

Docket No.: R.07-05-025

Exhibit No.: _____

Date: February 25, 2011

Witness: Mark E. Fulmer

**REPLY TESTIMONY OF MARK E. FULMER ON BEHALF OF
THE DIRECT ACCESS PARTIES
CONCERNING
THE TRANSITIONAL BUNDLED SERVICE RATE,
DIRECT ACCESS SWITCHING RULES, MINIMUM STAY PROVISIONS, AND
ENERGY SERVICE PROVIDER FINANCIAL SECURITY REQUIREMENTS**

1 **I. INTRODUCTION AND SUMMARY**
2

3 **Q: Please state your name and business address.**

4 A: My name is Mark E. Fulmer. I am employed by MRW & Associates, LLC. My business
5 address is 1814 Franklin Street, Suite 720, Oakland, California.

6 **Q: Are you the same Mark E. Fulmer who filed opening testimony on January 28, 2011**
7 **in this docket on behalf of the Direct Access (DA) Parties?**

8 A: Yes, I am.

9 **Q: What is the purpose of your reply testimony?**

10 A: This testimony addresses portions of the opening testimonies sponsored by witnesses on
11 behalf of Pacific Gas and Electric (PG&E), Southern California Edison (SCE), San Diego
12 Gas and Electric (SDG&E) (collectively, the "IOUs"), the California Large Energy
13 Consumers Association and California Manufacturers and Technology Association
14 (CLECA-CMTA), and the Division of Ratepayer Advocates (DRA). Silence on any
15 particular position taken by any of the three IOUs or any other party in this proceeding
16 should not be interpreted as the DA Parties support for, or acceptance of, that position.

17 **Q: Please summarize your rebuttal testimony.**

18 A: First, in general, parties were in consensus that the Transitional Bundled Service rate
19 should be calculated consistent with the Market Price Benchmark. The DA Parties
20 recommend that the implementation details can, and should, be worked out in a future
21 workshop.

22 Second, parties were in consensus that six months is an appropriate length of time
23 for a customer to notify the host IOU of its intention to return to bundled service. The

1 DA Parties continue to disagree with the IOUs that a six-month notice is necessary for
2 bundled customers begin DA service.

3 Third, the IOU testimonies provide no evidence that there is any benefit to setting
4 the minimum stay on bundled service at 18 months rather than the 12 months proposed
5 by the DA Parties.

6 Fourth, there are a number of flaws in the formula proffered in the CCA Bonding
7 Settlement that make it inappropriate for use in setting the Financial Security
8 Requirement (FSR) for Energy Service Providers. As such, it should not be adopted.

9 Fifth, any FSR model that is ultimately adopted must be premised on data and
10 inputs that are fully available to those who will be required to provide financial security
11 as determined by that model, including access to all formulae and inputs.

12 **II. THERE IS GENERAL CONSENSUS ON THE TRANSITION BUNDLED RATE**

13
14 **Q: In opening testimony, the DA Parties recommended that the Transition Bundled**
15 **Service (TBS) rate be calculated in a manner consistent with the market price**
16 **benchmark (MPB). Did other parties agree?**

17 A: Yes. The three utilities, as well as Dr. Barkovich for CLECA-CMTA, and Mr. Owyang
18 for the Division of Ratepayer Advocates all agreed in principal with the DA Parties that
19 the TBS rate should be calculated consistent with the MPB.¹ This consensus is one of the
20 productive results that came out of the Workshops held in December 2010 and January

¹ PG&E at 2-3; SCE at 32; SDG&E (Choi) at TC-3; Barkovich at 16-18; Ouyang at 12.
Intervener Jan Reid is silent on this issue.

1 2011. The DA Parties recommend that the details of matching the TBS rate to the MPB
2 be worked out in workshops once the Commission rules on the MPB.

3 **III. SWITCHING RULES AND MINIMUM STAY PROVISIONS**

4
5 **Q: In opening testimony, the DA Parties recommended that a customer returning to**
6 **bundled service provide six months notice to the host utility of its action. Was there**
7 **consensus on this issue?**

8 A: In general, yes. However, not all parties agreed with the DA Parties that voluntarily and
9 involuntarily returned customers should be treated differently. PG&E and SCE asserted
10 that an involuntarily returned customer should be placed directly on bundled service
11 rather than a TBS rate like all other returning DA customers. Both the DA Parties and
12 the utilities agree that whether or not an involuntarily returned DA customer may be
13 placed on TBS or bundled service is a question of interpreting PUC Code Section
14 394.25(e). As this issue is being concurrently briefed, the DA Parties did not provide
15 factual testimony on the matter.

