BEFORE THE PUBLIC UTILITIES COMMISSION OF THE

STATE OF CALIFORNIA

Order Instituting Rulemaking to Consider the Annual Revenue Requirement Determination of the California Department of Water Resources and related issues.	))))	R.11-03-006 (Filed March 10, 2011)

OPENING BRIEF OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E)

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I.

INTRODUCTION AND SUMMARY

Pursuant to Administrative Law Judge Wilson's email ruling of November 20, 2012 ("Ruling"), Southern California Edison Company ("SCE") submits this Opening Brief on the allocation of costs related to the firm gas transportation service agreement ("Kern TSA") between Kern River Gas Transmission Company ("Kern River") and the California Department of Water Resources ("DWR").

In the Determination of its 2013 Power Charge Revenue Requirement, DWR has allocated the costs of the Kern TSA – the only remaining costs associated with the expired Sunrise Power Purchase Agreement ("PPA") (as defined herein) – to San Diego Gas and Electric Company's ("SDG&E's") customers. This is consistent with a long line of Commission decisions, including Decision ("D.") 08-11-056, which established a fixed indifference payment schedule for each investor-owned utility ("IOU") as a component of transitioning to a "cost-follows-contract" allocation. Integral to the "cost-follows-contract" methodology was the requirement for each IOU's customers to bear 100 percent of the costs associated with contracts allocated to their use. Since 2004, 100 percent of the costs of the Kern TSA have been allocated to SDG&E's customers.

Nevertheless, after almost ten years of treating the Kern TSA in this manner, SDG&E seeks to depart from this established approach, attempting, instead, to have most of these costs allocated to SCE's and Pacific Gas and Electric Company's ("PG&E's") customers. The basis for SDG&E's claim that costs should now be shared among the IOUs' customers is that the Sunrise PPA has expired. SDG&E never opposed the cost allocation methodology when it was receiving deliveries under the Sunrise PPA. Now that SDG&E is left with only costs and no benefits, it seeks to spread most of these costs among the other IOUs' customers. As explained herein, SDG&E should not be allowed to create for itself a free option, in order to keep any upside of the contract for itself while spreading any downside across all IOUs' customers. Nor should the other IOUs' customers be penalized for SDG&E's failure to raise alleged equity concerns under the Kern TSA in a timely manner.

SDG&E also bases its request to modify the long-established cost allocation methodology on Sunrise's alleged breach in refusing to accept reassignment of the Kern TSA upon expiration of the Sunrise PPA. However, this purported breach in no way justifies a departure from the Commission-adopted cost-allocation methodology, because SDG&E's obligation under the Kern TSA is still ongoing and because SDG&E can recover costs related to any purported breach through mitigation and/or litigation.

SCE is surprised to be in front of the Commission again in a dispute over the method for allocating DWR costs, especially given the clear Commission precedent developed with extensive IOU input that established, once and for all, how these costs should be allocated and foreclosed the re-look opportunity that SDG&E now requests.[1] Every time the DWR cost allocation methodology is revisited on grounds of "equity," SCE's customers stand to lose.

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1 *See* D.05-06-060 at 6 (establishing a permanent allocation methodology for the DWR revenue requirement in order to eliminate the annual litigation process).

Because SCE has no DWR contracts left in its portfolio, there is only potential downside for SCE's customers when another IOU seeks to change the Commission's "permanent" allocation methodology. Moreover, SCE's customers have endured a significant disproportionate burden of DWR's costs in the past: SCE's customers were allocated 47.5% of the unavoidable DWR contract costs in D.05-06-060 even though they represented approximately one-third of the net load requirements DWR was seeking to serve through its long-term contract commitments. SCE's customers have also been allocated the servicing of approximately $532 million more of DWR bonds than they received in bond proceeds. Although the extent of the disparity in the bond charge allocation was an order of magnitude greater than the costs at issue here, the Commission declined to grant SCE's request to revisit the bond charge allocation, opting for consistency in application over an equitable adjustment of the bond charge.[2] Accordingly, SCE rejects SDG&E's "equity" argument, and so should the Commission.

