

Application No: R.10-05-006
Exhibit No.: SDG&E-2
Witnesses: Robert Anderson
Juancho Eekhout
James Magill
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 TESTIMONY
OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902 E)**

****PUBLIC VERSION****

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

July 1, 2011



TABLE OF CONTENTS

I. INTRODUCTION AND BACKGROUND..... 1

II. PURPOSE..... 2

**III. PROCUREMENT OF GHG-RELATED PRODUCTS
(Witness: Ryan Miller) 3**

**IV. PROCUREMENT RULES RELATING TO ONCE-THROUGH
COOLING ISSUES (Witness: Robert Anderson) 17**

**V. REFINEMENTS TO THE BID EVALUATION PROCESS;
WEIGHING COMPETING BIDS BETWEEN UTILITY-OWNED
GENERATION AND POWER PURCHASE AGREEMENTS
(Witness: Robert Anderson) 19**

**VI. REFINEMENTS TO THE EXISTING TIMELINES ASSOCIATED
WITH THE UTILITIES’ RFOS FOR RESOURCE ADEQUACY
PRODUCTS (Witness: Ryan Miller) 22**

**VII. PROCUREMENT OVERSIGHT RULES
(Witnesses: James Magill; Juancho Eekhout)..... 25**

WITNESS QUALIFICATIONS OF ROBERT ANDERSON 1

WITNESS QUALIFICATIONS OF JUANCHO EEKHOUT 2

WITNESS QUALIFICATIONS OF JAMES MAGILL 3

WITNESS QUALIFICATIONS OF RYAN MILLER..... 4

1 **PREPARED TRACK III TESTIMONY OF**
2 **SAN DIEGO GAS & ELECTRIC COMPANY**

3
4 **I. INTRODUCTION AND BACKGROUND**

5 In the *Administrative Law Judge’s Ruling Addressing Motion for Reconsideration,*
6 *Motion Regarding Track I Schedule, and Rules Track III Issues* issued June 13, 2010 (“ALJ
7 Ruling”), the Commission provided direction concerning certain Rules Track III issues to be
8 addressed concurrently with the System Track I schedule. The ALJ Ruling specifically
9 identified five Rules Track III issues and invited parties to make proposals regarding each in
10 testimony to be served concurrently with System Track 1 testimony. The five Rules Track III
11 issues enumerated in the ALJ Ruling are:

- 12 1) Utility procurement of greenhouse gas (“GHG”) related products;
13
14 2) Procurement rules relating to once-through cooling (“OTC”) issues;
15
16 3) Refinements to the bid evaluation process, particularly weighing competing bids between
17 utility-owned generation (“UOG”) and power purchase agreements (“PPAs”);
18
19 4) Refinements to the existing timelines associated with the utilities’ request for offers
20 (“RFOs”) for resource adequacy (“RA”) products; and
21
22 5) Procurement oversight rules, including the oversight responsibilities and authority of
23 various entities, including Independent Evaluators (“IEs”) and the Procurement Review
24 Group (“PRG”), and standards of conduct applicable to the IOUs and their employees.^{1/}

25 The ALJ Ruling acknowledges that “it may be possible only to address some of these
26 issues in part, or to resolve certain threshold issues.”^{2/} It notes that while the preferred approach
27 would be to address these Rules Track III issues with the System Track I issues, it will consider

^{1/} ALJ Ruling, p. 6.

^{2/} *Id.* at pp. 7-8.

1 other procedural approaches to addressing these issues.^{3/} In order to assist the Commission to
2 determine the optimal procedural approach for addressing Rules Track III issues, the ALJ Ruling
3 directs parties to clearly specify in their testimony if their proposals are:

- 4 1) Specific proposals for the Commission to approve by the end of this calendar year on
5 these issues;
- 6
7 2) General policy recommendations that the Commission should consider, on an ongoing
8 basis, when making determinations on these issues; or
9
- 10 3) Proposals for future Commission processes to address these issues.^{4/}

11 In accordance with the Commission’s direction, SDG&E sets forth below its proposals
12 related to the five Rules Track III issues identified in the ALJ Ruling. It emphasizes that the
13 only Rules Track III issue that requires resolution by the end of this calendar year is the IOUs’
14 proposals regarding procurement of GHG related products. As discussed in more detail herein,
15 the remaining Rules Track III issues should be considered on an ongoing basis or in a future
16 Commission proceeding. Given the extremely aggressive timeline in place for resolving Track I
17 and Track II issues, the Commission’s focus in Track III should be limited to procurement
18 authority that is required to allow the IOUs to comply with requirements adopted by the
19 California Air Resources Board (“ARB”) pursuant to Assembly Bill (“AB”) 32.^{5/}

20 **II. PURPOSE**

21 The purpose of this testimony is to describe SDG&E’s proposals related to the five Rules
22 Track III issues identified in the ALJ Ruling, and to briefly address the proposed shutdown of
23 nuclear plants included in the testimony submitted on behalf of Women’s Energy Matters
24 (“WEM”) in Track II.^{6/}

^{3/} *Id.* at p. 7.

^{4/} *Id.* at pp. 6-7.

^{5/} Assembly Bill (“AB”) 32 (Stats. 2006, Ch. 488).

^{6/} Women’s Energy Matters/George, Track II Exh. 800.

1 **III. PROCUREMENT OF GHG-RELATED PRODUCTS (Witness: Ryan Miller)**

2 **A. Introduction**

3 AB 32 establishes a goal of reducing California’s GHG emissions to the 1990 level by
4 2020, and granted ARB broad authority to regulate GHG emissions to reach this target. ARB’s
5 Scoping Plan includes a recommendation that California adopt a portfolio of emissions reduction
6 measures, including a California GHG cap-and-trade program that can link with other programs
7 to create a regional market system.^{7/}

8 In October, 2010, ARB released its *Proposed Regulation to Implement the California*
9 *Cap-and-Trade Program*, which was approved by its Board in December, 2010.^{8/} Appendix A
10 of that document contains ARB’s Proposed Regulation Order.^{9/} The proposed ARB regulations
11 would create a GHG emissions allowance cap-and-trade system, with compliance obligations in
12 the electricity sector applicable to “first deliverers of electricity.” Generally, first deliverers of
13 electricity are electricity generators inside California that emit more than 25,000 metric tons of
14 GHGs and importers of electricity from outside of California. The proposed regulations require
15 that first deliverers of electricity, except publicly-owned utilities, purchase all of the allowances
16 and offsets required to meet their compliance obligations. The proposed ARB regulations,
17 including the GHG emissions allowance cap-and-trade system (the “Cap-and-Trade Program”),
18 are currently scheduled to become effective in January, 2012.^{10/}

^{7/} ARB Resolution 10-42 at 3.

^{8/} The regulation has not yet been finalized and submitted to the Office of Administrative Law for approval.

^{9/} The ARB documents referenced are available at:
<http://www.arb.ca.gov/regact/2010/capandtrade10/capandtrade10.htm>.

^{10/} In testimony before the Senate Select Committee on Environment Economy and Climate Change on June 29, 2011, ARB Chairman, Mary D. Nichols, indicated that the start of compliance for the Cap-and-Trade Program could be delayed until 2013. See <http://www.arb.ca.gov/cc/testimony/testimony.pdf>

1 With implementation of the Cap-and-Trade Program, SDG&E will face GHG cost
2 exposure for its UOG, including the Palomar and El Dorado combined cycle generation facilities
3 and the peaking generation located at the Miramar facility. In addition, SDG&E will have GHG
4 obligations for imported electricity purchased under existing long-term contracts and spot market
5 purchases. Lastly, SDG&E will have contractual obligations for GHG compliance responsibility
6 for some bilateral contracts.

7 **B. GHG Products Procurement and Hedging Proposal**

8 SDG&E describes herein its GHG product procurement and hedging strategy. Its GHG
9 procurement plan, when approved, will be incorporated into SDG&E's authorized Long Term
10 Procurement Plan ("LTPP") and, as such, would become the upfront guidelines envisioned in
11 Assembly Bill ("AB") 57 that will guide SDG&E's future procurement of GHG products.^{11/} As
12 noted above, the Cap-and-Trade Program is currently scheduled to become effective in January,
13 2012. **Accordingly, SDG&E submits this GHG product procurement and hedging proposal**
14 **as a specific proposal that must be approved by the Commission by the end of this calendar**
15 **year.**

16 **C. Compliance Obligation**

17 *(i) Requirements*

18 During the first two years of a compliance period, SDG&E and all participants in the
19 GHG Cap-and-Trade Programs must surrender compliance instruments covering 30% of their
20 respective emissions for that year. At the end of the third year in a compliance period, SDG&E
21 must surrender the balance of compliance instruments equal to the remainder of its actual GHG
22 emissions for the full compliance period.

