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Witness:	Kenneth Deremer

PREPARED DIRECT TESTIMONY OF

KENNETH DEREMER

ON BEHALF OF

SAN DIEGO GAS & ELECTRIC COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

August 16, 2013

PREPARED DIRECT TESTIMONY

OF

KENNETH DEREMER

I. PURPOSE OF TESTIMONY

This testimony is submitted in accordance with the California Public Utilities Commission (Commission or CPUC)'s Order Instituting Investigation (OII) I.12-10-013 (issued November 1, 2012) and Administrative Law Judge (ALJ) Darling's July 1, 2013 ruling on the Miscellaneous Scheduling and Procedural Issues and Notice of Phase 2 Prehearing Conference. My testimony addresses the current revenue requirement for San Diego Gas & Electric Company (SDG&E)'s share of the San Onofre Nuclear Generating Station (SONGS) investment and provides a proposal for the recovery of the remaining book value of the SONGS investment, including costs associated with the Steam Generator Replacement Project (SGRP), the non-SGRP capital investment, SONGS-related construction work in progress (CWIP), the unamortized balance in the nuclear fuel inventory and the current operating & maintenance (O&M) revenue requirement billed from Southern California Edison (SCE). SDG&E previously filed testimony in Phase 2 of this proceeding on July 24, 2013, providing an accounting of the assets and amounts currently in SONGS rate base, and proposing interim rate reductions related to the O&M and capital-related recovery of SONGS costs.[1] Specifically, this testimony addresses the ongoing recovery of SDG&E's share of SONGS costs, and provides a framework and clear justification for the following:

- Continued cost recovery of SONGS investment that is still used and useful, including the balance in the material and supply (M&S) inventory, at SDG&E's current authorized rate of return (ROR) on rate base through 2017 and a reduced rate of return thereafter.
- Cost recovery of retired SONGS investment over a five-year period at a reduced rate of return consistent with prior Commission treatment of retired plant.

[1] SDG&E's proposal for interim rate reductions filed on July 24, 2013 is pending CPUC resolution.

- Application or transfer of current CWIP balances into appropriate plant categories for applicable cost recovery as described herein.
- Deferral on recovery of the balance of unamortized nuclear fuel until such time it is determined what remaining portion of inventory is left to be recovered.
- A reduction in the total refundable O&M revenue requirement to reflect the lower costs expected to be billed by SCE, which will help mitigate the overall impact of the capital revenue requirement.

Additional detail on the derivation of the revenue requirement adjustment proposed in my testimony is contained in the direct testimony of SDG&E witness Deborah Hiramoto.

II. BACKGROUND

SONGS is operated exclusively by SCE, the Nuclear Regulatory Commission's (NRC's) designated operator. SDG&E relies upon SCE as the operating agent and the exclusive NRC licensed operator of the station. SDG&E's influence as a minority owner over SCE's expenditures related to SONGS is also subject to the terms of the Second Amended San Onofre Operating Agreement between the SONGS co-owners.[2]

The capital-related revenue requirement (i.e. recovery of depreciation, return on rate base and related taxes) for SDG&E's share (20%) of the non-SGRP SONGS investment is reflected in the overall revenue requirement that is approved in SDG&E's General Rate Case (GRC).[3] As part of this process, the SONGS capital costs reflected in SDG&E's GRC revenue requirement are actually litigated and approved in SCE's most recent GRC.[4]

On November 30, 2006, the Commission issued D.06-11-026, approving an unopposed settlement of the ratemaking treatment of SDGE's share of costs related to the SGRP at SONGS. The settlement provided for ratemaking treatment of SDG&E's 20%

[2] *E.g.*, SDG&E is contractually entitled under the Second Amended San Onofre Operating Agreement to continue auditing SONGS costs as part of its customary audit procedures.

[3] The revenue requirement for SONGS reflected in current rates was contained in SDG&E's 2008 GRC Decision (D.)08-07-046. Recently, this revenue requirement was adjusted in conjunction with the adoption of SDG&E's 2012 GRC (D.13-05-010).