In fact, if SDG&E wants to re-look at the cost allocation with respect to the Kern TSA issue, there are a number of other issues that SCE's customers would like to re-examine as well. In other words, if the Commission agrees to reevaluate the allocation for the sake of equity, it should do so in a deliberate, careful and thorough fashion and look at all potential issues related to shifting of DWR's power and bond costs among the IOUs' customers since the effective date of the "permanent" allocation methodology in D.05-06-060. The Commission should not allow SDG&E to cherry-pick and reopen the single issue of allocation of the Kern TSA costs, and foreclose the other IOUs from having their own issues re-examined. SCE submits that rather than reopening these issues, the Commission should opt for certainty by not modifying the adopted cost allocation methodology.

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2 *See* D.04-05-054, Opinion Denying Petition to Modify Decision 04-01-028 (dated May 27, 2004).

II.

STATEMENT OF FACTS

A. Through Several Commission Decisions, a Clear Methodology Has Been Adopted and Applied to Allocate DWR Contract Costs and Benefits to IOUs' Customers

During California's 2000-2001 energy crisis, Assembly Bill 1 from the First Extraordinary Session ("AB1X") authorized DWR to become the electric power supplier of last resort for retail customers of the IOUs. DWR supplied the "net short," i.e., the difference between the IOUs' demand and the power supplied under existing power contracts of the IOU or generated by an IOU facility. To meet this excess demand, DWR entered into a series of contracts for the procurement of electric power to serve customers in the service territories of the IOUs. AB1X authorized DWR to recover such power costs from IOUs' customers through electric charges established by the Commission. Through various Commission proceedings and decisions, the Commission has adopted and applied several different methods to allocate DWR power charges, culminating, once and for all, in the current "cost-follows-contract" methodology for so called "avoidable costs."

D.02-09-053 determined that avoidable DWR contract costs should be allocated 100 percent to the IOU with control of the dispatch of the avoidable energy.[3] A separate decision, D.02-12-045, allocated all non-avoidable DWR contract costs *pro rata* to each IOU based on each IOU's share of the total 2003 DWR delivered energy. The cost allocation percentages were 46.16% for PG&E, 44.49% for SCE, and 9.35% for SDG&E.

On June 30, 2005, the Commission issued D.05-06-060, which maintained the so called cost-follows-contract method for avoidable contract costs adopted in D.02-09-053 and

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[3] D.02-09-053 at 5 (requiring each IOU to "perform all of the day-to-day scheduling, dispatch and administrative functions for the DWR contracts allocated to their portfolios, just as they will perform those functions for their existing resources and new procurements," while leaving "[l]egal title, financial reporting and responsibility for the payment of contract-related bills" to DWR).

established fixed percentage allocators for unavoidable contract costs. The Commission established this permanent allocation in D.05-06-060 on the grounds that "[a]nnual litigation of the allocation methodology is not an efficient use of the parties' or the Commission's time and resources…."[4] PG&E's, SCE's and SDG&E's fixed percentage allocators were set at 42.2%, 47.5%, and 10.3%, respectively. While SCE's customers were allocated 47.5% of the unavoidable DWR contract costs in D.05-06-060, its customers represented approximately one-third of the net load requirements DWR was seeking to serve through its long-term contract commitments.

On November 21, 2008, D.08-11-056 was issued to allow for novation of the DWR contracts. To achieve this novation, D.08-11-056 established a cost-follows-contract methodology for all costs and authorized so called "indifference payments" among IOUs to ensure that an IOU would be indifferent on a forecast basis relative to D.05-06-060 to accepting full cost responsibility under each contract allocated to its customers. The indifference payment calculations done pursuant to D.08-11-056 and reflected in the IOUs' jointly proposed schedule were intended to establish the indifference payments, once and for all, and then allow changes in contract costs and benefits to follow the contract (i.e., be allocated 100 percent to the IOU's customers to which the contract was allocated) going forward.

B. Since 2004, the Costs and Benefits of the Sunrise PPA (Including the Costs Associated with the Kern TSA) Have Always Been Allocated to SDG&E's Customers

On December 31, 2002, DWR and Sunrise Power Company, LLC ("Sunrise") entered into an Amended and Restated Master Power Purchase and Sale Agreement and an Amended and Restated Confirmation Agreement (collectively, the "Sunrise PPA"). On August 28, 2003, Kern River and DWR entered into the Kern TSA, whereby DWR agreed to pay Kern River for

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4 D.05-06-060 at 6.

the use of Kern River's gas pipeline. The Kern TSA expires by its terms in 2018. Contemporaneously therewith, DWR and Sunrise entered into a separate Agreement on Reassignment of Firm Transportation Service Agreement ("Reassignment Agreement"), which obligated DWR to assign its rights in the Kern TSA to Sunrise at the end of the Sunrise PPA term in 2012.

