Application No: R.10-05-006
Exhibit No.:
Witnesses: Robert Anderson
Juancho Eekhout
Ryan Miller

Order Instituting Rulemaking to Integrate and Refine Procurement Policies and Consider Long-Term Procurement Plans.	Rulemaking 10-05-006 (Filed May 6, 2010)

PREPARED TRACK III REBUTTAL TESTIMONY

OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902 E)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

August 11, 2011

PREPARED TRACK III TESTIMONY OF

SAN DIEGO GAS & ELECTRIC COMPANY

I. PROCUREMENT OF GHG-RELATED PRODUCTS (Witness: Ryan Miller)

Q. What is the purpose of your testimony?

A. I am responding to testimony submitted by Pacific Environment (PE), the Green Power Institute (GPI) and the Division of Ratepayer Advocates (DRA) regarding the greenhouse gas (GHG) product procurement plan proposed by San Diego Gas & Electric Company (SDG&E).

Q. SDG&E originally requested that that the Commission approve its GHG product procurement and hedging proposal by the end of 2011 based on the expectation that the California Air Resources Board (ARB) would finalize its regulations and implement a cap-and-trade program effective January 2012. Since ARB has delayed the implementation of cap-and-trade, should the Commission delay its issuance of a decision regarding SDG&E's proposed GHG procurement plan?

A. While the delay in implementation of the cap-and-trade program reduces the need for a decision by the end of 2011, it is still important that the Commission issue a decision well in advance of the first auction. A decision regarding GHG product procurement authorization sooner rather than later would greatly increase SDG&E's ability to plan for implementation of its GHG procurement plan. Additionally, ARB's current plan is to initiate the cap-and-trade program in January 2012. This means that ARB-approved offsets will become available in 2012, and secondary markets have already begun trading for GHG products. If opportunities should arise, SDG&E would like to be able to take advantage of them on behalf of the ratepayers.

I do not anticipate that the delay in implementation of the cap-and-trade program will cause a material change in SDG&E's GHG product procurement proposal from what I presented in my testimony submitted July 1, While the first compliance period will be spread over two years as opposed to three, SDG&E intends to use same methodology for GHG procurement. Thus, there is no reason for the Commission to significantly delay a decision on SDG&E's GHG product procurement proposal. While SDG&E would prefer a decision by the end of 2011, it submits that a decision on GHG procurement authorization during the first quarter of 2012 would be still provide adequate time for SDG&E to prepare for implementation of cap-and-trade.

Q. Do you agree with Pacific Environment's claim that a portion of GHG compliance costs should be allocated to utility shareholders?

A. No, I do not. Once the cap-and-trade program is implemented, GHG-related procurement obligations will become a variable cost for generating electricity, much like natural gas is now. And like the Commission-authorized products associated with generating electricity, GHG costs should be fully recoverable in the same manner as other procurement costs related to generating electricity.

Q. Do you agree with Pacific Environment's suggestion that the utilities should be required to obtain approval from the Commission for all offset transactions?

A. No, I do not. SDG&E expects that ARB cap-and-trade regulations will be designed so that offsets are developed as standard products that can be traded quickly. Requiring the utilities to seek Commission approval for each offset transaction would inject unworkable delay into the process, and would create an unfair competitive advantage for entities not subject to Commission jurisdiction. A pre-approval requirement would cause SDG&E to miss out on opportunities to purchase cost-effective offsets, which would result in increased costs for SDG&E ratepayers.

Q. Do you agree with Pacific Environment's suggestion that the cost for GHG products be recovered only after the products are used for GHG compliance?

A. SDG&E does not oppose recovering GHG procurement costs after the allowances are retired, provided that a methodology is developed to allow IOUs to recover costs for GHG products that were procured consistent with their respective approved LTPP GHG procurement plans, but go unused as a result of changes in applicable GHG rules. Also, the IOUs should be able to recover carrying costs from purchasing allowances at one point in time, but not recovering cost until later.

Q. GPI would like SDG&E to identify a date-certain for implementation of a GHG allowance tracking system. What is your reaction to this proposal?