16 **Q: The three IOUs all recommend keeping the current requirement that bundled**
17 **customers provide six month notice prior to taking DA service. In opening**
18 **testimony the DA Parties argued that this notification period was not necessary and**
19 **that assuming there was room underneath the cap, a bundled customer should be**
20 **able to take DA service on the next billing cycle. Did the IOUs offer any viable**
21 **rationale for keeping the six-month notice?**

1 A: Each IOU offered a different reason for the six-month notice provision for customers
2 going from bundled to DA service, none of which were convincing. PG&E seemed to
3 suggest that it was needed by ESPs: “Because ESPs have similar obligations as IOUs
4 (e.g., administrative implementation, RA compliance filings), the notice period for
5 customers returning from DA to bundled service should also be six (6) months.”² The
6 DA Parties, including the ESPs, do not see the 6-month notification to take DA service as
7 necessary. SCE argues that it is needed to account for selling excess RA and energy,
8 which it may be forced to do at a loss.³ This argument does not acknowledge the current
9 capped DA market, nor the magnitude of the departure of a single or a few DA customers
10 at a time relative to their overall bundled load and the myriad of other uncertainties SCE
11 must plan for. SDG&E, on the other hand, argues that the six month notification is
12 required precisely because of the re-opened market.⁴ However, the examples Mr.
13 Spurgeon provides relate more to growing pains of the transitional period than any
14 ongoing issues that would warrant the 6-month notification.

15 **Q: SCE argues (in a footnote) that “The Commission should impose on ESPs the same**
16 **requirement that CCAs have to provide a minimum one-year advance notice to the**
17 **IOU of a voluntary service termination, which results in a mass involuntary return**
18 **of CCA customers to IOU procurement service.”⁵ Is this recommendation**
19 **reasonable?**

20 A: No. SCE has offered no rationale for this proposal. Furthermore, this recommendation is
21 flawed with respect to ESPs, primarily because an ESP’s contracts with its customer have

² PG&E at 3-5

³ SCE at 8.

⁴ SDG&E at JS-4.

⁵ SCE at 64, footnote 52.

1 varying terms and conditions, including different expiration dates. Therefore, if an ESP
2 were to decide to stop serving retail load in California, it would most likely simply cease
3 any effort to renegotiate its existing contracts or execute contracts with new customers.
4 A good example of this is the exit of APS Energy Services (APSES) from the California
5 market in 2008. A year before exiting the market, APSES voluntarily notified the
6 Commission and its customers (and presumably the IOUs) of its intent so as to ease the
7 transition. It fully served all its customers through the expiration of each contract (or
8 arranged for another ESP to serve the customer for the remainder of the contract) to the
9 point when in July 2008 it withdrew its ESP registration. This process allowed its
10 customers ample time to negotiate with other ESPs or provide notice to their host IOUs
11 of their intent to return to bundled service. While APSES provided a year's notice of its
12 intent to exit the market, there was no mass involuntary return of customers to IOU
13 service that resulted.

14 Furthermore, as described in the DA Parties' opening testimony, when an ESP
15 exits the market without breaking any of its contracts, or simply cannot come to
16 agreement with a customer concerning a contract renewal or extension, that customer
17 cannot for these purposes be considered "involuntarily returned." If the definition of
18 "involuntarily returned" was broadened to encompass such situations, a customer could
19 simply not negotiate in good faith and thus receive any potential benefits of being
20 "involuntarily" returned, such as (as proposed by utilities) returning to bundled service
21 rather than TBS. This is clearly not reasonable.