^{11/} See Assembly Bill ("AB") 57, Sec. 2, §§ 454.5(c)(3) and 454.5(d)(2) (Stats. 2002, Ch. 835).

1 (ii) *Compliance Periods*

2 Compliance periods are currently established as follows:

- 3 • 2012-2014 (electricity and industrial only)
- 4 • 2015-2017 (fuel providers added)
- 5 • 2018-2020

6 (iii) *Allowance Accounts*

7 SDG&E will have three accounts containing its GHG allowances:

- 8 • Limited Use Holding Account: The Limited Use Holding Account will hold
9 allowances allocated to SDG&E by ARB that can only be sold in the auction.
- 10 • Holding Account: Allowances and offsets acquired by SDG&E go into its Holding
11 Account. Allowances are transferred from the Holding Account into SDG&E's
12 Compliance Account to meet its GHG obligations.
- 13 • Compliance Account: Allowances in the Compliance Account are "retired" and can
14 no longer be traded. SDG&E must meet its obligation for each three-year
15 Compliance Period by acquiring allowances and offsets and retiring them, with at
16 least 30% of its annual obligation retired in each of the first two years.

17 Any additional allowances remaining in SDG&E's Holding Account after its GHG
18 emissions obligations have been met can be sold to other parties or "banked" for future use – *i.e.*,
19 unused allowances are carried forward to the next compliance period for use for future
20 compliance.

21 All cost associated with SDG&E's compliance with GHG requirements will be included
22 and recovered in SDG&E's Energy Resource Recovery Account ("ERRA") in a manner identical
23 to other procurement costs. As with other procurement-related costs, forecasts of SDG&E's

1 GHG compliance costs will be included in SDG&E’s annual ERRR forecast filing with actual
2 compliance cost tracked in comparison to the approved forecast costs on a monthly basis.

3 **D. Products for meeting GHG Obligations**

4 ARB has identified two types of tradable instruments that it may issue: (i) California
5 GHG Emission Allowances (allowances); and (ii) California Offset Credits (offsets). These
6 compliance instruments are matched against emissions to satisfy a surrender obligation.

7 *(i) Allowances*

8 Allowances will effectively serve as permits to emit GHGs. All allowances are
9 distributed by ARB to compliance entities or placed into the auction to be procured by entities.

10 ARB anticipates there will be four auctions per year where entities can bid for and acquire
11 allowances. In addition, SDG&E expects one or more exchanges to develop to allow for trading
12 of allowances between auctions.

13 SDG&E will receive free allowances through the life of the Cap-and-Trade Program, but
14 the allowances distributed to SDG&E, like other California IOUs, must be consigned from the
15 Limited Use Holding Account to be sold in the auction, and SDG&E must use all of the proceeds
16 to benefit its ratepayers.

17 *(ii) Offsets*

18 An offset is a credit for a verified emission reduction from a source outside the Cap-and-
19 Trade Program, with the intention of reducing emissions in sectors not captured in the Cap-and-
20 Trade Program. These offsets can be in California or in North America in non-covered sectors
21 such as agriculture, forestry, and consumer products. ARB will develop the procedures to
22 demonstrate verified emission reductions; once approved, an offset can be used in lieu of
23 allowances.

1 There currently exist four compliance offset protocols included within the Cap-and-Trade
2 Program.

- 3 1. Livestock Manure (Digester) Projects Protocol
- 4 2. Urban Forest Projects Protocol
- 5 3. U.S. Ozone Depleting Substances Projects Protocol
- 6 4. U.S. Forest Projects Protocol

7 SDG&E anticipates that ARB may develop at least four additional protocols before
8 commencement of the Cap-and-Trade Program.

9 ARB has set a limit of 8% of a participating entity's GHG obligation that can be met with
10 offsets.

11 **E. Products for Hedging and Procuring GHG Obligations**

12 *(i) Future Vintage Allowances*

13 Future vintage allowances are expected to be auctioned in limited quantities in the ARB
14 auctions. For example, some 2015 allowances may be auctioned in 2014. These allowances
15 could not be used for compliance before 2015.

16 *(ii) Futures*

17 Futures for GHGs are standardized contracts that obligate the seller to sell either
18 allowances or offsets. Because these contracts are standardized, they can be traded on exchanges
19 and can be converted to allowances or offsets in the future. ARB is not developing these
20 products, so it will depend on exchanges to develop them in response to compliance entities'
21 need to hedge future obligations.

22 *(iii) Forwards*

1 Forwards for GHGs are also obligations to sell at a future date, but the contracts are not
2 as standardized and would not be traded on exchanges. Forwards could be traded as financial
3 obligations that would settle against an index, or as an obligation to actually deliver allowances.
4 SDG&E expects the markets for actual allowances and offsets to be liquid enough to support
5 SDG&E's procurement needs, but if the financially settled swaps become the more actively
6 traded market, then SDG&E may consider using financial swaps to protect its exposure to
7 potentially volatile GHG prices.

8 *(iv) Options*

9 Options can be either calls or puts. Calls give the buyer the option to buy one allowances
10 or offsets at a future date for a certain price. A put would give the buyer the right to sell at a
11 future date. Calls and puts could potentially be used together to create a collar, where a price
12 range could be locked in by purchasing a call and selling a put. Because of the characteristics of
13 the ARB GHG market (*e.g.*, reserve price and the Price Containment Reserve that limits upward
14 price exposure) as well as currently unknown volatility in the market, it is expected that options
15 may be slow to develop.

16 If and when options develop into a liquid market, SDG&E may use options to protect
17 ratepayers from future price moves without actually trading allowances or offsets.

18 **F. Transaction Methods**

19 *(i) Auction*

20 Absent a delay in commencement of the Cap-and-Trade program, it is expected that ARB
21 will begin auctions for allowances in February 2012; auctions are to be held quarterly after
22 that.^{12/} Allowances sold in the auction may come from: (i) allowances held by entities; (ii)

^{12/} Should the schedule for auctions be revised or supplemented, SDG&E will adjust its schedule consistent with the schedule revisions.

1 remaining allowances not allocated by ARB; and (iii) allowances budgeted for future compliance
2 periods. 2% of allowances budgeted for the second compliance period will be auctioned in the
3 first compliance period, and 2% of the allowances budgeted for the third compliance period will
4 be auctioned in second. SDG&E, as well as all covered entities, can purchase a maximum of
5 10% of the available allowances at each auction.

6 Auction bidders will submit sealed bids. The highest bids will be cleared first, continuing
7 to the next lowest bid until the demand for the accepted bids have been met or all the allowances
8 have been sold. The price for all allowances purchased in the auction will be the lowest accepted
9 bid. No bids will be accepted below a reserve price, which ARB has set at \$10/MTCO₂e for
10 2012. This reserve price will increase annually by 5% plus inflation as measured by the
11 percentage change in the consumer price index.

12 To assure the availability of allowances, ARB will maintain a reserve of allowances to be
13 sold three weeks after each auction. For the first year, the reserves will be made available in
14 three tiers: \$40, \$45, and \$50 (each of the prices of the three tiers will increase by 5% plus
15 inflation). The participants in the reserve auction would submit volumes in each tier. The
16 reserves will be sold and the bidders in each tier will be awarded the bid volume, unless the
17 volume of the tier is exceeded, in which case the allowances would be prorated amongst the
18 bidders.

19 At this point, it is not clear what would result if all three tiers of the reserve auction were
20 to be exhausted. As the rules for this event become clarified, updates to SDG&E's procurement
21 plan may be required.

1 The reserve price and Price Containment Reserve established by ARB effectively create a
 2 floor and a cap for the price of allowances, starting at \$10 floor and \$40 cap, and increasing each
 3 year. The illustrative chart below captures the expected price range for the auction.