A. Since neither a Commission decision authorizing GHG product procurement, nor final ARB regulations, are available at this point, SDG&E cannot fully determined what the system needs and parameters will be. Until the Commission issues a decision on SDG&E's GHG product procurement strategy, it would be premature to set a specific date for creating a GHG allowance tracking system. SDG&E will establish its GHG allowance tracking system prior to the time SDG&E procures it first allowances.

Q. DRA has suggested that the utilities should be required to provide bid curves for the auctions for allowances and GHG forward curves to the Commission in advance of the auctions, does SDG&E support this proposal?

A. No, SDG&E believes the more appropriate venue to share such information would be with its procurement review group (PRG). SDG&E is willing to review this information with the PRG prior to the scheduled auctions.

Q. In light of section 95852 of the ARB July 2011 Discussion Draft, DRA expressed concerns that Ratepayers "are not overpaying for renewable contracts that place on the buyer a GHG

compliance obligation for the associated replacement power." Does SDG&E have similar concerns?

A. Yes, SDG&E shares DRA's concerns related to the ability to count out-of-state renewable resources as zero carbon resources. It is important to remember, however, that the final regulation has not been established. SDG&E is working on its own and with the Joint Utility Group to modify the replacement electricity requirements such that the ability to count out-of-state renewable energy is aligned with the intent of both the State's renewable portfolio standard (RPS) legislation and Assembly Bill (AB) 32.

I note further that the outcome of this decision does not affect SDG&E's plan for GHG procurement or SDG&E's methodology for the GHG procurement, only the volumes which SDG&E would need to procure.

Q. DRA expresses concerns for the protection of ratepayers for GHG procurement. What protections are in place to provide protections for rate payers?

A. Once GHG procurement is approved, the same mechanisms that protect ratepayers for energy procurement will be in place for GHG procurement. These protections include: (i) SDG&E consultation with its PRG (which SDG&E anticipates will include GHG procurement issues); (ii) inclusion of GHG transactions in SDG&E's Quarterly Compliance Reports (QCRs), which are reviewed by Energy Division; and (iii) adherence to the principals of least-cost dispatch, which apply for decisions regarding GHG. Also, as part of SDG&E's GHG procurement plan, SDG&E intends to purchase GHG products more or less ratably over time, thereby minimizing the impacts of short-term market swings on prices to effect reasonable overall cost for compliance with GHG requirements.

Q. DRA suggests delaying a Commission decisi on until (1) the cap-and-trade regulation is finalized and (2) supplemental testimony is filed on the allocation of GHG risks and responsibilities in long-term electricity contracts, and bid evaluation for electricity procurement contracts with out-of-state renewables. Do you agree?

A. No, I do not. The finalized regulation may impact the *amount* of compliance instruments SDG&E is required to procure, but not SDG&E's strategy or methodology for GHG procurement. Likewise, GHG risks and responsibilities in long-term contracts and evaluating bids are important matters, but they only affect the *amount* of GHG allowances or offsets SDG&E will need to acquire. They do not affect SDG&E's strategy or methodology for GHG procurement.

Q. DRA has asked SDG&E to clarify whether SDG&E is requesting authority to procure GHG products only for the current compliance period or for future compliance periods as well. Can you clarify SDG&E authorization request?

A. SDG&E is requesting authority to purchase GHG products as far out as are offered in ARB's Advance Auctions, which may include GHG products for future compliance periods. In the revised cap-and-trade regulation, ARB will offer through the advance auction 10 percent of allowances from a budget year three years subsequent to the current calendar year. In 2012, ARB will offer 10 percent of the 2015 vintage allowances in the advance auction that will take place at the same time as the auction of allowances for the current compliance period. SDG&E's procurement for allowances in years outside of the current compliance plan will not exceed the minimum obligation forecasted that given year.

SDG&E will include this option when it makes its compliance filing for GHG procurement (Appendix F in SDG&E's LTPP) in accordance with the Commission's decision in this proceeding.

Q: Does this conclude your testimony?

A: Yes, it does.

II. REFINEMENTS TO THE BID EVALUATION PROCESS; WEIGHING COMPETING BIDS BETWEEN UTILITY-OWNED GENERATION AND POWER PURCHASE AGREEMENTS (Witness: Robert Anderson)

Q. What is the purpose of your testimony?

A. I am responding to testimony filed by the Independent Energy Producers Association (IEP) regarding proposed modifications to the utilities' request for offers (RFO) process.