SDG&E has always controlled the dispatch of the Sunrise PPA pursuant to D.02-09-053. In 2003, the Kern TSA costs were allocated *pro rata* to each IOU's customers based on each IOU's share of the total 2003 DWR delivered energy.[5] Since 2004, the Kern TSA costs have been allocated 100 percent to SDG&E's customers as avoidable contract costs. SDG&E never sought indifference payments for assuming the Kern TSA costs associated with the Sunrise PPA; nor did SDG&E ever object to receiving 100 percent of the costs and benefits[6] in accordance with the cost-follows-contract methodology and D.08-11-056.

C. <u>The Sunrise PPA Expired in 2012, Leaving Only Costs Related to the Kern TSA to be Allocated</u>

On June 30, 2012, the Sunrise PPA expired according to its terms.[7] However, the Kern TSA, which expires in 2018, remains in effect and requires DWR to continue to pay Kern River for reserved gas transportation capacity on Kern River's pipeline.

The Reassignment Agreement requires DWR to use "best efforts" to assign the Kern TSA back to Sunrise upon expiration of the Sunrise PPA.[8] Pursuant to the Reassignment Agreement (and the Kern TSA), any reassignment is conditioned on Kern River's consent.[9] The

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5 DWR Response to SDG&E Data Request No. 1, Question # 3 at 5 (Dated December 14, 2012).

6 It appears that the proceeds of two settlements in 2008 and 2010, respectively, were allocated among the IOUs. *See id.*

7 *See* DWR Memorandum to the Honorable Michel P. Florio, Assigned Commissioner, and the Honorable Seaneen M. Wilson, Administrative Law Judge, Re Rulemaking No. 11-03-006 – Comments of San Diego Gas & Electric, at 2 (dated October 26, 2012) ("DWR October 26 Memorandum").

8 *See* Reassignment Agreement, Section 1 at 2.

9 *Id.,* Section 2 at 2.

Reassignment Agreement does not contain language obligating Sunrise to accept this assignment or Kern River to provide its consent to such reassignment. Moreover, the Reassignment Agreement provides that:

> In the event that at the end of the term of the [Sunrise PPA], Sunrise does not meet Kern River's creditworthiness standards or cannot supply adequate security assurances to Kern River or, if Kern River rightfully withholds its consent for any other reason, CDWR hereby agrees and covenants to Sunrise that CDWR shall use its best efforts to promptly assign the [Kern TSA] to any affiliate or successor entity of Sunrise that would be acceptable to Kern River.[10]

Sunrise has refused to take over the Kern TSA obligation without DWR continuing to remain ultimately responsible for the cost.[11] Kern River has asserted that Sunrise is not creditworthy under its tariff.[12] Edison Mission Energy and Chevron (affiliates of Sunrise) have asserted in writing that they have no legal obligation to DWR.[13]

D. <u>SDG&E Now Seeks to Have the Kern TSA Costs Allocated Among the IOUs' Customers</u>

On August 2, 2012, DWR issued its original Determination of Revenue Requirement for 2013. This version did not include any Kern TSA costs because DWR "anticipated that Sunrise would have taken reassignment of the TSA under the Reassignment Agreement."[14]

At the September 4, 2012 Prehearing Conference ("PHC") in this proceeding, no party raised any objection to the Revised Determination. SDG&E's lawyer requested an expedited schedule, stating "I don't think any of the parties are anticipating that there would be controversies associated with this particular proceeding."[15]

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10 *Id.*

11 *See* DWR Response to SDG&E Data Request No. 1, Question # 4(c) at 6 (Dated December 14, 2012).

12 *Id.*

13 *Id.*

14 *See* DWR Memorandum to the Honorable Michel P. Florio, Assigned Commissioner, and the Honorable Seaneen M. Wilson, Administrative Law Judge, Re Rulemaking No. 11-03-006, at 1 (dated November 26, 2012).