22 **Q: The three IOUs all recommend that if a customer returns to bundled service after**
23 **having been on direct access service that the customer must remain on bundled**

1 **service for at least 18 months. The primary rationales for this position are to**
2 **prevent price arbitrage between DA and bundled service (in particular with respect**
3 **to seasonal rates) and to allow the IOUs to better manage procurement obligations.**

4 **How do the DA Parties respond?**

5 A: Neither of these reasons justifies an 18 month minimum stay. Seasonal price arbitrage
6 can just as well be prevented with 6 months notice for a DA customer to return to IOU
7 service along with a 12 month minimum stay (as proposed by the DA Parties). Second,
8 in their testimonies supporting the six-month notification provision, all three IOUs say
9 that six months is enough to modify their portfolio to deal with DA customer returns.⁶

10 **IV. FINANCIAL SECURITY REQUIREMENTS (GENERAL)**

11
12 **Q: The DA Parties argued in briefs that involuntarily returned customers should be**
13 **placed on the TBS rate and in opening testimony that the FSR should be calculated**
14 **based on six months of reentry fees. What then is the purpose of this portion of the**
15 **rebuttal testimony?**

16 A: The issue of whether involuntarily returned customers must be returned to fully bundled
17 service or whether they can be put on TBS service for six months is being addressed via
18 briefs submitted by the parties on January 24, 2011 and February 3, 2011. Regardless of
19 how the Commission rules on that issue, there are specific problems with the CCA bond
20 model proposed by PG&E and SCE that should lead the Commission to reject it as the
21 tool by which the FSR is calculated.

⁶ SCE at 8; PG&E at 3-4 – 3-5; SDG&E at JS-4.

1 **Q: In your response above, only PG&E and SCE are identified as sponsoring the CCA**
2 **Bond model for calculating the ESP FSR. What was SDG&E’s position?**

3 A: SDG&E stated that the DA customers in workshops expressed a willingness to be
4 potentially subjected to the TBS rate in the event of an involuntary return, and that their
5 paying the TBS rate would protect bundled customers from the risk that an involuntary
6 return of DA customers would impose costs on them.⁷ As such, SDG&E’s main
7 recommendation, should the DA Parties position on the issue prevail, was for the DA
8 customer to sign and return to SDG&E and acknowledgment form.⁸ The DA Parties
9 have no objection in principal to such a form, but would request that the language of the
10 form be reviewed and approved by the Energy Division.

11 **a. THE FSR SHOULD ONLY BE CALCULATED OVER 6 MONTHS**

12
13 **Q: The CCA Bond model proposed by PG&E/SCE assumes that if there is a**
14 **“catastrophic event” where one or more major ESPs fail, the involuntarily returned**
15 **DA load would be on IOU service for at least a year. Is this a reasonable**
16 **assumption?**

17 A: No. In fact, the DA Parties believe that it is more likely that involuntarily returned
18 customers would elect new DA service rather than remain on IOU service, unlike
19 involuntarily returned CCA customers, who must remain on IOU service. The CCA
20 Bond Model does not account for this. Additionally, these returned DA customers opted
21 into direct access in the first place for the benefits DA service provided. This same desire

⁷ SDG&E, Spurgeon at JS-7 – JS-8.

⁸ SDG&E, Spurgeon at JS-8.

1 and benefits do not vanish in this scenario and so the assumption that a customer would
2 quickly try to secure another direct access arrangement to meet their own energy needs is
3 far more plausible and reasonable.

4 **Q: Why should this be accounted for?**

5 A: First, the DA Parties propose switching rules that allow such customers a greater
6 flexibility so as to allow in involuntarily returned DA customer to choose another ESP
7 and thus remain on Direct Access. Even the IOU proposals on switching rules and
8 minimum stay provisions allow involuntarily returned customers a Safe Harbor to return
9 to DA service.

10 Second, in the only case in California that could be considered catastrophic, the
11 2000/2001 power crisis, DA customers who were returned to IOU service did not remain
12 on IOU service for a full year, as is implied in the proposed CCA Bond model. Instead,
13 they overwhelmingly returned to DA service. This is clearly shown in the figure below,
14 which graphs the penetration of DA load as a fraction of total IOU load during the crisis.
15 The figure shows DA load bottoming out at about 2% of total load in the spring of 2001,
16 but returning to, and even exceeding, the pre-crisis levels within six months. This further
17 demonstrates the points made earlier that customers see benefits by being served on
18 direct access and they will continue to seek the right DA program if , for some reason,
19 their ESP can no longer serve them.