Q. **Do you agree with IEP's recommendation that the Commission adopt substantial modifications to the RFO process?**

A. No, I do not. IEP's proposal is a solution in search of a problem. There exists no compelling evidence to support the claim that the current process needs to be modified, as IEP suggest. While SDG&E is constantly looking to improve the RFO process by considering feedback and lessons learned after each RFO to identify areas that can be improved for the next solicitation, the basic approach to utility RFOs remains sound.

In addition, the rationale proposed by IEP to support its proposed modifications is weak. For example, IEP suggests that adoption of its information disclosure proposal will result in more bids and lower prices, but as IEP admits in its testimony, the responses to Utility RFOs have resulted in offers that greatly exceeded the capacity needed. Practically speaking, if the utilities are receiving bids that exceed the need by up to ten times, increasing the response so that the

utilities receive bids that exceed the need by eleven times, or more, will not have much impact on pricing.

Q. IEP claims that if production cost models are used, the modeling assumptions should be provided to prospective bidders. Do you agree?

A. No, I do not. First, the utility models often include confidential data based on existing contracts. The Commission ruled in D.06-06-066 that much of this data should remain confidential. Secondly, consultants that run production cost models, including models of the California Independent System Operator (CAISO) system, are widely available. Thus, if a bidder believes that it can enhance its bid by engaging a consultant with access to production cost models, it is free to do so. Also substantial historical data regarding the CAISO market prices are publicly available to bidders.

Q. Do you agree with the recommended adders that IEP witness Monson has proposed in his testimony related to capital, Operations & Maintenance (O&M) and heat rate for Utility-Owned Generation (UOG) projects?

A. No, I do not. First, given the fact that parties had barely a week from the time IEP submitted its testimony to prepare rebuttal testimony, it is not possible for SDG&E or any party, to conduct the comprehensive research necessary to fully review and evaluate the analysis. However, SDG&E did conduct a cursory review, based on the limited time and data available, and identified several reasons that there may be substantial flaws in IEP's analysis.

Before addressing individual items, it should be generally noted that IEP's testimony on page 40 assumes that, for Independent Power Producer (IPP) projects, the capacity, heat rate and O&M are fully specified, and therefore that there is little or no uncertainty in those factors. In making this assumption, IEP ignores costs and risks that ratepayers have faced in connection

with IPP projects. For example, IEP conducted no analysis and provided no calculations regarding the delta between the 'initial cost estimates" of IPP project and the final cost ratepayers are paying today. As the Commission is aware, more than a few PPAs have come back to the Commission after their initial approval for re-pricing due to cost increases. However, IEP has not proposed any adjustments in evaluating IPP projects to account for these situations.

Q. Do you believe that the capital cost adder proposed by IEP on page 41 of its testimony is appropriate for UOG offers?

A. No. SDG&E received the IEP work papers the night before rebuttal testimony was due. A very quick review of the analysis already raises issues. For example, the work papers show SDG&E's Palomar Plant dropping from 550 MW in the initial application to 500 MW as actual. However, Palomar has a CAISO net qualifying capacity (NQC) rating of 565 MW. If the 500 MW used by IEP is replaced the correct 565 MW value, then the IEP worksheet goes from showing Palomar at being 12% over on a $/kw basis to 1% under.

In any case, for all of SDG&E's new utility owned generation, the Commission, in approving the plant, approved a specific cost cap. The cost cap may have included provisions that permitted the builder to receive bonus payments if the plant performed at a heat rate better than the original contract heat, and if the capacity was greater than the initial contract capacity. Incentives like this make sense since ratepayers will benefit from a plant that is larger and more efficient than what was originally evaluated. So unless IEP adjusted all costs for increases in capacity or better performance, then IEP's calculation are likely to be misleading. In addition it should also be noted that once each of the UOG projects was placed in service, SDG&E was required to make an advice letter filing, which allows the Commission to be sure the costs recovered in rates are consistent with the Decision approving the project.