15 Transcript of 2013 DWR Prehearing Conference at 24.

DWR included the Kern TSA costs for 2013 ($14.594 million) in its Proposed Revised 2013 Determination issued on October 4, 2012 and its Revised 2013 Revenue Requirement provided to the Commission on October 15, 2012, allocating, pursuant to prior Commission decisions, all the costs associated with the Kern TSA to SDG&E's customers.

On October 19, 2012, after assuming the costs and benefits of the Kern TSA for nine straight years, SDG&E filed comments on DWR's revised revenue requirement reserving rights with respect to the Kern TSA cost allocation.[16] On November 15, 2012, SDG&E filed opening comments on the proposed decision,[17] questioning the allocation of costs related to the Kern TSA.

E. The Commission Has Chosen Not to Revise Prior Decisions Relating to DWR Bond Charges and Bond Proceeds

The Commission rejected SCE's attempt to reopen the cost allocation set forth in D. 04-01-028, which required SCE's customers to pay for 44.4% of the cost of certain DWR bond charges, even though they were only allocated 37.8% of the bond proceeds. PG&E's customers were required to pay for 45% of the cost of the DWR bonds, but were allocated 50.6% of the bond proceeds. SDG&E's customers were required to pay 10.6% of the cost of the DWR bonds, but were allocated 11.6% of the bond proceeds. SCE filed a petition for modification to revise the bond charge allocation on equitable grounds. The Commission denied SCE's request in order to promote certainty of the cost allocation methodology. This allocation resulted in SCE's customers paying for approximately $532 million more than they received in bond proceeds.

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16 *See generally,* Comments of SDG&E, and Reservation of Rights re Revision to the Determination of Revenue Requirement by the California Department of Water Resources (dated October 19, 2012).

17 *See generally,* Opening Comments of SDG&E on Proposed Decision of Administrative Law Judge Seaneen Wilson at 3-6 (dated November 15, 2012).

III.

ARGUMENT

A. In Order to Remain Consistent With the Long Line of Commission Decisions in this Proceeding Going Back to 2004, the Kern TSA Costs Should Continue to be Allocated According to the Cost-Follows-Contract Methodology

As explained in Section II.A, above, a long line of Commission decisions in this proceeding have assigned contract administration responsibility to the IOU with dispatch capability and have consistently required that IOU to assume all avoidable costs associated with the contract. Pursuant to these decisions, the Kern TSA costs have been allocated 100 percent to SDG&E's customers as avoidable costs since 2004. Moreover, the Commission has made clear that the allocation of contract responsibility should not be revisited on a case-by-case or annual basis.[18] Accordingly, the Kern TSA costs must be allocated 100 percent to SDG&E's customers in accordance with the long-line of Commission precedent. Any other allocation of these costs would be inconsistent with past precedent and the Commission's clear intent to avoid revisiting prior allocation methodologies.

B. A Departure From this Well-Established Cost Allocation Methodology is Especially Unwarranted Given SDG&E's Failure to Raise this Issue in a Timely Manner

SDG&E had the chance to raise the Kern TSA costs issue when the IOUs engaged in the process of calculating indifference payments, but failed to do so. Pursuant to D.08-11-056, the IOUs established and agreed to comply with a schedule of indifference payments to ensure that each IOU would be willing to <u>assume full responsibility over its contracts</u> and assume <u>all the costs</u> and benefits related thereto. The calculations done pursuant to D.08-11-056 and reflected

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[18] *See* D.05-06-060 at 6 (establishing a permanent allocation methodology for the DWR revenue requirement in order to eliminate the annual litigation process). *See also* D.08-11-056 at 59 (reiterating the Commission's policy against revisiting the cost-follows-contract allocation methodology adopted in D.05-06-060).

in the IOUs' jointly proposed schedule were intended to establish the indifference payments once and for all, and then allow changes in contract costs and benefits to follow the contract going forward. That schedule assigned all costs associated with the Sunrise PPA, including the Kern TSA costs, to SDG&E's customers. Each IOU expressed approval of the calculation before the indifference payment schedule was submitted to the Commission through a joint IOU advice letter and was subsequently approved by the Commission's Energy Division.[19] SDG&E never objected to the schedule of indifference payments. Nor did SDG&E ever suggest that the costs and benefits associated with the Kern TSA should be considered "unavoidable" or otherwise entitling SDG&E to indifference payments.