[4] *See* D.12-11-051, SCE's 2011 GRC.

share of SGRP costs in a manner consistent with the ratemaking treatment the CPUC authorized for SCE's share of the SGRP costs in D.05-12-040. The ratemaking treatment for SDG&E was to be consistent with what was authorized for SCE in D.05-12-040, as confirmed in D.11-07-049 issued on August 3, 2011. The SGRP was completed and placed into service beginning in April 2010 (Unit 2) and has generated electricity for customers until the outages began in the first quarter of 2012.

The revenue requirement for both the non-SGRP and the SGRP portions of SDG&E's SONGS investment is recovered through electric commodity rates, which are charged to all bundled service customers. On a monthly basis, the authorized SONGS capital revenue requirement is recorded to the Non-fuel Generation Balancing Account (NGBA) and compared to actual revenues billed to customers for the NGBA portion of customer rates. SONGS capital costs that are not yet recognized in plant in service are recorded to CWIP, accruing allowance for funds used during construction (AFUDC), until such time the costs are placed into service and considered part of SONGS rate base. Once in service, these costs are then recovered as part of the overall SONGS capital revenue requirement as described above.

On behalf of itself and on behalf of the minority owners, including SDG&E, SCE acquires the nuclear fuel and signs the contracts to effect the conversion of the fuel to a reactor-ready state. Up until the point the nuclear fuel goes into production, it is treated as inventory on SDG&E's balance sheet with a carrying cost applied on a monthly basis, reflecting short term interest rates. Once the nuclear fuel is placed into service, the inventory amount is expensed (i.e. amortized) to the Energy Resource Recovery Account (ERRA) based on the amount of output produced at the applicable unit on a monthly basis. The balance of nuclear fuel remains on the balance sheet until expensed through production.

III. COST RECOVERY PROPOSAL FOR REMAINING SONGS INVESTMENT

A. Recovery of remaining SONGS investment is appropriate given both Commission policy and prior regulatory precedent

The Commission has traditionally maintained a policy that provides the regulated utilities recovery of their costs through "cost of service" ratemaking principles, allowing the utilities to recover reasonably incurred costs and expenses and a return of its invested capital associated with financing those costs. This principle encompasses both the recovery of costs for plant that remains in service as well as plant that was previously used and useful, but subsequently removed from service. Commission precedent supports the policy of allowing recovery of remaining costs of un-depreciated (or unamortized) where specific generation assets have been retired from service.

When addressing potential cost recovery for plant that is no longer used and useful, the Commission has considered the recovery of, and return on, plant on a case-by-case basis. Particularly, the Commission has considered the causes and the respective shareholder/ratepayer burdens and benefits of cost recovery.

The Commission's regulatory track record provides a basis for the utility to manage financial risk by giving it a fair opportunity to recover its prudent and reasonable costs associated with providing safe and reliable electric service to customers. This serves to the benefit of utility customers by affording SDG&E the ability to maintain its strong "A" investment grade credit rating to attract capital needed to replace and enhance its system at the lowest possible rates, reducing the costs of financing in customer rates. Given this prescribed policy, which has been consistently demonstrated in regulatory outcomes, the basis for the continued recovery of SDG&E's share of SONGS investment is evident.

B. Recovery of SONGS Plant that continues to be used and useful should be recovered at SDG&E's authorized ROR through 2017 and a reduced return thereafter

A portion of the remaining SONGS book investment has been identified by SCE as necessary to ensure the safe and efficient operation of the facility as it transitions into the decommissioning phase. This reflects capital projects that are needed to support ongoing operations at the plant, such as maintaining used fuel cooling and decommissioning preparation work. As contained in the testimony of Ms. Hiramoto, SDG&E's share of these un-depreciated costs is $111 million. SDG&E proposes to initially establish a revenue requirement effective June 1, 2013, that continues to recover these costs over a 9 1/2-year period, which aligns with the end of the original licensing period in 2022, at its current authorized ROR of 7.79%.[5] However, beginning in January 1, 2018, SDG&E proposes to amortize the remaining net investment over a shortened 3-year period through December 31, 2020, at a reduced ROR of 5.07%, which is described in Section III.C below. Setting the revenue requirement over two separate periods (4 ½ years and then 3 years) reflects SCE's expectation that most of these assets will be retired by 2018 and a shortened recovery period in the later years at a reduced return is reasonable.