Q. Do you agree that a heat rate adder should be added only to UOG bids?

A. No, I do not. In general, a plant's heat rate may degrade slightly over time, but so long as the plant is performing major maintenance (overhauls, refurbishments, and upgrades) based on a periodicity set by the original equipment manufacturer, the degradation will be minimal. Although one may see minor variations in heat rate between major maintenance cycles one would not expect to see any serious degradation in efficiency. But this would apply equally to UOG and IPP plants. There is no reason that a UOG plant would experience more or less degradation than an independently-owned plant, so long as they are carrying out the required maintenance. Thus, the idea that an adder should be applied only to UOG plants does not make sense.

Second, it is very likely that IEP relied on irrelevant data in develop its heat rate adder proposal. Information on yearly heat rates is not particularly useful in evaluating plant degradation. The only way to determine true degradation is through very specific performance tests. SDG&E is not aware of any database where plants report their performance test heat rates. Thus, any reported heat rate database is most likely based on the heat rate that results from actual yearly dispatch. The variation in yearly heat rates is a function of the number of starts and stops, where the plant was dispatched between minimum and maximum load, and even how dispatch was spread over the year between summer and winter weather conditions. Analysis of this data provides no useful information regarding actual plant performance.

Q. Do you agree with IEP proposal to adopt an O&M cost adder?

A. IEP makes a number of claims regarding O&M costs, but offers no credible evidence to establish that its claims are accurate as they relate to SDG&E's UOG. IEP's claim that ratepayers are at risk for direct pass-through of unexpected O&M costs is wholly incorrect.

First, the Commission reviews the O&M costs of all of SDG&E UOG in each general rate case, which occurs every three to four years. If SDG&E were to propose a change in O&M costs, the Commission has the ability to fully review that request and decide what is reasonable. Also, if SDG&E were to experience an unexpected O&M cost increase between rate cases, SDG&E would only be able to pass that cost on to ratepayers with specific Commission approval.

Q: Does this conclude your testimony?

A: Yes, it does.

III. PROCUREMENT OVERSIGHT RULES (Witness: Juancho Eekhout)

Q. What is the purpose of your testimony?

A. I am responding to testimony submitted by Pacific Environment (PE), the Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN), the Western Power Trading Forum (WPTF) and L. Jan Reid (Reid).

Q. What topics does your Rebuttal Testimony cover?

A. I will be responding to testimony submitted in two areas: (i) proposals regarding modifications to SDG&E's Procurement Review Group (PRG); and (ii) proposals regarding the relationship between the Independent Evaluator (IE) and SDG&E.

Regarding the PRG, I am responding to testimony regarding the organization and composition of the PRG, the scope and nature of the PRG's work and the timing and conduct of PRG meetings and meeting follow-up. Regarding the IE, I address issues relating to the relationship between SDG&E and its IEs, and whether or not there exists an inherent conflict of interest in that relationship, as well as issues around who should select, hire and pay for the IE, and the scope of the IE's involvement in SDG&E's procurement activities.

Q. What specific recommendations do you make?

A. I believe that most of PE's proposals are duplicative of what is already being done. Other changes recommended by PE would add unnecessary time and complexity to the conduct of PRG meetings.

With regard to the proposal that the Commission, rather than the IOUs, hire and compensate IEs, I would like to start by pointing out that, in my opinion, the concerns regarding whether there is a conflict of interest created by the fact that the IOUs select and compensate the IEs is overstated. In making procurement decisions, SDG&E does not have a profit motive. Rather, it seeks to follow the Commission rules in order to develop cost-effective procurement solutions on behalf of its ratepayers. Therefore, the public interest supports continuation of the current approach, which allows SDG&E to have timely access to a competent IE that helps it to ensure that its processes and transactions are open, fair, and transparent. In that context, SDG&E opposes the view that IEs should not continue to be hired and compensated by SDG&E. The IOUs are in the best position to select an IE that has the relevant expertise and capability to complete his/her tasks in a competent and timely way, with an independent perspective.

In the specific case of affiliated transactions, although SDG&E believes the current process ensures transparency and fairness, SDG&E does not have an opinion at this time regarding whether the IE for such transactions should be selected and compensated by the Commission, and reserves the right to advocate a position on this issue at a later time.

In the event the rules around the hiring and compensation of IEs are modified through this proceeding, SDG&E requests the Commission establish a selection process that selects IEs based upon their expertise related to the particular type of procurement at issue (for example, renewable versus conventional) and their proven ability to produce quality work in a timely

fashion. In addition, it is important for the IOU to be able to provide feedback to the Commission on the IE's performance, and for this input to be considered in terminations and/or contract renewals.