4 **TABLE 1**

| Year | Price Floor | Price Ceiling | Price Containment Reserve | | |
|---------------------------|-------------|---------------|---------------------------|----------|----------|
| | | | Tier 1 | Tier 2 | Tier 3 |
| 2012 | \$ 10.00 | \$ 40.00 | \$ 40.00 | \$ 45.00 | \$ 50.00 |
| 2013 | \$ 10.70 | \$ 42.80 | \$ 42.80 | \$ 48.15 | \$ 53.50 |
| 2014 | \$ 11.45 | \$ 45.80 | \$ 45.80 | \$ 51.52 | \$ 57.25 |
| 2015 | \$ 12.25 | \$ 49.00 | \$ 49.00 | \$ 55.13 | \$ 61.25 |
| 2016 | \$ 13.11 | \$ 52.43 | \$ 52.43 | \$ 58.99 | \$ 65.54 |
| 2017 | \$ 14.03 | \$ 56.10 | \$ 56.10 | \$ 63.11 | \$ 70.13 |
| 2018 | \$ 15.01 | \$ 60.03 | \$ 60.03 | \$ 67.53 | \$ 75.04 |
| 2019 | \$ 16.06 | \$ 64.23 | \$ 64.23 | \$ 72.26 | \$ 80.29 |
| 2020 | \$ 17.18 | \$ 68.73 | \$ 68.73 | \$ 77.32 | \$ 85.91 |
| Escalation Rate of Prices | | | | | |
| Inflation | 2% | Plus | 5% | | |

5
 6 *(ii) Exchanges*

7 SDG&E expects exchanges to be developed to offer California GHG products.
 8 Exchanges may consist of existing exchanges such as the Intercontinental Commodity Exchange
 9 (“ICE”) or newly-created exchanges. Exchanges will operate as marketplaces for the trading of
 10 GHG products. Exchanges ensure fair and orderly trading and allow for transparent price
 11 information. Exchanges also provide protection against credit risk.

12 Exchanges act as an intermediary between buyer and seller, effectively becoming the
 13 counterparty for the transaction. This is the case for transactions executed through the exchange,
 14 as well as for transactions executed over-the-counter and then cleared through the exchange.
 15 The exchange alleviates the need to extend credit and establish master trading agreements with
 16 individual counterparties, thus increasing the pool of potential counterparties. Thus, the ability

1 to clear products through exchanges increases SDG&E's options in the execution of its GHG
2 allowance strategy.

3 SDG&E is aware of several exchanges that are working to finalize their infrastructures to
4 be ready for commencement of the Cap-and-Trade Program. To the extent these exchanges
5 become operational and develop into viable and liquid trading marketplaces, SDG&E may elect
6 to use one or more of these exchanges to buy or sell allowances.

7 *(iii) Brokers*

8 Brokers are the manual equivalent of electronic exchanges in that brokers have access to
9 a wide pool of buyers and sellers, and convey pricing information to all participants, thereby
10 creating price transparency similar to what exists on exchanges.

11 Brokers match up individual counterparties, who would need to have a master trading
12 agreement and credit provisions in place. In the event a broker transaction occurs between
13 parties that do not have a master trading agreement and credit provisions in place, the broker
14 transactions must be cleared through one of the exchanges.

15 *(iv) Direct Transactions*

16 SDG&E may wish to transact directly with counterparties, when the pricing is equivalent
17 or better than pricing offered through brokers or exchanges. This may be beneficial for non-
18 liquid products that may be hard to find through a broker or exchange, or to save the transaction
19 costs of using a broker. It is expected that offsets in the early years of the Cap-and-Trade
20 Program will be developed mostly through brokers and direct transactions, unless ARB
21 significantly alters its offset liability provisions.

1 Like transactions undertaken through a broker, direct transactions will require that a
2 master trading agreement and credit provision are in place. Otherwise, SDG&E will need to
3 clear the transaction at one of the exchanges.

4 **G. Tracking and Forecasting Emissions Needs**

5 SDG&E regularly forecasts its expected energy supply dispatch needs and will similarly
6 track expected GHG requirements when the GHG compliance program begins. SDG&E will
7 update its forecast internally prior to actual implementation of the GHG compliance program,
8 and will thereafter update its forecast quarterly or during market events and market volatility.
9 The latest GHG forecast will be incorporated into each annual ERRA forecast filing. Because
10 GHG emissions are a function of efficiency and fuel type, the formulas below provide adequate
11 approximations for all resources for which SDG&E will have GHG obligations, regardless of
12 whether the resource is utility-owned or not. The approximations will be trued-up after the end
13 of the year as part of the ARB mandatory reporting process.

14 The following list, for illustrative purposes, approximates GHG emissions per MWh from
15 electric generation

- 16 • Natural Gas – $0.0531 \text{ metric tons./MMBtu} \times \text{heat rate}/1000$
- 17 • Coal – $0.0980 \text{ MT/MMBtu} \times \text{heat rate}/1000$
- 18 • Fuel Oil – $0.076 \text{ MT/MMBtu} \times \text{heat rate}/1000$

19 Where the heat rate equals the btu/kWh measured at high heating value.

20 Also, emissions will need to be accounted for non unit-specific imports into California.
21 These imports will have an emissions rate assigned by ARB. ARB is developing specific rates
22 for BPA, Pacificorp and certain other asset-owning entities that sell system power, and a default

1 rate for all other unspecified power.^{13/} The emissions rates will be set before the start of the
2 compliance period and will remain the same for the entire compliance period.

3 The forecast for SDG&E's GHG emissions for the first compliance period can be found
4 in confidential Appendix A.

5 At an appropriate point during the compliance period, SDG&E will reconcile actual
6 generation with what was forecasted and adjust its forecasts as necessary.

7 *(i) GHG Allowance Tracking System*

8 SDG&E expects to add a GHG allowance tracking system, not only to track its expected
9 need for allowances, but also to track the allowances and offsets SDG&E has procured and the
10 resulting remaining open position. As with any other open position related to energy
11 procurement, SDG&E will monitor the forward GHG allowance prices and the impact to overall
12 procurement costs.

13 The options SDG&E is currently considering to enable this monitoring include adding a
14 new module to its current Energy Trading and Risk Management system, or having a separate
15 system either purchased or built in-house that will both track SDG&E's compliance positions
16 and aid with settlement functions.

17 **H. Energy Dispatch**

18 Implementation of the Cap-and-Trade Program will result in a modification of SDG&E's
19 decision-making for energy dispatch. The cost of GHG will be an added component to
20 generation costs of each resource in SDG&E's portfolio, including its owned generation,
21 generation from purchase power agreements and imported power. As the first deliverer of

^{13/} Firmed and shaped renewables and renewable energy certificates ("RECs") currently may not receive zero-GHG treatment. SDG&E has participated in the Joint Utility Group to have the zero-GHG attribute be applied to other imports with emissions rates less than the default factor.

1 electricity, SDG&E is also responsible for GHG costs for energy it purchases outside of
2 California and imports into the state. Accordingly, GHG costs will be included in decisions to
3 purchase energy outside of the state.

4 In addition, the additional costs will impact overall dispatch of SDG&E resources and
5 could impact the overall economics of generating facilities. For example, plants that have higher
6 GHG emissions compared to other generating units being bid into the CAISO market may be
7 less economic to run, and thus may be dispatched less often than they are today. GHG costs will
8 be reflected in SDG&E bids submitted to the CAISO, so that SDG&E's plants will only generate
9 when they are economic (including the GHG costs) compared to other resources bid into the
10 CAISO market.

11 Once a forward market for allowances develops, SDG&E will use the forward market
12 prices to calculate GHG costs. The forward costs will provide an indication of what SDG&E
13 expects to pay for the GHG emissions associated with generation. Until liquid forward prices are
14 available, the auction clearing prices will be used.

15 **I. Procurement Strategy**

16 Since the allowances allocated to SDG&E must be made available in the auction,
17 SDG&E will need to procure the allowances required to meet the GHG obligations associated
18 with the energy needs of its bundled customers. Much like its current energy hedging strategy,
19 SDG&E will follow an "incremental and over time" procurement program spread over the 3-year
20 compliance programs.^{14/} SDG&E's overall GHG emissions allowance procurement strategy
21 will continually be reviewed and updated periodically as required.

22 *(i) Product Mix*

^{14/} See SDG&E 2012 Long-Term Procurement Plan, Track II Exh. 304, p. 54. The "incremental and over time" hedging program involves layering on hedges over time so as to reduce overall portfolio risk.

1 If, as expected, offsets trade at a discount to allowances, and there are sufficient offsets
2 available in the market, SDG&E will purchase offsets up to the maximum 8% allowed by ARB
3 in order to meet its GHG emissions reduction obligations. It may not be possible for SDG&E to
4 purchase the full 8%, as ARB may not approve enough offsets in time to meet the markets'
5 demand for offsets in the early years for the Cap-and-Trade Program.

