Application No: R.12-03-014
Exhibit No.:
Witness: Robert Anderson

**PREPARED TRACK I REBUTTAL TESTIMONY OF**

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

**BEFORE THE PUBLIC UTILITIES COMMISSION**
**OF THE STATE OF CALIFORNIA**

**July 23, 2012**

#269580

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## I. PURPOSE OF TESTIMONY

The purpose of my testimony is to respond to statements concerning allocation of procurement costs through the Cost Allocation Mechanism ("CAM") contained in the testimony of witnesses Sue Mara and Mark Fulmer submitted on behalf of the Alliance for Retail Energy Markets ("AReM"), Direct Access Customer Coalition ("DACC") and Marin Energy Authority ("MEA").

## II. "MINIMIZING" ALLOCATIONS OF COSTS VIA THE CAM

In her testimony, Ms. Mara indicates it should be the Commission's policy to "minimize" utility procurements that would result in the recovery of resource costs via the CAM. I disagree that any such policy should be the Commission's principal goal in determining whether a utility should be authorized to procure (or ordered to build) new generation resources meeting system or local reliability needs, or any other important aspect of state energy policy. Rather, such authorizations (or orders) should be focused on assuring that the identified reliability needs or policy directives will be addressed by the utility procurement (or construction). In other words, the Commission may structure its procurement orders to address policies and requirements beyond a utility's bundled loads and, where the reflection of those policies and requirements in a utility's procurement plans redound to the benefit of consumers other than the utility's bundled customers, the Commission should allocate costs to all benefiting consumers via the CAM.

The resource needs under consideration in this track of the proceeding relate to an analysis of local reliability needs in Southern California Edison's ("SCE's") service area performed by the California Independent System Operator ("California ISO" or "ISO"). The

Commission will separately consider local reliability needs for other service areas, including those of SDG&E.[1] In addition, the Commission may consider other needs such as long-term system reliability needs in future tracks of this proceeding.[2] In determining whether to authorize utility procurements (or order construction) that would resolve some or all of the identified needs, I expect the Commission will consider the full range of alternative solutions that could address these needs. As the Commission does this, I expect this process will entail considering resource solutions that would address the full extent of resource "needs" not only as defined by the ISO's analyses, but by a host of other state policies and interests – certainly the Commission can be expected to look beyond the forecasted consumption of utility bundled loads in determining the total needs and the resources that should be used to resolve those needs. Because defining "needs" and procurement authorities in this all-encompassing way results in the provision of benefits to customers other than utility bundled customers, the Commission should allocate the costs of the utility's procurements via the CAM.

I agree with Ms. Mara that the Commission's consideration of the needs it authorizes the utilities to resolve through their procurement activities, and any allocation of costs to customers other than the utilities' bundled customers, should receive the Commission's careful attention. I believe the Commission has done this in the past. But in reviewing Ms. Mara's testimony, I found that her point does not appear so much to be that the Commission has failed to explain its reasoning behind allowing resource costs to be recovered via the CAM, but rather that the Commission should not permit *any* recovery of resource costs via the CAM except in the most extraordinary cases. To the extent that this is the purpose behind her recommendations, I would respectfully disagree with her.

[1] The Commission is currently considering SDG&E's local reliability needs in A.11-05-023.

[2] *Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge*, dated May 15, 2012, p. 9.

As I have noted, serving state policies and interests through utility procurements provides benefits to more than the utility's bundled customers. The Commission should take Ms. Mara's objections to the allocation of costs via the CAM into consideration as it assesses state resource requirements and determines whether, and if so how, to address state policies and interests through utility procurements. But where the Commission chooses to define needs beyond the narrow needs of the utilities' bundled customers and authorizes utility procurement activities that will provide benefits to customers other than the utilities' bundled customers, the Commission should not then refuse to allocate the costs of such procurements via the CAM. In saying this, I reiterate and emphasize that I do not believe that minimizing the allocation of procurement costs via the CAM should be an overriding consideration, particularly where, as in this case, system and local reliability needs identified by the California ISO and/or the Commission constitute the state interests proposed to be served through utility procurement activities.