The overall ratemaking treatment for these class of assets is appropriate as the assets continue to be used and useful and should receive the same "rate based" type treatment of other utility assets in service as they are being depreciated over their anticipated useful lives. Beginning in 2018, since the recovery of the remaining investment is being accelerated over a shorter period, it is appropriate to apply a reduced rate of return.

The costs contained in this category include SDG&E's share of the balance in inventory of M&S that have historically supported normal operations of the plant. The value of the M&S inventory itself has not yet been recovered in rates as it is not depreciated over time like other capital costs in service. Instead, it is continuously replenished when a component is placed into service and SDG&E has earned its full rate of return on the value of the M&S inventory as part of rate base. Some portion of the inventory will still be necessary for ongoing (decommissioning) activities, while other amounts can be redeployed or sold to third parties. Salvage of any M&S inventory would reduce the amount of the amortization charged to customers. SDG&E proposes that the balance of M&S inventory not be replenished, but instead amortized over a similar period as the other used and useful assets, with a reduction in revenue requirement for any salvage proceeds.

C. Recovery of SONGS net investment for retired plant should continue to be recovered, but at a reduced rate of return consistent with prior Commission treatment of retired assets.

SONGS Units 2 and 3 have been significant and efficient contributors to SDG&E's energy portfolio, providing safe, reliable and affordable electricity to SDG&E

[5] Adopted in SDG&E's most recent Cost of Capital decision (D.12-12-034), effective January 1, 2013.

customers for approximately 30 years. During this time, SDG&E has been able to recover the costs associated with its portion of the investment via cost of service ratemaking principles as consistently adopted in the appropriate rate recovery proceedings, including previous GRCs.

With the retirement of the majority of the SONGS assets, it is appropriate for SDG&E to be able to recover the remaining book value of this capital investment that has provided substantial benefits to customers over the many years of service. It is important to note that utility investors fund these capital investments upfront and their funds are returned to them generally over the lives of the capital projects. Customers pay for the costs of these investments over the investment lives, including a return to investors for their contribution to the capital. Some assets remain productive beyond their anticipated useful lives, while other assets are retired early. Just as customers would see the benefit of assets that are still productive after fully depreciated, they should also be responsible for paying costs for assets that are retired early as long as those assets were operated prudently.[6]

Consistent with the Commission's policy on retired assets, SDG&E believes it is appropriate to recover these assets at a reduced rate of return, similar to its treatment of prematurely retired generating assets, as well as "stranded" generation assets approved for recovery as part of Assembly Bill (AB) 1890 electric industry restructuring[7] and more recently the retired legacy meters due to SDG&E's implementation of "Smart Meters."[8]

In alignment with this precedent, SDG&E requests to recover all of the remaining un-depreciated costs associated with the retired SONGS capital investment, including

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6 The reasonableness review of both SCE's and SDG&E's costs related to the SGRP will be examined by the Commission in Phase 3 of this proceeding, and the Commission retains the ability to impose a disallowance if it makes a finding of imprudence in that phase. Subject to this prudence review, however, the Commission should find that the original capital investment in the SGRP should be recovered through rates.

7 D.97-11-074 authorized reduced rates of return of 7.14% and 6.75% for SDG&E nuclear and non-nuclear generation assets, respectively, in rate base at the time and eligible for transition cost recovery pursuant to AB 1890. Reduced ROR for SONGS transition assets was initially established in D.96-04-059.