6 For the remainder of its allowances, SDG&E will look to the products listed above and
7 will procure the product(s) that provide the best price and method for reducing SDG&E's
8 exposure to GHG allowance prices. Since allowances can be carried forward, procurement of
9 allowances effectively acts as a hedge against future prices. SDG&E expects to use allowances
10 purchased through the auction or futures, which can be easily converted into allowances, to meet
11 its GHG obligations. If the markets for allowances and futures do not provide the same liquidity
12 as the financial market, SDG&E may elect to purchase financial swaps to provide price
13 protection and then procure the allowances at a later time.

14 If a liquid options market develops, SDG&E may purchase calls, which provide a cap for
15 the price of allowances while allowing SDG&E to benefit from possible decreases in prices.
16 This gives SDG&E an alternative to locking in prices during volatile market conditions.
17 SDG&E expects the options market to develop slowly, as the auction structure already
18 effectively provides a cap and floor for prices.

19 *(ii) Volumes*

20 SDG&E will forecast its needs for the entire compliance period and will procure a
21 percentage of that forecast each year. A more detailed explanation and breakdown of these
22 target percentages can be found in confidential Appendix B.

23 *(iii) Risks for Allowance positions*

1 There are risks associated with having either a short or a long position. If SDG&E has a
2 short position, SDG&E would be at risk of a price spike occurring at the end of the compliance
3 period (2014 for the first compliance period). Also, if SDG&E were to fail to meet its
4 obligations, the penalties for being short are four times the cost of short allowances from the next
5 compliance period plus any added ARB fines, which are currently not well-defined.

6 If SDG&E has a long position, in addition to the risk that prices could decline, there is a
7 risk that federal legislation pre-empting the California Cap-and-Trade Program could be adopted,
8 which might result in allowances in SDG&E's holding account becoming worthless. ARB has
9 indicated that it will attempt to protect participants in the Cap-and-Trade Program in the event of
10 passage of federal legislation, but there is nothing specific in the ARB regulations addressing
11 federal preemption.

12 If SDG&E has a long position and perceives that its position exposes it to unreasonable
13 risk, it may choose to sell some its excess allowances. It notes, however, that its "incremental
14 over time" strategy limits its exposure to both price increases and price decreases.

15 **J. Conclusion**

16 The Commission should grant authorization by the end of this calendar year for SDG&E to
17 acquire allowances in ARB's auctions, and to acquire allowances and offsets through the other
18 methods of procurement described herein, in order to meet the GHG emission reduction
19 obligation associated with the energy needs of its bundled customers. In addition, SDG&E
20 should be authorized to use hedging instruments once those markets develop. GHG-related costs
21 will be included as part of SDG&E's annual ERRA forecast cost and in SDG&E's annual ERRA
22 compliance filing. GHG costs should be approved for full recovery through SDG&E's ERRA,

1 in the same manner as for other procurement related costs, based on the outlined program being
2 fully compliant with AB 57's upfront standards requirement.

3 **IV. PROCUREMENT RULES RELATING TO ONCE-THROUGH COOLING ISSUES**
4 **(Witness: Robert Anderson)**

5 The ALJ Ruling directed parties to comment on a proposal by staff of the Commission's
6 Energy Division ("Staff") regarding procurement rules related to contracts with any facility
7 subject to the State Water Resources Control Board's *Statewide Water Control Policy on the Use*
8 *of Coastal and Estuarine Water Used for Power Plant Cooling (OTC Facilities)*. Staff's
9 proposed OTC facility contracting rules are attached to the ALJ Ruling as Appendix A (the
10 "Staff OTC Proposal").

11 As a threshold matter, it is important for the Commission to recognize that the future
12 viability of OTC facilities creates a number of resource planning issues for the IOUs, especially
13 since the IOUs are currently being held responsible for ensuring that adequate resources are
14 available to meet *all* system reliability needs, in addition to meeting the needs of IOU bundled
15 customers. There is particular difficulty where planning involves facilities that are located in
16 areas with local capacity constraints. Should these facilities need to shut down, the only option
17 for the replacement of all or a portion of their capacity is to have new facilities built.

18 Plainly, procuring new capacity is a time-consuming proposition. It involves: (i) holding
19 a Request For Offers ("RFO"); (ii) obtaining Commission approval; (iii) obtaining all necessary
20 permits and licenses; (iv) navigating the CAISO interconnection process; and (v) completing the
21 construction process to build the new plant. In most, if not all, cases, the time required to solicit,
22 approve, and build new generation will exceed the period of time that remains once it is known
23 whether an existing OTC plant can meet new requirements or must be shut down. Thus, the
24 challenge that must be overcome by the Commission is the need for it to issue determinations

1 regarding authorization of new capacity in the absence of perfect information. Failure to
2 approve new capacity to be located in constrained areas in a timely manner will result in OTC
3 facilities being retained beyond the dates in the OTC regulation due to reliability concerns.

4 The Staff OTC Proposal fails, however, to address this critical issue. Rather, it focuses
5 solely on developing rules regarding limiting the IOUs' ability to contract with existing OTC
6 facilities, without addressing the resulting impact on reliability or the need for replacement
7 capacity. SDG&E fully acknowledges the Staff's desire to ensure that the IOUs' respective
8 procurement strategies do not rely on OTC facilities beyond the compliance period, until the
9 facilities have shown that they are able to meet the regulation. As SDG&E points out above,
10 however, reliance on OTC facilities such as those located in SDG&E's service area will not be
11 driven by the length of contract with the existing facilities, but rather by whether new plants have
12 been built so that a procurement option other than contracting with existing OTC facilities exists.

13 The Staff OTC Proposal proposes a number of rules regarding limiting the contracting
14 with OTC facilities over a time period that exceeds the compliance date for that facility. For the
15 most part, SDG&E has no objections to these provisions. SDG&E does not, however, agree with
16 the aspect of the Staff OTC Proposal that limits contracts with OTC facilities to one year. For
17 example, the compliance date for the remaining OTC facility located in SDG&E service area is
18 the end of 2017. Limiting SDG&E's ability to contract with this OTC plant to one-year
19 contracts in 2012, 2013 and so on serves no discernable purpose. It does not lower the costs
20 borne by SDG&E ratepayers; indeed, such a limitation might actually *increase* transaction costs
21 for customers as new agreements will need to be negotiated for each year. Nor does limiting the
22 contracting period to one year address the main obstacle to advancement of the State's policy on
23 OTC – the need for compliance or the procurement of replacement capacity. Rather than

1 limiting contracts with OTC units to one year, as is proposed in the Staff OTC Proposal, the
2 Commission should focus its OTC policy implementation on addressing the need for
3 replacement capacity. This is the most effective means of preventing over-reliance on OTC
4 plants. If the Commission feels that some limitation on OTC contracting is necessary, SDG&E
5 recommends that the one-year contract terms limit be imposed only during the final two year
6 period before the OTC plant is scheduled to either comply or shutdown.

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

10 The ALJ Ruling invites parties to propose refinements to the bid evaluation process,
11 including methods for weighing competing bids between UOG and PPAs. As discussed below,
12 SDG&E does not perceive a need to alter the existing approach for evaluating UOG versus PPA
13 bids. It presents its general policy recommendations, which the Commission should consider on
14 an ongoing basis when making determinations on this issue.

15 The Commission has recognized that UOG and PPA resources both offer benefits to
16 ratepayers. In the 2004 LTPP decision, the Commission expressed a preference for a hybrid
17 market that includes both UOG and PPAs.^{15/} Applications for approval of both UOG and PPAs
18 have been brought to Commission since 2005, and the Commission has demonstrated that it is
19 fully capable of weighing the entire record presented and applying judgment to render a decision
20 as to what resources are in ratepayers' best interests. IOU-developed evaluation processes have
21 been used in these Applications; thus, the tools necessary to analyze the attributes of UOG versus
22 PPAs and to weigh the differences currently exist. In addition, there are a number of checks on
23 the IOU evaluation process that provide fair evaluation to all bidders. These include:

^{15/} D.04-12-048, *mimeo*, p. 217, Finding of Fact ("FOF") 85.

- 1 a. The Commission-adopted standards of conduct (“SOC”);
- 2 b. IE involvement and expertise regarding how to compare UOG and PPA projects.
- 3 c. Full access to the evaluation process by the PRG and Energy Division.