## III. STATUTORY GUIDANCE REGARDING RECOVERY OF THE COSTS OF GENERATION RESOURCES VIA THE CAM

Whenever the Commission authorizes the utility to procure (or orders the utility to build) generation resources necessary to meet system or local reliability requirements, recovery of the "net capacity costs" associated with those generation resources are to be allocated to all benefiting customers via the CAM. Ms. Mara interprets various provisions of California statutes related to the structure of the Commission's resource adequacy program in a way that would in most instances preclude this allocation. In order to reach her result, I believe she disregards the plain language of the statutes she cites as well as the policies the Commission has adopted in implementing those statutes.

First of all, my sense of the legislative direction under which the Commission has implemented and administered the CAM is that the Commission should distinguish between those generation resources relied upon by the utilities to provide delivered energy and capacity solely to bundled customers, on the one hand, and those providing additional resource adequacy benefits by meeting system or local reliability requirements, on the other. With respect to the former, the utilities will bear the entire costs of these resources. But with respect to the latter, both the California Legislature and the Commission have recognized that there is an intrinsic and inherent reliability benefit delivered by generation resources that is shared among and enjoyed by all consumers, whether they are bundled utility customers or not. The provision of these benefits justifies the allocation of costs to all consumers via the CAM.

In Public Utilities Code § 365.1(c)(2)(A), the Legislature specifically directs the Commission to allocate to all benefiting customers the net capacity costs of "generation resources that the commission determines are needed to meet system or local area reliability needs for the benefit of all customers in the electrical corporation's distribution service area." In practice, the Commission has often cooperated with the California ISO to analyze and determine system and local reliability needs within the ISO's footprint. In other cases such as the combined heat and power ("CHP") settlement, the Commission looked to achieve a state-wide policy objective.[3] While the analyses presented by the ISO are subject to vetting by interested parties and review by the Commission, the Commission's ultimate determination that generation resources should be procured to address the deficiencies in the generation fleet underlying any reliability concerns raised by the ISO fully meets the single qualification specified by the Legislature for allocating the costs of a generation resource via the CAM.

[3] *See* D.10-12-035, *mimeo*, p. 2.

## IV. RELIABILITY: INTRINSIC VERSUS TANGENTIAL (OR INCIDENTAL) VALUE

To paraphrase Ms. Mara's testimony at page 18, she indicates the Commission should not "presume some tangential link between each and every project authorized and system and local reliability." I have a completely different view regarding the nature of the reliability benefits provided by generation resources and the resulting presumptions that should prevail in determining how the costs of those resources should be allocated. In my opinion, the reliability benefits provided by generation resources are more appropriately characterized as "intrinsic" rather than "tangential". This is more than a semantic difference – the nature of system and local reliability needs defines whether costs associated with the procurement of generation resources may be allocated beyond the procuring utility's bundled customers.

As Ms. Mara indicates in her testimony, the Commission's decisions in the past evidence an unstated "presumption" that costs resulting from the procurement of new generation resources should be recovered via the CAM. In order to make this clear, I believe the Commission should explicitly adopt a rebuttable presumption that, for those certain generation resources it authorizes the utilities to procure (or orders to build) in order to meet system or local reliability requirements, the net capacity costs of those resources will be allocated to all consumers within the procuring (or building) utility's service territory and recovered via the CAM. At the very least this should apply to the costs of new generation resources resolving system or local resource deficiencies as may be determined by the Commission.

The rebuttable presumption I describe above is consistent with general principles of cost allocation applied in other contexts. For example, the California ISO is authorized under certain of its tariffs to procure resources it determines are needed to meet system or local resource adequacy or reliability requirements. Where these needs are not attributable to the specific failure of a single load-serving entity to meet its resource adequacy requirements, costs are allocated by the ISO on a load-ratio share basis. This allocation is based upon "costs-follow-benefit" principles, which are distinct from the "cost-causation" principles largely relied upon by Ms. Mara. I would also point out that, in addition to its existing procurement authorities, the California ISO intends to seek the further authority to procure units at risk of retirement where it determines those resources may be needed to meet potential future system or local resource deficiencies. Once again, the ISO proposes that the costs of this procurement be allocated on the basis of load-ratio share under the theory that all consumers within the ISO footprint will benefit from the continued availability of these units, even if the units are never in fact called upon by the ISO or required to meet the ISO's operational requirements. Without addressing the merits of the ISO's authorities or the manner in which the ISO may choose to exercise them, the cost-allocation principles used in these cases are consistent with the rebuttable presumption I describe in this testimony: by procuring those incremental resources it believes are necessary to meet its operational requirements, the ISO justifiably presumes that *all* loads benefit from the procurement of those resources and accordingly allocates the costs of these procurements on a load-ratio share basis.

