comments will be helpful. Despite all the assurances that everything was done correctly with regard to the San Onofre settlement, we see now that Peevey had pre-negotiated the deal and then the rest was all just window-dressing. No one asked us to participate in any settlement negotiations.

There was no opportunity for us to present our settlement proposal. But more than that, an investigation like this should not be cut short on the whim of the utility and one outside advocate.

Citizens' Oversight is happy that you are continuing to pursue this and we hope you will stand strong and not allow utility money, largess, nor international vacations to sway your resolve. We have been involved for the past two years and have been treated to perhaps the full gamut of missteps by the Commission. With no oversight by your committee and most of the intervenors happy to play patty cake and not stir up any animosity means that the Commission has been running rudderless for years.

Regards,



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