While SCE can only speculate as to why SDG&E would have failed to request this change if it deemed the cost-follows-contract methodology inappropriate, no reason justifies changing the cost allocation approach at this juncture. If SDG&E intentionally chose not to object to the cost-follows-contract methodology because it stood to benefit from favorable terms of the Kern TSA, SDG&E should not now be able to spread the remaining costs among all the IOUs' customers, while keeping all the past benefits for its customers. Nor should SDG&E's attempt to create a free option for a post-2012 Kern TSA be sanctioned. In essence, SDG&E has created an opportunity to amass significant benefits for its customers, in the event the post-2012 Kern TSA were profitable, while spreading the costs of the post-2012 Kern TSA among all three IOUs' customers if it turns out to be unprofitable. SCE suspects that if SDG&E were now sitting on an economic Kern TSA, SDG&E would not be attempting to spread the net benefits among all three IOUs' customers.

Even if SDG&E was simply unaware of the provisions of the Sunrise contracts allocated to it, which clearly extended the Kern TSA beyond the term of the Sunrise PPA and did not include any assurance that DWR would be able to reassign the Kern TSA at the end of the Sunrise PPA term, the other IOUs' customers should not now have to assume these costs. These

[19] PG&E Advice 3384-E, SCE Advice 2304-E and SDG&E Advice 2051-E at p. 2.

costs are associated with SDG&E's failure to exercise due diligence in familiarizing itself with the terms of and risks associated with the Kern TSA. It is possible that had SDG&E identified and raised this issue, the costs could have been mitigated or avoided altogether. Unlike SDG&E, SCE had no control over the administration of the Kern TSA; it was therefore in no position to proactively mitigate the risk and potential costs related to the Kern TSA that are now in dispute. While SDG&E may attempt to paint a picture of itself as a victim of unforeseen circumstances, these circumstances were, in fact, foreseeable. It should have been apparent from the Kern TSA, which extends through 2018, and the Reassignment Agreement, which is conditioned on Kern River's consent, that these post-2012 Kern TSA costs could arise and were potentially able to be avoided.

C. **The Fact that the Sunrise PPA has Expired Does Not Justify Changing the Cost Allocation Methodology**

SDG&E asserts that "the Sunrise Power contract has expired, undermining any *ab initio* basis for the assertion that there is a contract for post-2012 Kern River GT costs to 'follow.'"[20] By focusing on the phrase "cost follows contract," SDG&E misconstrues its meaning. As explained in D.08-11-056, "cost follows contract" has always meant that "contract costs would be allocated to the customers of the IOU that administers the subject contract."[21] Accordingly, the costs under the "cost-follows-contract" methodology do not actually follow the contract, rather they follow the IOU that has assumed responsibility for administering the contract, in this case, SDG&E.

SDG&E seeks to avoid paying the costs associated with the Sunrise PPA (specifically, the Kern TSA costs), now that the Sunrise PPA (and its benefits) have terminated. Yet D.08-11-056 provides that "[t]he IOU that administers a given contract thereby receives whatever benefits

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20 Opening Comments of SDG&E on Proposed Decision of Administrative Law Judge Seaneen Wilson at 5 (dated November 15, 2012).

21 *See* D.08-11-056 at 57.

that contract offers and is responsible for the avoidable costs associated with it."[22] The expiration of the Sunrise PPA has not changed the fact that SDG&E is still the IOU that administers the Sunrise PPA and should still be held responsible for the ongoing costs associated with it. These ongoing costs include Kern TSA costs, which have been classified as avoidable costs assigned to SDG&E's customers for nine years straight. SDG&E should not be allowed to receive "whatever benefits" offered by the Sunrise PPA, and by extension the Kern TSA, and then avoid its responsibility for the residual costs associated with it. Therefore, regardless of the expiration of the Sunrise PPA, SDG&E should still be responsible for the costs associated with the Kern TSA costs.