20

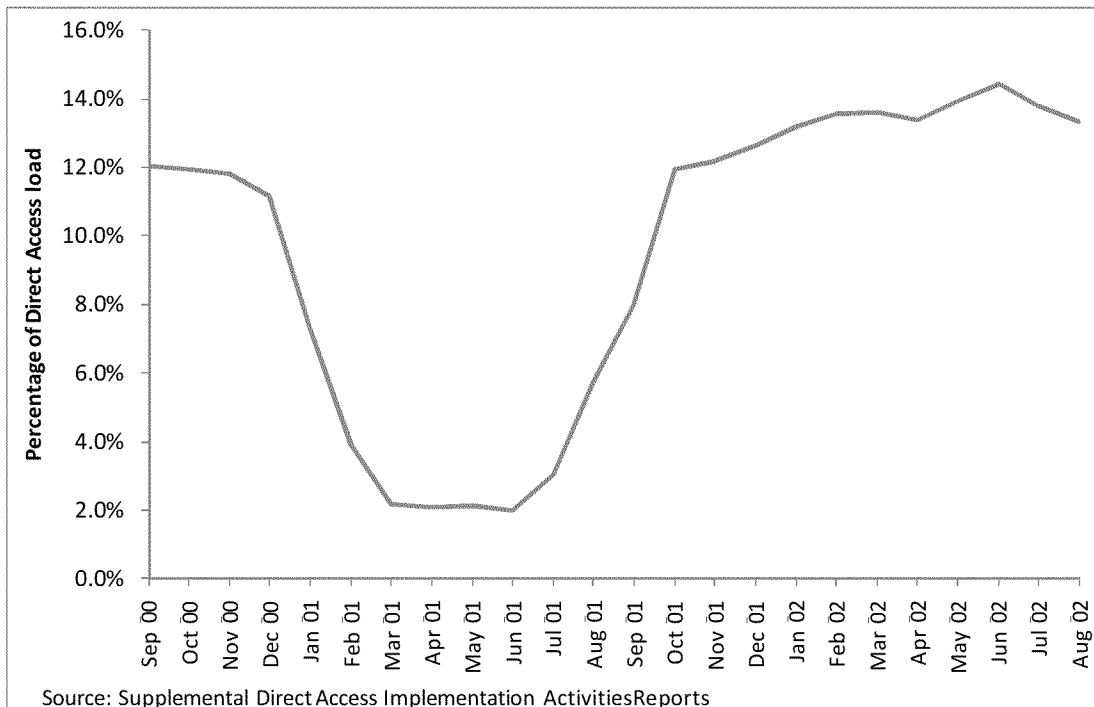


Figure 1. DA Penetration, September 2000 through August 2002

This simply and clearly illustrates that the assumption implicit in the proposed CCA Bond model that involuntarily returned DA customers will stay on IOU service for a year is inaccurate. Even in the worst-case scenario experienced almost exactly 10 years ago, the DA load that was involuntarily returned to IOU service quickly went back to direct access.

Q: Since a full year is clearly the wrong time frame to use in calculating the ESP FSR, what do the DA Parties recommend?

A: As noted in the DA Parties' opening testimony, six months is the appropriate time frame over which to calculate the ESP FSR.

1 **b. SCE OVERSTATES THE RISK OF ESP’S FAILURE**

2
3 **Q: SCE notes in its testimony that “[t]he risk that an ESP will involuntarily return its**
4 **customers to IOU procurement without notice during stressed market conditions**
5 **must be considered.”⁹ Do you agree?**

6 A: While the risk should that an ESP will involuntarily return its customers should be
7 considered, SCE consistently, explicitly and implicitly, overstates that risk.

8 **Q: On page 35 of its opening testimony SCE states “ESPs, like CCAs are not required**
9 **to engage in hedging/contracting like the IOUs.” Is this an example of exaggerating**
10 **risk?**

11 A: Yes. The statement implies that ESPs and CCAs will not hedge their risk without a
12 regulator looking over their shoulder. This ignores the obvious fact that most business
13 enterprises that hedge are not ordered to do so by the government. No non-regulated
14 entity is *required* to hedge, but they do so as part of their own portfolio risk management,
15 as it simply is sound business practice. In fact, they have much more incentive to engage
16 in hedging strategies than regulated entities, who may simply just ask the regulators to
17 allow them to collect the additional revenue when market events cause their costs to
18 increase. ESPs are keenly aware of the value of properly hedging their portfolio; this
19 should not be discounted and cannot just be assumed away because they are not subject
20 to regulatory oversight.

⁹ SCE at 35.