4 Since the Commission already has the ability to effectively weigh competing UOG and
5 PPAs bids, additional “refinements” to the process are not necessary. The Commission should
6 not attempt to predetermine specific bid evaluation methodologies that would be applied to
7 future solicitations; it is not necessary or desirable to adopt a strict, structured set of rules for
8 comparing UOG and PPAs. Any such rules or mechanisms adopted in this proceeding are
9 unlikely to fit all circumstances or the unique characteristics of all potential projects. What is
10 preferable is to conduct the analysis in each RFO under the auspices of the IE and PRG in order
11 to ensure that each project’s individual circumstances and attributes are fully considered.

12 SDG&E believes that the existing policy, which requires that any hybrid product
13 evaluation employ the least-cost/best-fit (“LCBF”) guiding principle with oversight from an IE
14 in accordance with Commission guidelines, should be maintained:

15 . . . The IOUs will employ the LCBF methodology when evaluating PPAs and utility-
16 owned bids in an all-source open RFO, taking into account the qualitative and
17 quantitative (Qualitative and quantitative attributes such as performance risk, credit risk,
18 price diversity (10 vs. 20 yr. price terms), and operational flexibility etc.) attributes
19 associated with each bid. In addition, when seeking Commission approval for the
20 proposed contracts the IOUs will need to demonstrate that they employed LCBF
21 principles . . . ^{16/}

22
23 The FERC guidelines provide for substantial IE involvement in resource solicitations at
24 the ‘design, administration, and evaluation stages of the competitive solicitation process.’
25 FERC has set forth ‘minimum standards for assuring independence and the scope of the
26 third party’s role.’ . . . We determine here that we will not allow the IEs to make binding
27 decisions on behalf of the utilities. We will require the use of an IE in resource
28 solicitations where there are affiliates, IOU-built, or IOU-turnkey bidders . . . ^{17/}
29

^{16/} *Id.* at pp. 217-218, FOF 86.

^{17/} *Id.* at pp. 219-220, FOF 93.

1 IEs should come equipped with technical expertise germane to evaluating resource
2 solicitation power products. In the case of an affiliate/IOU-turn key power plant, IEs
3 should be able to quickly scrutinize, examine, and essentially break down bids to
4 determine whether the various cost components are reasonable as presented. IEs should
5 be skilled in analyzing a range of power market derivatives (e.g., futures, contracts,
6 options, swaps). IEs should be familiar with the various standard contracts and industry
7 practices. IEs should have experience analyzing the relative merits of various types of
8 PPAs. IEs should be able to evaluate PPAs, turn-keys, and IOU-builds on a side-by-side
9 basis.^{18/}

10 Rather than attempting to develop a strict, one-size-fits-all analytical construct, SDG&E
11 recommends that the current approach of conducting the analysis in each RFO with the
12 involvement of the IE and PRG to ensure that each project's unique circumstances and attributes
13 are captured, should be maintained. The PRG should continue to be able consider all options to
14 act in the best interest of consumers, in accordance with the 2004 LTPP decision:
15

16 Given our desire to consider all competitive options, instead of continuing the ban, and
17 carving out exceptions for unique resources from time to time, we now find that it is in
18 the best interest of the ratepayers and consumers to allow for a full vetting of all available
19 resources in a RFP. We will institute appropriate safeguards for the solicitations for long-
20 term transactions, in part through continuation of utility PRGs and through the use of
21 independent third-party evaluators. Such safeguards can protect consumers from any anti-
22 competitive conduct between utilities and their affiliates.^{19/}

23 Where appropriate, the Commission can adopt incentive and penalty mechanisms for
24 UOG projects to mimic PPA contractual terms such as establishing targets for heat rates and
25 availability factors. Likewise, the utilities are held accountable for cost-overruns and project
26 delays:
27

28 Putting shareholders – not ratepayers – at risk for cost overruns will put IOU-owned
29 projects and PPAs on equal footing (at least with respect to the allocation of risk), impose
30 some measure of market discipline on IOUs when formulating their bids, and better
31 ensure that the resource solicitation process is fair and competitive.’ Consequently, IOUs
32 will not be allowed to recover initial capital costs in excess of its final bid price for
33 utility-owned resources.^{20/}

^{18/} *Id.* at p. 220, FOF 95.

^{19/} *Id.* at p. 233, Conclusion of Law 29.

^{20/} D.04-12-048, *mimeo*, p. 218, FOF 87.

1 Accordingly, there is not currently a need to alter the existing approach for evaluating
2 UOG versus PPA bids. The existing policy requiring that any hybrid product evaluation employ
3 the LCBF guiding principle with oversight from an IE in accordance with Commission
4 guidelines should remain in place.

5 **VI. REFINEMENTS TO THE EXISTING TIMELINES ASSOCIATED WITH THE**
6 **UTILITIES' RFOS FOR RESOURCE ADEQUACY PRODUCTS**
7 **(Witness: Ryan Miller)**

8 In D.06-06-064, the Commission directed the IOUs to develop “least cost/best fit”
9 portfolios and to sell contracted resources that are not required to meet customer need.
10 IOUs must provide the excess resources to the market with sufficient time to permit other LSEs
11 to purchase them in order to meet their resource obligations. *The Assigned Commissioner and*
12 *Administrative Law Judge’s Joint Scoping Memo and Ruling* issued December 3, 2010
13 (“Scoping Memo”) identifies as a Track III issue whether to adopt schedule milestones that IOUs
14 can follow to allow for smoother load-serving entity (“LSE”) compliance with RA filing
15 deadlines.^{21/} SDG&E sets forth below its general policy recommendations, which the
16 Commission should consider on an ongoing basis when making determinations on this issue.

17 SDG&E believes that changes to the current process and timeline for the IOUs’ RFOs for
18 RA not warranted. Under the existing process, SDG&E has been able to procure RA when
19 needed, and to make its excess RA available when appropriate. Further the Commission should
20 recognize that certain decisions related to the determination of SDG&E’s RA position and
21 therefore the timing of RA related RFOs, are outside of SDG&E’s control. Accordingly, if the
22 Commission elects to refine the timelines for RA RFOs, it must remain mindful of the fact that
23 the IOUs’ determination of their respective RA positions, and whether they have excess RA to

^{21/} Scoping Memo, p. 45.

1 sell, depends to a large degree on factors that are outside of their control and that impact their
2 ability to either buy or sell RA according to a timeline.

3 When SDG&E perceives that it may have excess RA that it can make available to other
4 market participants, it must first evaluate how certain it is that its RA position will not change.
5 SDG&E strives to avoid situations where it over-sold and would be forced to buy RA back, or
6 where it purchased too much RA and would have to sell the excess or allow the RA to go
7 unused. To avoid either of these undesirable outcomes, SDG&E does not issue RFOs for RA
8 until it has a fairly clear view of its RA position, including availability and amount of RA
9 resources and demand position. As a practical matter, however, there are several moving pieces
10 that contribute to the determination of SDG&E's actual RA position, many of which are outside
11 of SDG&E's control. Listed below are several external decisions that must be issued before
12 SDG&E can reach a definitive determination regarding its RA position:

13 • **Local and System RA requirements based on CEC load forecast (CPUC)**

14 The CPUC notifies SDG&E of its Local and System RA obligations in a preliminary
15 notification which is issued by the end of July each year; final notifications are issued by
16 the middle of September. (September deadline is pending a final decision in Rulemaking
17 09-10-032.)

18 • **Demand response Net Qualifying Capacity (“NQC”) allocation (CPUC)**

19 The CPUC notifies SDG&E of its demand response programs that would count for RA at
20 the end of July along with the RA requirements.

21 • **NQC validation and updates (ISO)**

22 ISO publishes RA amounts for all ISO resources for the following compliance year by
23 the end of July.

1 • **Path 26 capacity allocation (ISO)**

2 ISO notifies SDG&E the volume of resources located North of Path 26 that can be used
3 to meet system RA requirements by middle of August.

4 • **RA import allocation process (ISO) –**

5 ISO notifies SDG&E of the volume of RA for imports at each intertie by the middle of
6 August.

7 While SDG&E develops estimates regarding what to expect from each of the decisions
8 detailed above, even small variances from SDG&E’s expectation in multiple CAISO allocations
9 or CPUC decisions can impact SDG&E’s net RA position. In the absence of certainty regarding
10 its RA position, it would be unwise for SDG&E to issue an RFO to either buy or sell RA prior to
11 when SDG&E can reasonably determine its RA position. Further, SDG&E will typically choose
12 to maintain a small contingency of RA supply above required minimums to protect against
13 variances to SDG&E’s supply position or RA requirement in order to ensure it has met its RA
14 obligations at the time RA-related filings are made to the CAISO and CPUC. .