8 D.13-05-010 authorized a rate of return of 6.20% for SDG&E retired legacy meters in conjunction with the implementation of smart meters approved in D.07-04-043, also known as Advanced Metering Infrastructure (AMI). The Utility Reform Network (TURN) filed a Petition for Modification of D.13-05-010 on June 26, 2013 to correct the 6.20% return based on an error contained in the calculation. The Petition is currently pending before the Commission.

SGRP, of $295 million over five years at a reduced rate of return of 5.07%, which represents SDG&E's current authorized embedded cost of debt, adjusted for the weighted preferred stock component[9]. The accelerated 5-year life is consistent with the period used for recovery of retired costs from the SONGS Unit 1 closure and is beneficial to the customers by allowing SDG&E to redeploy the capital into other key areas of the operations.

D. Current CWIP balances should be applied or transferred to appropriate SONGS plant balances ("used and useful" or "retired") and amortized according to the applicable cost recovery treatment.

As part of SDG&E's overall investment in SONGS, approximately $129 million of plant capital costs were placed into CWIP, but not yet put into service as of May 31, 2013. Nuclear facilities such as SONGS generally experience high CWIP balances due to the long lead time needed between the time the capital asset is funded and when it is actually placed into service. This is largely due to the fact that many of the capital projects cannot be placed into service while the plant is operating.

SDG&E is proposing that the CWIP balance attributable to assets still needed for ongoing operations be treated as normal CWIP and receive the rate-based recovery described in Section III.B above once the assets are placed into service. For CWIP associated with retired assets, SDG&E requests that these balances immediately transfer to the retired SONGS plant account and be recovered as prescribed in Section III.C above.

E. Recovery of the unamortized nuclear fuel inventory should be deferred, but remaining balance should accrue a "carrying cost" equal to the short-term debt rate.

As of June 30, 2013, SDG&E has a balance of unamortized nuclear fuel inventory of $116 million, which consists of inventory in stages of both "pre-core" (not yet placed in reactor) and "in-core" (in reactor at one point). SDG&E's share of nuclear fuel inventory was a necessary cost to provide electricity to customers. This nuclear fuel process entails a long lead time since the fuel must go through various stages of conversion, enrichment and fabrication before its ready to be placed into plant production. Therefore, the capital obligations were prudently made before the outages

[9] D.12-12-013, SDG&E's Cost of Capital decision effective January 1, 2013, authorized an embedded cost of debt of 5.0% and preferred stock of 6.22%, as part of its overall ROR of 7.79%.

occurred and SDG&E should be allowed to recover the cost already incurred and any charges that result from cancelled nuclear contracts. Because SCE has not conducted the full assessment of what portion of nuclear fuel can be sold to other parties, the final remaining balance to be recovered from customers is not yet known. SDG&E proposes to defer the recovery of nuclear fuel for the time being and will seek recovery in the future once a full evaluation is completed. Until such time, SDG&E should earn a carrying cost on the unamortized portion of the nuclear fuel inventory equal to the short-term debt rate utilized by SCE.[10] Any proceeds received for the disposition of fuel should be credited to the inventory balance.

F. The ongoing SONGS O&M revenue requirement should be reduced to reflect the lower amount of O&M expected to be billed from SCE

SDG&E's share of O&M costs at the SONGS facility is billed to SDG&E from SCE based on the operating agreement between the two utilities. In SDG&E's most recent GRC (D.13-05-010), an amount of approximately $122 million[11] was authorized to be recovered in rates, subject to a monthly true-up of actual costs recorded in the SONGS O&M balancing account (SONGSBA).[12]

With the transition of SONGS Units 2 and 3 to the decommissioning phase, SCE expects these costs to decline, most significantly beginning in 2014. As a result, SDG&E proposes to reduce the ongoing SONGS O&M revenue requirement based on the latest SCE estimates, and apply this change to customer rates beginning in 2014.[13] SDG&E requests that the SONGSBA be retained and continue in operation until it is no longer needed, and that the ongoing balances in the account continue to be amortized in rates on an annual basis according to the SONGSBA adopted tariff.