## V. USING INCREASES TO PEAK DEMAND OR SYSTEM LOAD FACTORS TO ALLOCATE COSTS

Ms. Mara recommends that the Commission should determine which group of consumers are driving increases in peak demand or decreases in system-load factors, and that the allocation of the costs of incremental generation resources should follow this determination. I disagree that this is an appropriate approach. Ms. Mara conveniently avoids addressing fundamental flaws in her recommendation by assuming that utility bundled loads drive the growth in peak demand and decreases in system load factors. Those assumptions are contestable and in any event do not address the underlying issues related to the fair allocation of procurement responsibilities.

The Commission has used the long-term procurement plan process to determine how the energy and capacity needs of utility bundled customers should be met. For practical reasons and of necessity, the Commission has also relied upon the utilities to procure (or build) new generation resources where it has determined that resources are needed to meet utility loads *and, concurrently, other requirements.* The utilities have accepted the responsibility of procuring new generation resources since this represents the most feasible method of assuring that needed new resources are added to the California electricity system. To the best of my knowledge, no load-serving entity other than a utility has undertaken this responsibility or offered to do so in lieu of utility procurement. Procuring (or building) new resources requires substantial long-term financial commitments. While non-utility load-serving entities could certainly make these commitments and develop the *bona fides* necessary to support the procurement of new resources, it is generally the case that the nature of their business models, based on relatively short-term customer commitments and the absence of binding obligations to serve beyond those assumed under contract, are not conducive to placing large amounts of capital at risk to serve customers with a propensity to migrate to other providers.

The Commission and the California ISO can and do impose relatively short-term resource adequacy requirements on non-utility load-serving entities, however, this provides no basis upon which to assume those entities would accept or meet the longer term and far more substantial financial commitments that would be assigned to them under any regulatory regime in which they would be responsible for meeting the long-term reliability needs of their customers. Under these circumstances, the claim that stricter or more precise "cost causation principles" should be used to determine the costs allocable to the customers of non-utility load-serving entities reveals itself simply to be a cost-avoidance stratagem. Ms. Mara's characterization of reliability as an "incidental benefit" [at page 28] provided by generation resources is indicative. Moreover, if we cannot agree on the subjective characterization of reliability benefits (are they intrinsic and valuable, or tangential and incidental?), then reducing those benefits to objective terms, expressed in the calculus of a cost-allocation formula, can only be expected to be even more difficult. Ms. Mara's reference to the recent change in the coincidence adjustment factor used in the Commission's resource adequacy program does not convince me otherwise. It is one thing for the Commission to make a relatively minor arithmetic adjustment to the annual and monthly resource adequacy coincidence adjustment factor (and even this was done only after years of vetting in the resource adequacy workshops and a commitment by the California Energy Commission to calculate entity- and class-specific adjustment factors) and quite another to assume there is a simple, objective formula that can be devised for quantifying and allocating reliability benefits among different customer groups. Ms. Mara dismisses the problems implicit in developing such a formula by simply declaring, "Obviously, the 'need' must be incremental to 'needs' already associated with … the IOUs' bundled customers," but this conclusion is not so "obvious" as it is self-serving.

To make the point clear, I will use Ms. Mara's "real world example" of the reliability needs tied to the impending closure of the once-through cooling ("OTC") units. In her example, Ms. Mara asserts that state laws "require the [utilities] to procure to *replace* any unmet needs created by the closing of [these] units used to serve bundled load." [Emphasis in original.] This assertion ignores several important facts: first, it is not necessarily the case that these units are relied upon by the utilities to meet any of their needs; second, the California ISO itself calls upon these units to meet system and local reliability requirements. Despite these facts, Ms. Mara simply declares that the utilities own the primary responsibility to replace these units upon their retirement and that the utilities' bundled customers stand first in line to bear the financial burdens associated with the replacement resources. The Legislature and the Commission have nowhere indulged this set of cost-causation "principles" and, to the contrary, explicitly and repeatedly rejected the idea that competition in the electricity sector should involve bundled utility customers subsidizing others. In the long-term procurement planning proceedings, the Commission should in fact consider the need to replace the retiring OTC units but, in authorizing the utilities to procure replacement resources, should not ignore that the replacement resources will provide significant, rather than "tangential" or "incidental", benefits going far beyond the delivery of energy to the utilities' bundled customers.