15 As such, if the Commission elects to develop a schedule for IOU sale of excess RA, it
16 must take into account the timing of the decisions listed above and provide sufficient flexibility
17 in any schedule to ensure that the IOUs are not required to sell RA prior to reaching a final
18 determination regarding their respective RA positions.

19 SDG&E notes further that the proposed Rulebook contains a recommendation that the
20 assignment of an IE for each RFO conducted by the utility would require prior approval of the
21 Energy Division. This could further complicate the timing of RA RFOs, where affiliate bids are
22 expected, since RA RFOs are typically conducted on very short timelines. Since the Rulebook

1 has not proposed any criteria defining the type or timing of such approval, it is difficult for
2 SDG&E to assess the potential impact to RA RFO solicitations where affiliates may bid.

3 **VII. PROCUREMENT OVERSIGHT RULES (Witnesses: James Magill;**
4 **Juancho Eekhout)**

5 In the Scoping Memo, the Commission identified the “clarification/refinement of *existing*
6 procurement-related requirements” as a Track III issue and declared, “[t]his issue will be
7 addressed in the 2nd phase of Track III.”^{22/} Notwithstanding this determination set forth in the
8 Scoping Ruling, the ALJ Ruling directs the IOUs to submit testimony regarding proposed
9 procurement oversight rules on the same procedural schedule as Track I issues, providing the
10 IOUs with 3 weeks to review and comment on the proposed rules.

11 Review of the proposed rules suggests that their adoption before the end of this calendar
12 year would not be in the public interest. First, the Scoping Memo contemplated that the
13 “Rulebook” would include only *existing* rules. The procurement oversight rules proposed by
14 Staff, however, include substantive modifications to existing Commission decisions and newly-
15 created rules. The evidentiary record of the instant proceeding is inadequate to support the
16 modification of prior Commission decisions and the addition of new rules that, as discussed
17 below, could be detrimental. While the Rulebook offers value as a compilation of the various
18 Commission requirements related to procurement, it was not intended to and should not provide
19 an opportunity for modification of existing rules or creation of new rules that are unsupported by
20 existing Commission decisions.

21 In the absence of an adequate factual record, the Commission should not adopt any
22 substantive modifications to existing decisions; nor should it adopt new rules without permitting
23 sufficient time for meaningful stakeholder review and comment. By proposing to include the

^{22/} Scoping Memo, p. 43 (emphasis added).

1 revised Rulebook among the Rules Track III issues to be addressed on the Track I procedural
2 schedule, the ALJ Ruling does a double disservice. It provides insufficient time, given the other
3 critical issues parties in the LTPP proceeding must focus on in the immediate timeframe, for
4 careful review of the proposed modifications and additions to the Rulebook, thereby depriving
5 the Rulebook of the scrutiny it requires. It also, by demanding that parties expend some effort on
6 review, however cursory, of the Rulebook, diverts attention from the key issues being addressed
7 in the proceeding, including the determination of system and local capacity need and
8 procurement authorization related to GHG compliance, which are vital to the IOUs' operations
9 and must be resolved in the near term.

10 Accordingly, given the extremely aggressive schedule in place for resolving critical
11 Track I and II issues, as well as the need to address the IOUs' GHG product procurement
12 authority before the end of this calendar year, the Commission should consider the proposed
13 Rulebook in 2012 in the 2nd phase of Track III, as it originally contemplated. The Commission
14 should conduct workshops on a timeline that allows for meaningful stakeholder review and
15 input, and should focus on the Rulebook as a whole rather than taking the piecemeal approach
16 proposed by Staff (which proposed to address only the procurement oversight rules). SDG&E
17 discusses below aspects of the proposed Rulebook that it views as particularly problematic, but
18 notes that additional concerns may exist and reserves the right to raise additional issues related to
19 the Rulebook in the future.

20 **A. PRG Review of Overall Procurement Process (Witness: James Magill)**

21 In the Scoping Memo, the Commission recognized that “[o]ne of the key issues discussed
22 by the parties in comments was whether the Rulebook would serve as a compendium of existing
23 rules and policies, or whether it would replace prior Commission action and serve as a single

1 comprehensive governing document, much like a General Order.”^{23/} It noted further that “[o]ther
2 than SCE, all commenting parties favored treating this document as a compendium.”^{24/}

3 SDG&E supports the compendium approach. If the Rulebook is, instead, envisioned as
4 being akin to a General Order that would supersede prior Commission orders, it would be
5 necessary to closely review each and every provision contained in the Rulebook in order to
6 ensure consistency with prior Commission decisions and that relevant rules from such prior
7 Commission decisions had not been omitted or improperly modified. Plainly, as discussed
8 above, this degree of scrutiny is not possible given the scope of the issues currently before the
9 Commission in this proceeding and the truncated procedural schedule. Thus, if the Commission
10 elects to adopt the Rulebook before the end of this calendar year, it should (i) deem it to be a
11 non-binding compendium available as a reference for parties involved in electric procurement,
12 rather than as an enforceable document that supersedes prior Commission decisions; and (ii)
13 establish a reasonable process for making updates/corrections to the Rulebook.

14 With regard to the substance of the proposed Rulebook, Staff claims that most of the
15 language differences between Staff’s proposals and existing decisions are minor.^{25/} SDG&E
16 disagrees with this assertion and notes that certain omissions and/or additions deviate
17 significantly from the existing rule, thereby effectively creating new requirements. In addition,
18 Staff introduces a number of new requirements without the benefit of input from stakeholders.
19 Plainly, as discussed above, it is improper for Staff to make unilateral changes to Commission-
20 adopted reporting requirements and procedures without input from the IOUs, who will be
21 required to comply with the adopted rules, and market participants that must function within the
22 rules. Moreover, conducting review of the Rulebook in the piecemeal fashion proposed by Staff

^{23/} Scoping Memo, p. 43.

^{24/} *Id.*

^{25/} *Id.* at p. 4.

1 is counter-productive and inefficient. The proper forum for addressing the proposed Rulebook is
2 in a workshop environment that involves collaboration by all stakeholders rather than unilateral
3 action by Staff. SDG&E believes that this proposal should be considered by the Commission as
4 a potential process to address these issues.

5 *(i) Procurement Review Group – Concerns Regarding PRG Review*
6 *(Witness: James Magill)*

7 Staff's proposals for rules governing the PRG's review of the overall procurement
8 process generally comport with previous Commission decisions, which established the rules
9 currently in effect. SDG&E supports the Staff's proposed Rulebook where it comports with the
10 current rules. This includes:

- 11 • Each IOU is to maintain and routinely consult with a PRG at least on a quarterly
12 basis;
- 13 • The PRG is to review and assess the details of the IOUs' overall procurement
14 strategy and specific proposed procurement contracts and processes prior or
15 submitting filings to the Commission including, but not limited to the following;
16 and
- 17 • The IOU will consult with their PRGs on all transactions with delivery periods
18 greater than three calendar months.

19 SDG&E also supports the requirement to meet with its PRG on a quarterly basis to
20 review: (1) SDG&E's open position; (2) changes in market conditions from the previous quarter
21 including natural gas and electric prices; (3) hedging strategies going forward; and (4) the
22 necessity of filing a plan update.^{26/}

^{26/} D.03-12-067, *mimeo*, p. 47.

1 In some instances, however, Staff deviates from the current rules by either adding to or
2 omitting certain aspects of the rules. For example, Staff introduces a new requirement to report
3 on fuel forecasts. The proposed fuel forecast requirement is not required under current
4 Commission decisions, thus it is not appropriate for inclusion in the Rulebook, which is intended
5 to reflect “*existing*” procurement rules.^{27/} Moreover, because it is not a well-developed
6 requirement adopted on the basis of a factual record, the fuel forecast requirement inserted into
7 the Rulebook lacks necessary definition. It is not at all clear what information SDG&E would be
8 required to report to the PRG.