1 Furthermore, the paragraph that follows this hedging statement in SCE’s
2 testimony is full of “mays” and “coulds,” as it paints the downfall of ESPs. The factors
3 that SCE raises—shorter-term purchasing horizons, possible stressed markets, cash flow
4 lags and liquidity requirements—seem to inevitably lead, like a Greek tragedy, to the
5 downfall of the ESP as its “credit lines run out and cash dries up.” While colorful, all of
6 the risks and points raised are obvious, and thus would be addressed by a reasonable ESP,
7 who, as just noted, has a down-side risk from which the IOUs are protected.

8 **Q: SCE also notes that an ESP could intentionally drop all its customers: “However,**
9 **having long-term contracts ‘in the money’ during a stressed market may also create**
10 **a financial incentive for an ESP to terminate service, return its customers to IOU**
11 **procurement service, and sell the long-term contract for a higher price, as at least**
12 **one ESP was accused of doing during the California energy crisis. Nothing**
13 **prohibits an ESP from terminating its service in order to cash in on a valuable long-**
14 **term contract in a stressed market.”¹⁰ Is this a reasonable concern?**

15 A: No. Abrogating all contracts for a one-time gain is business suicide. Not only would an
16 ESP who did this face years of litigation from angry former customers, it is highly
17 unlikely that they would ever be able to serve another DA customer again, even if the
18 Commission allowed it to renew its ESP registration.

19 **Q: But SCE points out that “California saw ESPs dump their customers onto the IOUs**
20 **during the energy crisis in 2000-01.”¹¹ Why did that happen?**

¹⁰ SCE at 36.

¹¹ SCE at 35.

1 A: The key reason was that SCE and PG&E stopped paying the Power Exchange Credit
2 (“PX Credit”). Under decision D.99-06-058, the utilities were required, depending upon
3 the billing arrangement, to provide the DA customer or ESP with the PX Credit—
4 effectively the avoided cost of not serving that customer—even if that cost exceeded the
5 rate. What happened starting November 2000 is succinctly put by Peter W. Hanschen
6 and Gordon P. Erspamer in their *Electricity Journal* article:¹²

7

8 Unlike the utilities that had not mitigated or hedged the risk of their
9 wholesale electric purchases, many of the ESPs used the PX Credit as a
10 hedge against escalating energy prices. While the ESPs had to purchase
11 electricity in energy crisis markets, the PX Credit acted as a hedge because
12 it tended to increase as there were increases in wholesale markets. When
13 the IOUs stopped making these payments, the ESPs’ hedge was suddenly
14 eliminated. Consequently, the ESPs had no other choice but to return their
15 direct access customers to utility bundled service.

16

17 Thus, the returning of DA customers to IOU service was not a function of ESP failure to
18 hedge, but rather they were victims of the same power crisis that drove PG&E into
19 bankruptcy.

20 **V. EVEN IF THE FSR INCLUDES PROCUREMENT EXPOSURE, THE SCE/PG&E**
21 **PROPOSAL IS FLAWED**

22

23 **a. THE CCA BOND MODEL RESULTS IN GROSSLY EXCESSIVE FSR**
24 **AMOUNTS**

25

¹² Hanschen, Peter W. and Gordon P. Erspamer “A Public Utility’s Obligation to Serve: Saber or Double-Edged Sword?” *Electricity Journal*, December 2004. pp 44-45.

1 **Q: The CCA Bonding Settlement, which was attached to PG&E's and SCE's testimony,**
2 **showed a sample calculation of the proposed FSR model. Were those actual, real**
3 **values that would have represented the CCA Bond amount (or ESP FSR amount)**
4 **had it been calculated at a specific point in time?**

5 A: No. In discovery, PG&E (the author of the model) stated that the volatility values in the
6 sample calculation were illustrative.¹³

7 **Q: Have either of the two utilities provided any estimates of the model output with real**
8 **data?**

9 A: In response to a data request by the City and County of San Francisco, SCE provided a
10 spreadsheet that contained values of the average generation rate, stressed generation rate,
11 derived average volatility, and resulting stressed procurement price and resulting Bond
12 amount on a \$/MWH basis (setting aside for now administrative costs) every six months
13 from January 2005 through July 2010.¹⁴ While the data contained derived average
14 volatility rather than implied volatility at the time, it is the closest to real values that have
15 been provided to date.