Q. What is duplicative about the PE proposal?

A. First, PE proposes that the composition of the PRG be expanded to include more environmental justice groups. SDG&E notes that this viewpoint is already represented in its PRG by the Natural Resources Defense Council, which is a member of SDG&E's PRG. PE should clarify what is lacking in the current composition of the PRG with respect to environmental issues and offer a concrete proposal.

Similarly, SDG&E already maintains its PRG calendar online, so PE's recommendation concerning that issue is redundant. With regard to the other two areas PE suggests that the PRG should address – namely, the state loading order for preferred resources and project viability – those items are already within the purview of the PRG and the IE. Accordingly, the Commission need not make any changes at this time in response to those concerns.

Q. Do you have any other concerns with PE's proposals?

A. Yes, I do. Some of the proposals made by PE, if adopted, would turn the PRG meetings into a quasi-formal Commission proceeding, but without the procedural protections of a Commission proceeding. The SDG&E PRG is a forum where its members are encouraged to engage in a constructive dialogue regarding procurement proposals. Turning the PRG into a quasi-formal proceeding would alter this debate-oriented environment.

The recommendation that there be summaries of the PRG meetings distributed afterward would provide little value. It would not add to the quality of the PRG review and, if anything, could deter attendance. In addition, the requirement would be redundant since PRG members

receive a detailed packet of information two days prior to each meeting and any items referred for follow-up are reported on and discussed, as necessary, the following month. Any member who has a concern regarding a follow-up item or the content of any given material is welcome to bring it up at the meetings and the concern will be addressed.

The preparation of a public version of PRG information seems to create more process burden than benefit to the public interest. In particular, it could lead to greater contention within the procurement process and outside the context of a Commission proceeding. This is important because, in a proceeding where the IOU has made a filing seeking approval related to a specific proposal, the Commission has procedures for dealing with public review and comment, requirements for notice and posting, etc., as well as statutory direction regarding the findings the Commission is required to make and the impact of those findings on the IOUs and consumers. The "free for all" environment advocated by PE is more likely to lead to public confusion and contention rather than greater transparency. The public has ample opportunity to be heard on IOU procurement issues by their representation on the PRG (ratepayer groups, environmental groups and labor groups are all represented on SDG&E's PRG), and when the IOU seeks Commission approval of a procurement decision. The public interest is not served by turning the PRG into a public forum. It is also not clear from the PE proposal whether PE is proposing to compensate the additional members it proposes be added to the PRG. That aspect of the proposal could also prove costly to ratepayers without corresponding added benefit.

Q. Do you agree that a PRG recommendation against a specific project or contract should serve as a rebuttable presumption against Commission approval if the IOU decides to move forward with the project?

A. No, I do not. The PRG is an advisory body. It is an open forum where the IOU shares its procurement options and work-plans with the PRG members, and seeks to have an open and constructive dialogue regarding the merits of various options and potential areas of improvement. The IOU takes this feedback into consideration when making and fine-tuning its procurement decisions. While PRG feedback is an essential tool to the utility in managing its procurement, negative feedback in and of itself should not create a presumption of unreasonableness. Such a change would fundamentally alter the dynamics of the constructive dialogue that exists today. I am sure that PE would not support the parallel requirement that, in the absence of negative feedback from the PRG, the project or contract is granted a rebuttable presumption of reasonableness.

The time and scope of PRG meetings is not adequate to establish a presumption one way or the other. There is a great deal of additional analysis, give and take, and careful decision-making that informs an IOU's final decision on procurement. SDG&E would certainly think twice before entering into a transaction that its PRG had strongly opposed, but it is ultimately up to the Commission to make a decision regarding approval of a particular contract or project. Negative commentary does not by itself rise to the level of a presumption against the transaction, especially when negative feedback may be limited to only one or two parties. As a forum for input, discussion and feedback, the PRG provides a great deal of value. SDG&E supports continuation of this role for the PRG.