SDG&E intends to request authorization in the near future to access the SONGS decommissioning trusts to cover expenses at SONGS that will reduce O&M costs charged to customers.

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[10] Reflects five-year short term debt rate SCE applies to nuclear fuel inventory.

[11] Of this amount, $3 million is incurred separately by SDG&E and not subject to balancing account treatment.

[12] The SONGSBA was established pursuant to D.06-11-026.

[13] For 2013, SDG&E proposes to utilize the current overcollection in the SONGSBA of approximately $26 million to offset the 2013 revenue requirement proposed in this filing.

G. Summary and effective date of proposed SONGS capital-related and O&M revenue requirements

A summary of the revenue requirement based on SDG&E's proposal to recover the remaining un-depreciated (or unamortized) SDG&E's SONGS capital investment and revised O&M revenue requirement is reflected in the table below. Further detail on the derivation of the amounts is contained in the testimony of Ms. Hiramoto.

Table 1
Summary of SONGS Revenue Requirement
($ in millions, including FF&U)

Item	Jun - Dec 2013	2014	2015
Proposed Revenue Requirement			
Used and Useful	13	23	26
Retired	47	79	76
Nuclear Fuel Carrying Cost *1)*	-	-	1
O&M *2)*	57	52	36
Accelerated Savings from 2014-2017 *3)*	(5)	1	1
Proposed SONGS Revenue Requirement	112	155	140
Authorized SONGS Revenue Requirement *4)*	112	194	197
Increase/(Decrease) over Authorized *5)*	-	(39)	(57)

1) Reflects short term borrowing rate applied to nuclear fuel balance.

2) For 2013, includes current $26 million overcollection in SONGSBA.

3) $5 million of savings is applied to 2013 and offset by $1.25 million of annual revenue deferral in 2014-2017.

4) Reflects non-SGRP O&M and capital revenue requirement adjusted for adopted attrition in D.13-05-010 and authorized SGRP revenue requirement.

5) 2013-2015 combined reduction of $96.0 million is offset by revenue deferral of $3.0 million to 2016-2017 for 2013-2015 net savings of $93.0 million.

The effective date of the revised revenue requirement for the SONGS investment should be June 1, 2013, which coincides with the nearest month-end date (May 31, 2013) from when the determination was made by SCE to permanently retire the nuclear facilities. At that point, the capital investment in SONGS for the retired portion of the plant became no longer used and useful and subject to the separate rate recovery mechanism proposed herein. Until the time this determination was made, SDG&E should receive full recovery of and return on the assets since all efforts were being made to restore SONGS back to service.

Table 1 above reflects a combined reduction in the overall SONGS revenue requirement of $93 million for the period June 2013 through December 2015 as compared to the authorized revenue requirement currently in rates or expected to be in rates for the same time period. This reduction captures the expected savings from the lower O&M expected to be billed to SDG&E by SCE, with significant additional savings expected for 2016 and beyond. Because the initial 2013 (June-December) revenue requirement results in an increase of $5 million compared to authorized, SDG&E proposes to accelerate the savings in years 2014-2017 to completely offset the increase in 2013, such that the net overall impact to the 2013 revenue requirement is zero.

IV. PROPOSED RATEMAKING TREATMENT OF SONGS CAPITAL REVENUE REQUIREMENT

Given the current schedule outlined by the Commission for this phase of the SONGS investigation, which currently provides for a final decision in February 2014, SDG&E proposes to apply the change in the SONGS capital-related and O&M revenue requirements to electric commodity rates effective March 1, 2014. This rate change should include the prospective impact of the change in the SONGS capital-related revenue requirement. Additionally, SDG&E proposes to record to its NGBA the difference between the new revenue requirement adopted in this proceeding and the existing SONGS revenue requirement in current rates for the period June 1, 2013 through the month ended just prior to the implementation of the new rates (expected February 28, 2014). This adjustment will be amortized in customer rates effective January 1, 2015, as prescribed by the current NGBA tariff.