16 **Q: What do these values show?**

17 A: These values show that had the model been used in that time period, the CCA Bond / ESP
18 FSR would have varied from zero to over \$55/MWh. Assuming a large ESP with 2
19 million MWh of sales in SCE's service area, the FSR that the ESP would have to provide

¹³ PG&E response to Joint Parties discovery question 13(b).

¹⁴ Joint Responses of Pacific Gas and Electric Company (PG&E) Southern California Edison Company (SCE) and San Diego Gas & Electric Company (SDG&E) to Information Requests from City and County of San Francisco and Marin Energy Authority Regarding Bond Settlement, October 2011, question 3.

1 would have varied from zero to \$112 million. Assuming that the ESP would have had
2 proportionally similar loads in the other two IOU service areas, the total state-wide FSR
3 would have gone as high as \$250 million.

4 **Q: Have the DA Parties estimated what SCE's actual exposure would be had that ESP**
5 **failed during each of those periods?**

6 A: Yes. SCE's actual exposure was calculated by comparing the revenue it would have
7 received had the returned DA customers been placed on bundled service to the cost it
8 would have incurred to serve those customers from the spot market. Thus, for each 12-
9 month period beginning either January 1 or July 1, the DA Parties estimated the TBS rate
10 (the cost to serve the customers) assuming that the DA Parties recommendation
11 implemented, except for the green benchmark, as there were no RPS requirements at the
12 time. The commodity component of the TBS was estimated by taking a weighted
13 average of the peak and off-peak daily SP-15 values from Platt's *Megawatt Daily*. The
14 difference between this estimated TBS rate and the actual average generation rate (as
15 provided by SCE in response to CCSF's discovery) would represent the per-unit actual
16 exposure. This per-MWh exposure was multiplied by the annual estimated sales of the
17 large ESP, 2 million MWh per year, to arrive at the total exposure.

18 Table 1 and Figure 2 below compare the ESP FSR amount to the calculated actual
19 exposure. As is clearly shown, the actual exposure—the TBS rate minus the bundled
20 rate—has rarely, on an annualized basis, been positive. This is in contrast to the FSR
21 amounts, which would have averaged about \$25 per MWh served by the ESP.

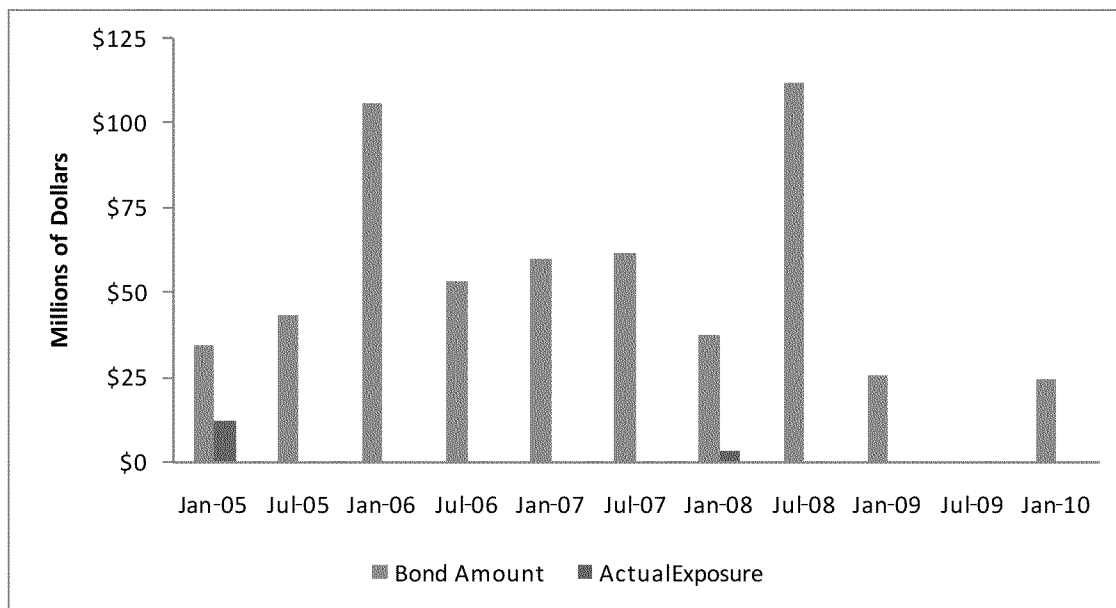
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Table 1. Calculation of Bond Amount and SCE Exposure Assuming the CCA Bond Model and an ESP serving 2 million MWh per Year