Q. Does SDG&E support the proposal to have the Commission, rather than the IOUs, hire and contract with the IE?

A. In the context of non-affiliate transaction, SDG&E does not support the proposal since it does not see the need for a change to the existing rules based on a perceived conflict of interest

that does not exist. For affiliated transactions, SDG&E believes the existing process very effectively deters the IOUs from unfairly benefiting an affiliate. Therefore, SDG&E does not take a position at this time but reserves the right to advocate a position at a later point.

The Commission is already closely involved in the IE selection process. It is my understanding that under the current process, both the Energy Division and the PRG play a significant role in the screening and selection of the IEs included in each utility's pool. For instance, the Energy Division participates in the evaluation and interviewing of potential IEs, and the Director of Energy Division gives final approval to the pool of IEs. The PRG devotes an entire meeting to interviewing the IE candidates, and members have the opportunity to vet each of the candidates and voice any support or objection prior to the final selection of the IE pool.

In terms of its relationship with its IEs, SDG&E promotes an environment of transparency, and of independence on the part of the IE. SDG&E encourages professionalism and discussion with the IE that yields quality analyses and independent judgments on the part of the IE.

SDG&E notes that the problem appears to essentially be one of perception – that is, neither WPTF, TURN, DRA nor PE pointed to any actual harm to ratepayers from the current approach; nor do they identify any example of a situation where an IE bowed to pressure from the IOU rather than maintaining his or her independence. In fact, TURN does the opposite, acknowledging in its testimony that the IEs have provided a valuable service to ratepayers and the Commission, notwithstanding the fact that they are hired by the respective IOUs. It seems that the parties arguing for modification of the current approach do so simply because they would feel more comfortable if the Commission were the contracting party instead of the IOUs.

SDG&E believes that, in view of the lack of an identified problem, there is no need to make this major modification to current IE procedures. Parties advocating for this modification do not

explain how the proposed approach will ensure continued efficiency and accountability by the IE for the timely and accurate management of workload. Inserting the Commission as middle-man creates a material risk that the IOU will be held up in its procurement activity by an IE that fails to provide timely work product and is not accountable to the IOU for doing so.

It is also not clear what the timeline would be for implementing the change under state contracting procedures. Since the proposal is little more than a general idea at this point, with no specifics as to process or potential consequences, it would be premature to adopt it in this LTPP cycle.

Q. What about the DRA proposal that Energy Division or the PRG should be responsible for assigning the IE to the IOU?

A. SDG&E does not support that proposal. The success of the IE-IOU relationship depends on expertise, a balance between trust and space, and an ability to communicate and work together effectively. It also depends on a working environment that is free of material conflicts of interest. The DRA proposal does not allow for application of the IOU's insight into the skills of a particular IE and why those skills might add value in the context of a given solicitation. The IOU and the IE are the parties best situated to evaluate these criteria and make a determination. Being forced into a potentially unsatisfactory or unworkable relationship is not in the interest of the IOU, the IE or the ratepayer. For these reasons, SDG&E believes that the IOUs should continue to select their IEs based on what is the best fit for both the IE and the IOU.

Q. What is your reaction to the points raised by L. Jan Reid regarding the re-evaluation of IEs who are inactive?

A. SDG&E agrees with Mr. Reid on this point. IEs who have not been active in the past two years need not be re-evaluated. The evaluation process is lengthy and involved, and it makes little sense to re-evaluate an IE that has been inactive.

Q. Should the IOUs participate in one another's PRGs?

A. No, they should not. Reid makes a further point in response to the ALJ Ruling, noting that it would be inappropriate for the IOUs to participate in one another's PRGs. SDG&E agrees with this point (and imagines that the "IOU" reference in the cited portion of the ALJ Ruling was a typographical error).

Q. What about Reid's proposal regarding the timeframe for submission of written comments to the IOUs after the PRG meetings?

A. SDG&E believes that the proposal should not be adopted. The fifteen (15) day period for submission of written comments encourages any party who may wish to submit data requests to the IOU to do so promptly, and to ensure that its data request is thorough. SDG&E currently responds to any requests for additional information or follow-up information related to concerns raised at a PRG meeting at the meeting following the one in which the issue or question arose. That process has worked well, and SDG&E does not see a need to change it to accommodate concerns expressed by a single member of one PRG.

Q: Does this conclude your testimony?

A: Yes, it does.