9 Staff’s proposed rulebook also makes a key omission in articulating an existing rule,
10 failing to include in the proposed Rulebook the Commission’s determination that “each PRG has
11 the option of conducting meetings by teleconference.”^{28/} Unilateral elimination of the
12 conference call option for PRG meetings is improper and makes little sense. To prohibit PRG
13 meetings to be held by teleconference would be highly unproductive for SDG&E and likely its
14 PRG members. The PRG meetings usually require critical input from a number of different
15 individuals as the topics discussed require that utility subject matter experts be present to discuss
16 the key aspects of pending procurement contracts and procurement and hedging strategies.
17 Requiring all of these individuals to travel for only a small portion of the actual meeting would
18 be an unproductive use of resources. In addition, elimination of this option would make it
19 extremely difficult for SDG&E to consult with its PRG in instances in which its estimated
20 portfolio risk exceeds the Customer Risk Tolerance (“CRT”) threshold, as required by D.03-12-
21 062.^{29/}

^{27/} See Scoping Memo, p. 43 (emphasis added).

^{28/} See D.03-12-067, *mimeo*, p. 47.

^{29/} *Id.*

1 As discussed in its proposed 2012 LTPP, SDG&E supports consulting with its PRG in
2 instances in which its estimated portfolio risk (VaR-to-Expiration at a 95% confidence interval)
3 exceeds the CRT threshold by 25%. However, Staff’s proposal omits a critical component by
4 not incorporating the current Commission adopted 95% confidence interval.^{30/} Nor does it
5 incorporate any discussion of the VaR-to-Expiration (“VtE”) component.^{31/} Staff’s proposal as
6 written would be inconsistent with the Commission’s approved risk metric. As a result of this
7 omission, PRG meetings wouldn’t be held until after the risk metric was already exceeded.

8 Finally, Staff introduces a new proposal that requires each IOU to confer with the PRG if
9 “material” barriers to hedging arise; it would require the PRG to discuss these barriers and
10 potential actions that might be taken to eliminate them. In addition, the IOUs would be required
11 to file modifications in an expedited application within fifteen days of the PRG meeting.^{32/} This
12 requirement does not exist currently as it is not required under any Commission decision.

13 Staff’s proposal is ill-defined and is not necessary. In making this proposal, Staff offers
14 no example or definition of what constitutes a “material” barrier to hedging. Therefore, it is not
15 clear when the requirement to confer with the PRG on these issues would arise. Moreover,
16 Staff’s proposed requirement would serve little purpose. SDG&E is already required to consult
17 with the PRG on a quarterly basis to review the company’s hedging strategy at which time any
18 other issues (*e.g.* material barriers) impacting SDG&E’s hedging strategy can be discussed.
19 Also, in those instances where SDG&E proposes to make changes to its Commission-adopted

^{30/} D.07-12-052, *mimeo*, p.175.

^{31/} SDG&E uses the term VtE synonymously with TeVaR (Terminal VaR). VtE/TeVaR presumes that all positions are held to expiration. “Value at Risk” refers to the statistical dollar amount that can be lost on the net open position of a portfolio over a specific time horizon and with a given confidence interval. TeVaR accounts for the increasing potential distribution of prices as time passes, as well as the expiration of the positions in the portfolio with the passage of time. The result is the estimation of loss, at the specified confidence level, assuming that the portfolio remains constant over time until all positions within it have expired.

^{32/} ALJ Ruling, Appendix B, p. 14.

1 LTPP, it can do so through an Advice Letter process.^{33/} To instead require SDG&E to file an
2 expedited application is more burdensome and would likely require more time, thus potentially
3 delaying the implementation of the proposed changes, which could be time-sensitive given
4 market changes.

5 *(ii) Procurement Review Group – Concerns Regarding PRG Meeting Protocols*
6 *(Witness: Juancho Eekhout)*

7 In addition to concerns regarding the issues subject to PRG review discussed above,
8 SDG&E notes that certain of the proposed PRG meeting protocols are overly-burdensome. First,
9 Staff proposes that PRG members be allowed to request a delay of the PRG meeting if they
10 believe there is inadequate time to review corrected materials provided by the IOU. SDG&E
11 agrees that it is crucial that PRG members receive notice of mistakes in presentation materials as
12 soon as possible. However, because of the difficulty in coordinating the schedules of PRG
13 members, Energy Division Staff and IOU representatives, SDG&E believes it is in the best
14 interest of all parties to minimize the possibility of re-scheduling meetings. Instead, SDG&E
15 proposes that if PRG members believe that there is inadequate time to review corrected
16 materials, such materials should be presented at the following PRG meeting. In the alternative, a
17 special PRG meeting could be called to address corrected materials if such materials are time
18 sensitive.

19 Second, Staff proposes that IOUs provide confidential meeting summaries and a list of
20 information requested or offered to be supplied to PRG members within 14 days of PRG
21 meetings. SDG&E's current practice is to provide a list of attending PRG members, their
22 organizations and an agenda of meeting topics on its PRG calendar, which can be accessed at
23 any time. SDG&E also provides detailed presentation materials prior to each meeting. This

^{33/} Consistent with Staff's proposal, under the Advice Letter process, SDG&E continues to operate under the existing LTPP until a resolution is adopted by the Commission.

1 process provides an efficient way for PRG members to keep track of the details of each meeting
2 by referring to the calendar and/or the relevant presentation materials at their convenience.

3 SDG&E also notes any information requested or offered to be supplied during a PRG meeting
4 and ensures that issues requiring follow-up are addressed at the next meeting. SDG&E believes
5 that this method has provided PRG members with the input they need in a timely fashion.

6 SDG&E also notes that PRG members may request, if the circumstances merit, that follow-up
7 materials be provided more quickly. Placing an arbitrary 14-day limit on these procedures adds
8 unnecessary administrative burden to the PRG process without providing any additional benefit.

9 *(iii) Independent Evaluator Oversight (Witness: Juancho Eekhout)*

10 The proposed Rulebook retains many of the existing rules regarding IE Oversight, but
11 also makes some revisions to the existing rules that raise concerns for SDG&E. First, Staff
12 proposes that communications between the IE and the Energy Division or PRG can occur
13 without any involvement or knowledge of the IOU. While SDG&E agrees that these parties
14 should communicate freely and independently, the IOUs must have enough information
15 regarding such communications to be able to verify the amounts billed to SDG&E by the IE.
16 SDG&E proposes that the Energy Division or PRG provide a monthly summary of any
17 communications with the IE. Such report should indicate the subject and duration of any
18 discussions that occurred and inform the IOUs of any work product requested of the IE. This
19 will allow each IOU to verify costs when it receives invoices from the IE.

20 Second, Staff proposes that costs associated with the Commission's use of IE services
21 should be paid by each IOU on a pro rata basis (*i.e.* 33% to each IOU) unless the IE performs
22 work related to only one specific utility. SDG&E recognizes that this requirement was
23 established through D. 08-11-008, but notes the disproportionate burden that this places on

1 SDG&E's ratepayers. SDG&E proposes that the costs be allocated on a proportional bases as is
2 common in other proceedings.^{34/}

3 Third, Staff proposes that IE reports for solicitations of products five years or greater in
4 length be filed with the Energy Division and the PRG at least seven calendar days before any
5 IOU application is filed with the Commission. SDG&E agrees that such reports must be filed
6 concurrently with any applications resulting from such solicitations, but questions the usefulness
7 of requiring that the IE report be filed seven days in advance. The IE's solicitation report cannot
8 be completed until the IOUs analysis and negotiations are complete; thus the IE report is a long
9 lead time item when preparing applications or advice letters. Requiring the IE report to be filed
10 in advance could result in needless delay as the IOU's application or advice letter is typically
11 nearly complete by the time the IE report is ready to be filed. SDG&E proposes that the IE
12 report be filed concurrently with any application or advice letter, as is the current practice.

13 Finally, Staff proposes that the Energy Division will have the right to final approval of
14 the use of a particular IE for each RFO. SDG&E believes that the Energy Division's
15 involvement in the IE selection process helps to ensure the quality of the individuals selected to
16 participate in the procurement process. However, the IOUs work closely with each of their
17 approved IEs and are best able to determine which IEs are most qualified for evaluating a certain
18 type of solicitation. For example, certain IEs may have a wealth of experience with renewable
19 procurement, but less experience with Resource Adequacy products. SDG&E proposes that once

^{34/} See, e.g., D.06-10-060, *mimeo*, Ordering Paragraph 8 ("The Executive Director may hire and manage one or more contractors to perform tasks described in this order for the purpose of advancing RPS Program goals. Such costs, if any, shall not exceed a total annual amount of \$400,000, **and the total shall be paid by PG&E, SCE and SDG&E on a proportional basis in relationship to retail sales** reported each year in the March 1 RPS compliance report [or other first report each year as directed by the Executive Director.]) (emphasis added).

1 the PRG and Energy Division select IEs to be part of the potential pool, the IOU should be able
2 to determine which IE has the best skills to participate in each specific solicitation.