Upon a final decision in this phase of the proceeding, SDG&E will file a compliance advice letter to implement the overall rate change going forward. Subsequent rate changes to reflect the annual change in the revenue requirement adopted in this proceeding will be addressed in SDG&E's annual NGBA update advice letter filing submitted in November of each year for rates effective January 1 of the subsequent year. As stated above, SDG&E will update its NGBA to reflect the SONGS capital revenue requirement that is ultimately adopted in this decision effective back to June 1, 2013.

V. CONCLUSION

As outlined in this testimony, Commission precedent supports a policy of providing for the "cost of service" recovery for costs reasonably and prudently incurred in providing safe and reliable electric service to customers at a fair rate of return for utility investors. This policy extends to assets that have been retired before the end of their anticipated useful lives and has been consistently evidenced in prior Commission decisions addressing cost recovery for retired utility plant. For these reasons, SDG&E respectfully requests that the revenue requirement and cost recovery mechanism associated with the remaining SONGS capital investment and O&M revenue requirement be adopted as proposed in this testimony.

Remaining capital costs associated with SONGS plant that is still considered "used and useful" for ongoing activities and transition to decommissioning activities should initially be recovered over the original SONGS license period (9 ½ years) at SDG&E's current authorized rate of return of 7.79% through 2017, but then accelerated beginning in 2018 over 3 years at a reduced ROR. Costs associated with retired plant should be recovered over a 5-year period, but at a reduced ROR consistent with SDG&E's embedded cost of debt, adjusted for the weighted component for preferred stock. As part of the cost recovery, the existing balances in CWIP should be applied or transferred to the appropriate plant accounts (used and useful or retired) and recovered accordingly. In addition, the unamortized nuclear fuel inventory should be deferred until such time the final balance is known, and accrue a carrying cost equal to the short-term interest rate. To mitigate the rate impact of the change to the capital-related revenue requirement, SDG&E proposes to reduce its SONGS revenue requirement for O&M costs billed from SCE and accelerate a portion of the estimated savings from 2014-2017 to offset the impact of the revenue requirement for 2013. Finally, the impact of the overall change to the SONGS revenue requirement adopted in this proceeding should be applied to customer rates as proposed herein.

This concludes my direct testimony.

WITNESS QUALIFICATIONS

My name is Kenneth J. Deremer and my business address is 8330 Century Park Court, San Diego, California 92123. I am currently employed by SDG&E as the Director of Financial Planning and Regulatory Accounts. My current responsibilities include the development, implementation and analysis of SDG&E's annual and multi-year financial planning process and regulatory account and cost recovery mechanisms. I assumed my current position in May 2011. Prior to this, I served as the Director of Financial Analysis since January 2009, where my responsibilities included overseeing the financial evaluation of major projects, the development and implementation of financing strategies and the oversight of regulatory account and cost recovery mechanisms for SDG&E and Southern California Gas Company (SoCalGas). Previously, I was the Director of Tariffs and Regulatory Accounts since May 2007, where my responsibilities included the implementation and oversight of the utilities' tariffs and regulatory compliance process. Prior to May 2007, I served as the Regulatory Accounts Manager since April 2002. In that position, I managed the process for implementing and maintaining regulatory accounts.

Over the past 10 years, I have served testimony in several regulatory proceedings, including the General Rate Case, Cost of Capital and Electric Commodity Cost Recovery (i.e. ERRA).

I have been employed by SDG&E and Sempra Energy since 1991. In addition to my work experience described above, I worked from 1999 through 2002 as a Regulatory Tariff Administrator and held various positions in the Financial Reporting Department.

I received a Bachelor's of Science in Business Administration from the University of California, Riverside in June 1987. I also received a Master's in Business Administration, with an emphasis in Finance, from the University of California, Riverside in December 1989.

I have previously testified before this Commission.