FSR Calculation Date	Jan-05	Jul-05	Jan-06	Jul-06	Jan-07	Jul-07	Jan-08	Jul-08	Jan-09	Jul-09	Jan-10
Stressed Price, \$/MWh	\$100.12	\$118.10	\$162.90	\$130.12	\$126.86	\$125.80	\$111.64	\$150.33	\$108.81	\$80.63	\$97.09
Stressed Rate, \$/MWh	\$83.00	\$96.50	\$110.00	\$103.50	\$97.00	\$95.00	\$93.00	\$94.50	\$96.00	\$90.50	\$85.00
Difference, \$/MWh	\$17.12	\$21.60	\$52.90	\$26.62	\$29.86	\$30.80	\$18.64	\$55.83	\$12.81	-\$9.87	\$12.09
FSR/Bond Amount (millions)	\$34.2	\$43.2	\$105.8	\$53.2	\$59.7	\$61.6	\$37.3	\$111.7	\$25.6	\$0.0	\$24.2
TBS Rate per DA Parties, \$/MWh	\$78.96	\$78.92	\$66.84	\$71.20	\$71.79	\$83.00	\$84.47	\$59.35	\$45.67	\$49.13	\$56.39
Average Generation Rate, \$/MWh	\$73.00	\$86.50	\$100.00	\$93.50	\$87.00	\$85.00	\$83.00	\$84.50	\$86.00	\$80.50	\$75.00
Difference, \$/MWh	\$5.96	-\$7.58	-\$33.16	-\$22.30	-\$15.21	-\$2.00	\$1.47	-\$25.15	-\$40.33	-\$31.37	-\$18.61
Actual Exposure (millions)	\$11.9	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$2.9	\$0.0	\$0.0	\$0.0	\$0.0
Difference, FSR - Actual Exposure	\$22.3	\$43.2	\$105.8	\$53.2	\$59.7	\$61.6	\$34.3	\$111.7	\$25.6	\$0.00	\$24.2

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Figure 2. Bond Amount and SCE Exposure Assuming the CCA Bond Model and an ESP serving 2 million MWh per Year

1 **b. IMPLEMENTING THE PROPOSED CCA BOND MODEL COULD RESULT**
2 **IN PERVERSE, UNINTENDED HARMFUL CONSEQUENCES**
3

4 **Q: The historical FRS estimates above showed that an ESP with 2 million MWhs of**
5 **load could have faced a bond amount of over \$100 million. Could it be even higher**
6 **than this?**

7 A: Yes. Both prices and volatilities could conceivably exceed that which SCE estimated for
8 July 2008. In those cases, an ESP could quickly be faced with a sudden liability on the
9 same order of magnitude as its annual gross revenue. This would stress even a healthy
10 company. If it were not in a position to come up with credit, cash or bond equal to its
11 annual revenue then the Commission could conceivably revoke the ESP’s registration,
12 causing the very situation that the FRS is supposed to protect against: a large number of
13 returned ESP customers returned to regulated IOU service.

14 **c. THE IMPLIED VOLATILITY DATA ARE NOT RELIABLE OR**
15 **CONSISTENTLY AVAILABLE**
16

17 **Q: An important input to the proposed FSR amount calculation is the implied**
18 **volatility. PG&E’s testimony claims that “there should be no doubt as to its**
19 **availability to anyone in the public.”¹⁵ Is this true?**

20 A: No. Amerex Brokers, LLC, the source of implied volatility listed by PG&E in its
21 testimony, expressly would not allow the DA Parties’ technical consultant, Mark Fulmer,
22 to receive even a sample copy of a broker’s sheet with implied volatilities. This is

¹⁵ PG&E at 4-15

1 because of Amerex’s policy not to sell or in any way provide data to consultants.