3 **B. PRG Oversight of Congestion Revenue Rights (Witness: James Magill)**

4 Staff recommends that when proposed or completed Congestion Revenue Rights
5 (“CRR”) procurement is reported to the PRG, the IOU shall present specific information on (i)
6 the contribution of congestion risk to the TeVaR (terminal VaR)^{35/} value; and (ii) the reduction
7 or increase in TeVaR due to CRR procurement.^{36/} SDG&E does not currently have the modeling
8 capability to produce this information. To model the potential impact of CRRs on the portfolio
9 would require complex modeling capability to capture the pricing differentials and potential
10 congestion at numerous generation nodes both inside and outside SDG&E’s service territory as
11 the prices relate to SDG&E’s load aggregation point. As pointed out above, it is improper for
12 Staff to impose new rules without input from the IOUs and other stakeholders.

13 **C. Staff Proposal to Make QCR Audit Reports Public (Witness: James Magill)**

14 Staff proposes to modify existing procurement rules to make quarterly compliance report
15 (“QCR”) audit reports public.^{37/} In order to do so, Staff proposes to: (i) redact market-sensitive
16 information from the audit reports; (ii) provide an opportunity for the IOUs to comment on audit
17 reports; (iii) work with the IOUs to resolve any discrepancies in the audit report; and (iv) *make*
18 *available the IOU rebuttals in those instances where discrepancies persist.*^{38/}

19 While SDG&E does not oppose making QCR audit reports public, it recommends that the
20 Energy Division be required to include in the body of the QCR audit report the IOU’s comments
21 in response to the findings set forth in such audit report – this should be required in *all* instances,

^{35/} SDG&E uses VtE as a proxy for calculating TeVaR.

^{36/} ALJ Ruling, Appendix B, p. 16.

^{37/} *Id.*

^{38/} *Id.* at p.7 (emphasis added).

1 not merely when discrepancies exist. This requirement would impose little or no additional
2 burden on Staff, and will ensure that the IOU's position on all findings included in a QCR audit
3 report are available, thereby avoiding creation of the perception that the IOU endorses a
4 particular finding due to its inability to address it.

5 **VIII. THE FUTURE OF THE STATE'S NUCLEAR POWER PLANTS SHOULD**
6 **NOT BE DECIDED IN THIS PROCEEDING (Witness: Robert Anderson)**

7 In its Track II testimony, WEM raised certain policy arguments related to the State's
8 nuclear power plants. Specifically, WEM proposed that as part of this LTPP proceeding, the San
9 Onofre Nuclear Generation Station ("SONGS") and Diablo Canyon Nuclear Generation Station
10 should be closed. SDG&E addresses this issue here in the event that WEM elects to reintroduces
11 its nuclear facility shutdown proposal in this Track of the LTPP proceeding.^{39/}

12 SDG&E points out that the shutdown of California's nuclear plants was not a scenario
13 identified either in the Scoping Memo or in the ALJ Ruling. The focus of Track I is on the need
14 for resources to integrate various portfolios of renewable resources that achieved the State's 33%
15 Renewables Portfolio Standard. The analysis was specifically structured to analyze this
16 question. It should also be noted that all of the required scenarios provided in the Scoping Memo
17 included the continued operation of the nuclear plants through 2020.^{40/} Thus, there is no analysis
18 in this proceeding that addresses the implication of shutting down the nuclear plants.

19 Not only is there no specific analysis that addresses the implication of a nuclear plant
20 shutdown, there is no data that could even be used to infer the impacts. A nuclear plant
21 shutdown analysis must identify specific replacement generation needs, which may be locational
22 and, especially in the case of SONGS, must include detailed transmission studies. Given

^{39/} SDG&E is entering this testimony at this time since the schedule adopted by the ALJ does not allow parties an opportunity to provide written rebuttal testimony and time for oral rebuttal is quite limited.

^{40/} Scoping Memo, Appendix C, p. 50.

1 SONGS' specific location, it is integral to overall system reliability in SCE and SDG&E's
2 respective service areas. Such studies would require a significantly different analysis,
3 considerably more time, different modeling and expertise, and would focus on different metrics
4 than have been considered in Track 1.

5 Thus, SDG&E strongly urges the Commission to refrain from issuing any decision
6 regarding the future of the State's nuclear plants in the instant proceeding. It should, instead,
7 continue to analyze issues related to nuclear generation in separate proceedings focused solely on
8 those issues.

9 This concludes SDG&E's testimony.

1 **WITNESS QUALIFICATIONS OF ROBERT ANDERSON**

2 My name is Robert B. Anderson. My business address is 8330 Century Park Court, San
3 Diego, California, 92123.

4 I am employed by San Diego Gas & Electric Company as Director - Resource Planning.
5 My responsibilities mainly include electric resource planning. I have been employed by SDG&E
6 since 1980, and have held a variety of positions in resource planning, corporate planning, power
7 plant management, and gas planning and operations.

8 I have a BS in Mechanical Engineering and a MBA - Finance. I am a registered
9 professional engineer in Mechanical Engineering in California.

10 I have previously testified before this Commission.

11

1 **WITNESS QUALIFICATIONS OF JUANCHO EEKHOUT**

2 My name is Juancho Eekhout. My business address is 8315 Century Park Court, San
3 Diego, CA 92123. I have been employed by San Diego Gas & Electric Company (SDG&E)
4 since February 2011 as the Director of Procurement and Portfolio Design in the Electric and Gas
5 Procurement Department. In my current role, I lead the team that creates strategic plans for the
6 procurement of renewable energy and conventional resources beyond one year.

7 Prior to this role, I was a Director with the Mergers & Acquisitions (M&A) team of
8 Sempra Energy. Before joining Sempra, I worked for BP in a series of commercially-focused
9 international appointments, including in Strategy Development, Marketing, Trading
10 Management, Strategic Planning, Performance Management, and Business Development. Prior
11 to BP, I worked for ING Barings both in the Money Markets Trading and the Investment
12 Banking divisions.

13 I received a BA in Economics from the Catholic University in Caracas, Venezuela and a
14 Master in Public Policy from the University of Chicago.

15 I have not previously testified before the Commission.
16

1 **WITNESS QUALIFICATIONS OF JAMES MAGILL**

2 My name is James R. Magill. My business address is 8315 Century Park Court, San
3 Diego, CA 92123.

4 I am currently employed by San Diego Gas & Electric Company (SDG&E). My current
5 title is Manager of Energy Risk in the Electric and Fuel Procurement Department. My
6 responsibilities include indentifying, managing, monitoring and reporting on procurement risk.
7 This includes trader authority limits, portfolio valuation and reporting based on Commission
8 established risk metrics, credit risk and operational risk.

9 I have held various positions of increasing responsibility at SDG&E in the areas of load
10 analysis and forecasting, market analysis and planning, and rates and regulatory analysis. Prior
11 to SDG&E, I was employed by Potomac Electric Power Company as Senior Strategy Analyst
12 and Duke Power Company as a Senior Rate Analyst.

13 I received a Bachelor's degree in Economics from Bucknell University and a Master of
14 Business Administration from the University of North Carolina at Charlotte.

15 I have previously testified before this Commission.
16
17

1 **WITNESS QUALIFICATIONS OF RYAN MILLER**

2 My name is Ryan A. Miller. My business address is 8315 Century Park Court, San
3 Diego, CA 92123. I am employed by San Diego Gas & Electric Company. My current title is
4 Electric and Fuels Trading Manager in the Electric & Fuel Procurement Department of SDG&E.
5 My responsibilities include overseeing a staff that performs short-term energy procurement and
6 policy functions such as day-ahead electric and fuel trading, short-term wholesale market
7 transactions, analysis and optimization of day-ahead energy and fuel procurement strategies,
8 development and execution of short-term natural gas hedging strategies, management of
9 SDG&E's UEG fuel transportation agreements, procurement of resource adequacy products,
10 and development of GHG procurement and hedging strategies.

11 I joined SDG&E in December 2002, and have held various positions with increasing
12 levels of responsibility within the Electric & Fuels trading group.

13 Prior to joining SDG&E, I worked as a Power Scheduler and Mid-Marketer with Mirant
14 Energy.

15 I received a Bachelor's degree in Management Science (MSCI) from the Georgia
16 Institute of Technology.

17 I have not previously testified before the Commission.
18
19

Appendix A – CONFIDENTIAL

[REDACTED]

Appendix B - CONFIDENTIAL

[REDACTED]