## VI. MODIFICATIONS TO THE CAM CHARGE FOR PPAs

In his testimony, Mr. Fulmer discusses the Joint Settlement Agreement ("Settlement") adopted in D.07-09-044. As Mr. Fulmer notes, the Settlement outlines principles for the energy auction to be used to establish net capacity cost for purposes of applying the CAM, and also establishes a non-auction cost calculation mechanism (the "Joint Parties' Proposal") to be used to value the energy rights if an auction is unsuccessful or has not yet occurred.[4] Mr. Fulmer correctly points out that a proxy calculation similar to the Joint Parties' Proposal was used to apply the CAM to a Pacific Gas & Electric Company ("PG&E") power purchase agreement ("PPA").

SDG&E supports continued use of the Joint Parties' Proposal as an alternative to the use of an energy auction to determine the net capacity costs for resources subject to CAM. The

[4] *See* D.07-09-044, *mimeo*, p. 1, Appendix A, § IV.

Commission should eliminate the restriction that the Joint Parties' Proposal may be used only if an auction is unsuccessful or has not yet occurred, and should permit the IOUs to apply the Joint Parties' Proposal in lieu of energy auctions until it determines through workshops (as I proposed in my opening testimony) what non-auction method(s) may be used on a permanent basis to establish net capacity costs. Alternatively, the Commission could elect to forego workshops and simply deem the Joint Parties' Proposal to be a permanently available alternative to the energy auction approach to determining net capacity costs. At the time the utility files its application, it would state its preference for which method would be employed. While SDG&E supports broad use of the Joint Parties' Proposal to establish net capacity costs, it does not support the proposed changes to the methodology suggested by Witness Fulmer. For the reasons outlined below, the revisions proposed by Mr. Fulmer should be rejected.

The first adjustment Witness Fulmer claims is required is an adjustment for ancillary services. He asserts that the Joint Parties' Proposal should be modified to include all major ancillary service products that are currently available in the CAISO market, including such ancillary services as regulation, spinning reserve and non-spinning reserve. I disagree for two primary reasons. First, the Joint Parties' Proposal's current assumption regarding valuation of included ancillary services is quite generous. The Joint Parties Proposal assumes that plant would receive non-spin revenues based on its capabilities when the unit was not cost-effectively providing energy. The equation assumes the unit would earn these revenues in each and every hour it was capable of providing them. Thus the Joint Parties' Proposal, as it currently exists, may *already* over-estimate ancillary service revenues since the total number of resources available to provide non-spin greatly exceed the need for non-spin.

In addition, Mr. Fulmer's assumption that a CAM unit will provide *every* ancillary product available in the CAISO market (and should therefore be valued as such) is misplaced; Mr. Fulmer offers no verifiable data demonstrating the likelihood that a unit will win in each one of the specified ancillary service auctions. In order to provide ancillary services such as regulation up, regulation down and spinning reserve, the unit would have had to have been operating, thus it would have been economic in the energy market. This alone would limit the number of hours it would even be able to offer certain services. Also, to provide service like regulation up and spinning reserve the unit would have to be loaded at a point other than full load. If the energy benefits are based on the plant being fully loaded, there is no additional capacity available for regulation up and spinning reserve. As Mr. Fulmer notes, regulation up and down markets average only 350 MW an hour. However, given that there are likely to be substantial resources available to provide this service in any hour, the likelihood that the CAM unit would win in each and every hour is extremely low.

## VII. MODIFICATIONS TO THE CAM CHARGE FOR UOG

Public Utilities Code § 365.1(c)(2)(C) requires that the "annual revenue requirement" for utility-owned generation ("UOG") be used for purposes of calculating the net capacity costs to be allocated under the CAM where utility resources are used. Mr. Fulmer asserts that the annual revenue requirement for a UOG must be analogous to the costs of a PPA; he argues that an annual levelized revenue requirement, rather than the actual yearly revenue requirement collected by the utility, should be allocated through the CAM. This conclusion is unsupportable and should be rejected. There is no mention in § 365.1(c)(2)(C) of a levelized revenue requirement and such a requirement would represent a significant departure from the plain language of the provision. As is demonstrated in Mr. Fulmer's Figure 1 [page. 46], requiring that the annual revenue requirement be levelized for CAM purposes would disadvantage ratepayers during the initial years of operation of the asset, and Mr. Fulmer fails to address a scenario in which the asset is not available for the entire anticipated plant life. SB 695 plainly does not contemplate the shifting of costs proposed by Mr. Fulmer. Since there exists no basis for the claim that the reference made in § 365.1(c)(2)(C) to the "annual revenue requirement" for UOG signifies anything other than the annual revenue requirement as calculated for ratemaking purposes, Mr. Fulmer's proposal regarding reliance on a levelized revenue requirement must be rejected.