2 Clearly, these data are NOT available to anyone in the public.

3 **Q: What about other sources for implied volatility?**

4 A: The City and County of San Francisco attempted to verify the public availability of
5 implied volatility data from sources beyond Amerex. CCSF contacted five major brokers
6 and energy data provider and was told that there is no publicly available data or even
7 subscription serve data for implied volatility at NP15.¹⁶ CCSF further reported that
8 “PG&E used SP15 data to estimate the necessary implied volatility values for NP15.”¹⁷

9 Furthermore,

10 CCSF has been informed by Amerex that it is only able to provide “indicative
11 data,” meaning that the data are based in whole or in part on estimates or
12 approximations of what prices would have been in a given period. Typically,
13 indicative data are provided when either no transactional data are available, or the
14 data aggregator believes that insufficient transactional data are available to
15 provide a reliable price indicator for the given period.¹⁸

16
17 While Amerex would not provide the DA Parties’ consultant sample data, Mr. Fulmer did
18 speak with the Amerex contact identified by PG&E in its testimony. Ms. Mundy
19 (formerly Ms. Gist) confirmed CCSF’s statements: Amerex does not provide quotes for
20 volatility at NP15, and the SF15 implied volatility quotes are merely indicative and are
21 available only to direct users.

22 **Q: To summarize, there are no sources for implied volatility for NP15 and the single**
23 **source for SP15 indicative volatility data is based on broker estimates. Should the**
24 **Commission impose costs on ESPs and CCAs based on such weak data?**

¹⁶ R.03-10-003, (Revised) Comments Of The City And County Of San Francisco On The Proposed Decision Of Administrative Law Judge Yip-Kikugawa, December 9, 2010, at 5.

¹⁷ Ibid.

¹⁸ Ibid. at 6

1 A: No. Requiring such a potentially large and varying FSR on an ESP, the cost of which
2 would inevitably be paid by its customers, based in large part the estimate of a broker
3 who does not answer to the Commission is clearly unreasonable.

4 **d. THE RATIONALE BEHIND CALCULATING THE FRS BASED ON THE**
5 **95TH PERCENTILE IS FLAWED**
6

7 **Q: SCE states in testimony that “The 95 percent confidence interval represents a one-**
8 **in-twenty (1-in-20) event and was adopted by the Commission in D.07-12-05 as the**
9 **confidence interval to be used by IOUs to manage rate level risk for bundled service**
10 **customers. This same confidence level should apply to forecasting the possible**
11 **reentry fees that could occur. The bond should provide the same level of protection**
12 **that the bundled service customers currently have.” Is the bundled ratepayer risk**
13 **being addressed in D.07-12-025 analogous to the risk bundled customers face from**
14 **involuntarily returned DA customers?**

15 No. The problem is that when a 95 percent confidence interval is applied to the IOUs
16 management of market risk in their procurement portfolio, as called for in D.07-12-025,
17 the result is a level of hedging that is designed to protect bundled customers against
18 market risk: if the IOU doesn't hedge based on a 95 percent confidence level, then there
19 is a 5% risk that rates will be unacceptably high. In the FSR case, even if the market
20 events that result in wholesale costs that are above the 95th percentile, there is still a large
21 likelihood that the IOU will not bear any costs: simply because the wholesale prices are
22 exceptionally high DOES NOT in itself mean that that an ESP will default. The
23 probability of the ESP actually defaulting is not accounted for; the model effectively

1 assumes that if these prices are reached, then the ESP will default. As discussed above,
2 an ESP defaulting due simply to high market prices is highly unlikely. But the FSR
3 model calculates the IOU potential exposure implicitly assuming a default will occur
4 when the prices reach the 95th percentile.

5 **VI. ANY FSR MODEL MUST BE FULLY AVAILABLE TO THOSE WHO PAY THE**
6 **RESULTING AMOUNT**
7

8 **Q: Is it reasonable for an ESP to simply post tens, if not hundreds of millions of dollars**
9 **of surety based on the unverified calculations of a competitor?**

10 A: Clearly it is not. It is, in fact, irresponsible. If this or any other model is used to calculate
11 an ESP FSR, or CCA Bond amount for that matter, it must be provided in its entirety to
12 those paying the FSR or Bond.¹⁹ This is only fair. There should be nothing in the model
13 that can be treated as confidential. The unattractive alternative is to have each ESP (and
14 CCA) keep parallel calculations and protest to the Commission if their shadow
15 calculations do not result in the same FSR (or Bond) as that presented in an invoice from
16 the IOU. Any dispute would be much more quickly and easily resolved if the IOUs
17 would provide to the ESP the underlying model and data each time the FSR is calculated.

18 **Q: Does this conclude your testimony?**

19 A: Yes.

¹⁹ This would likely require the ESP or CCA to have the appropriate subscription(s) or the permission of the provider of the market data (e.g., Amerex for volatility).