D. SDG&E's Assertion of Breach of the Kern TSA Does Not Support a Change in the Allocation of the Kern TSA Costs

SDG&E argues that the Kern TSA raises "an issue in equity" as to "how costs arising from a putative breach of contract should be allocated."[23] The "putative breach" to which SDG&E is referring is the claim made by DWR that "Sunrise has failed to comply with its obligations to take back the [Kern] TSA in accordance with the [Reassignment Agreement] dated September 5, 2003."[24] However, the Reassignment Agreement only obligates DWR to assign the TSA back to Sunrise and allows Kern River to rightfully withhold its consent.[25] Because this assignment has not yet occurred, there exists an ongoing obligation under the terms of the Kern TSA. Accordingly, SDG&E's/DWR's claim of "breach" should in no way factor into the Commission's cost allocation determination.

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22 *See* D.08-11-056 at 56.

23 Opening Comments of SDG&E on Proposed Decision of Administrative Law Judge Seaneen Wilson at 5 (dated November 15, 2012) (emphasis added).

24 *See* DWR October 26 Memorandum at 2.

25 Reassignment Agreement, Section 1 at 2.

E. **Even Assuming that Sunrise has Breached the Kern TSA, the Cost-Follows-Contract Methodology Still Applies**

Assuming, *arguendo*, that Sunrise has breached the Kern TSA, there is no reason to allocate the costs and benefits of the Kern TSA in a manner other than cost-follows-contract. In the event of a breach, DWR will have the opportunity to recover its costs through litigation and any proceeds can be allocated to SDG&E's customers. Moreover, DWR will be able to mitigate its damages, for example, by remarketing its rights under the Kern TSA. In fact, DWR and SDG&E may be able to recover more through remarketing than they would under the Sunrise PPA and in that event, SCE's customers would have no claim to the excess revenue. Furthermore, DWR and SDG&E have a direct and long-standing relationship with Sunrise and Kern River and have control over the administration of the Kern TSA. It would therefore be ineffective to spread the costs over all three IOUs' customers, given that SCE and PG&E would not have the same ability as DWR/SDG&E to resolve the contractual dispute or mitigate contract damages. Indeed, the ability and incentive to appropriately administer DWR contracts is what gave rise to the Commission's "cost-follows-contract" cost allocation methodology, including D.08-11-056.

F. **The Commission Should Not Revisit the Cost Allocation Methodology for the Kern TSA Costs, Unless it is Willing to Revisit All Past Cost Allocations**

In 2004, despite SCE establishing that its customers were required to pay for 44.4% of DWR bond charges, even though SCE only received 37.8% of the cash available from the bond sale (resulting in SCE's customers paying more than a half a billion dollars more than the benefit they received over the life of the bonds), the Commission declined to grant SCE's Petition for Modification of the DWR bond charge decision, opting for certainty for California ratepayers over adjusting the inequitable bond charge and proceed allocations.[26] Given that the

[26] *See* D.04-05-054, Opinion Denying Petition to Modify Decision 04-01-028 (dated May 27, 2004).

Commission denied SCE's previous request to revisit that allocation issue, which SCE brought to the Commission's attention immediately, the Commission should certainly decline to re-open the Kern TSA issue SDG&E raises nine years after-the-fact. Notably, when PG&E raised an allocation issue related to the DWR 2012 Revenue Requirement Determination, SDG&E warned that "'reopening' past allocations of the Department's revenue requirements or assignments of costs would be invited by the adoption of PG&E's view."[27] To avoid opening the floodgates to piecemeal revisions of permanent allocation methods based on "equity," the Commission should reject SDG&E's request.

Alternatively, if the Commission grants SDG&E's request to re-examine the allocation of the Kern TSA, it should also re-examine the prior allocation of DWR bond charges and proceeds. These charges were never factored into the indifference payments and SCE believes they are well above any comparable charges that the other IOUs' customers have paid due to their respective allocated contracts. If the Commission chooses to re-open the indifference payment calculation with respect to the Kern TSA, it should be prepared to re-open all issues of claimed inequity associated with the allocation of DWR's revenue requirement since 2001. In fact, there may be numerous errors or forecasts for the future that can be corrected in hindsight. If the Commission determines that now is the time to consider these adjustments, it should do so thoroughly and carefully, and not on a single, limited issue raised by SDG&E.

[27] SDG&E Opening Brief related to DWR 2012 Revenue Requirement at 3 (dated September 22, 2011).

IV.

CONCLUSION

For the reasons stated above, the Commission should reject SDG&E's attempt to modify the long-standing cost allocation methodology with respect to the Kern TSA issue.

Respectfully submitted,

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