## VIII. CAP ON CAM COSTS

Mr. Fulmer recommends that the Commission adopt a cap on costs allocated through the CAM. His proposal is flawed and must be rejected. First, there exists no indication that the Legislature intended that a cap be placed on costs allocated through CAM, and indeed Mr. Fulmer points to none. In addition, Mr. Fulmer's argument is based on a flawed premise. His testimony asserts at page 47 that "the net capacity cost calculations . . . may be faulty and systematically result in higher that reasonable net capacity costs," and further at page 48 that "unfair and inequitable costs could be imposed on CCA and DA customers." Mr. Fulmer fails, however, to provide any persuasive evidence of improper costs being imposed on any CAM participant. Moreover, he ignores the role of the Commission in ensuring equitable allocation of costs. The objective of the CAM is to pass on the net costs of the specific resources the Commission has previously found to be needed and that provide benefits to customers. In approving a PPA that will be subject to CAM, the Commission will undertake an evaluation as to whether the costs are reasonable. In the case of UOG, costs related to utility resources are reviewed as part of the application for approval of such resource, and also on an ongoing basis through the utility's general rate case. Thus, Mr. Fulmer's recommendation regarding adoption of a CAM cap should be rejected as unnecessary and contrary to law.

## IX. OPT-OUT

Ms. Mara proposes that LSEs be permitted to opt out of the CAM and be exempted from CAM charges. SDG&E does not support this proposal, which it views as being unreasonable and impractical. First, as I noted in my opening testimony, the CAM applies only to "generation resources that the commission determines ***are needed to meet system or local area reliability needs <u>for the benefit of all customers</u> in the electrical corporation's distribution service territory***."[5] Thus, by definition, the CAM is used *only* when the Commission has determined that that the benefits of a given resources extend beyond the IOU's bundled customers. Accordingly, since other LSEs are benefitting from the IOU's procurement, they should not be permitted to opt out of the CAM in favor of receiving a "free ride" at utility ratepayer expense.

Second, an opt out mechanism would, as a practical matter, be difficult to implement and would create additional program complexity. The only circumstance in which the Commission could allow an LSE to opt out is if the party provides resources that meet the <u>exact</u> needs, terms and conditions that have been identified by the Commission in determining that the CAM should be applied. In some cases, this could be a similar type of resource, but in other cases it might be the exact same resource. As the Commission has acknowledged, the requirement to provide a resource that meets the exact need, terms and conditions identified would present a challenge for non-utility LSEs. In deciding against inclusion of an opt out provision in the CHP settlement, for example, the Commission noted its concerns regarding the ability of non-IOU LSEs to procure the specific CHP resources needed (as well as the administrative burden inherent in placing that procurement obligation on non-utility LSEs).[6]

[5] SB 695, Sec. 2, § 365.1(c)(2)(A) (emphasis added).

[6] D.10-12-035, *mimeo*, p. 56.

Ms. Mara's opt out proposal fails to establish a process for determining that the exact needs identified by the Commission will be met. Merely having a party make a showing that it has contracted with existing resources for five years does not address the need for new resources that will likely require CAM treatment. For example, under the current market structure, the need for new local capacity is a procurement requirement that results from the market and current Commission and CAISO requirements failing to produce the needed resources; the Commission has ordered the utilities to step in and fill this need. Simply making a resource adequacy showing with existing resources does nothing to correct this shortfall or to address the specific need identified by the Commission. Moreover, the Commission has noted that the lead time for new units can be a long as seven years.[7] Thus, an LSE's showing that it has five years of resource adequacy commitments does not address the shortage at issue and does nothing to facilitate construction of new resources. In short, the opt-out concept offered by Ms. Mara is unworkable and should be rejected as an unreasonable attempt to force the cost of all new generation onto bundled customers.

This concludes my testimony.

[7] D.07-12-052, *mimeo*, p. 21.



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