

Application No.: A.10-07-XXX
Exhibit No.: _____
Witness: Kenneth J. Deremer

_____))
Application of San Diego Gas & Electric Company)
(U 902 E) to Amend Renewable Energy Power) Application 10-07-____
Purchase Agreement with NaturEner Rim Rock Wind) (Filed July 15, 2010)
Energy, LLC and for Authority to Make a Tax Equity)
Investment in the Project.)
_____)

CHAPTER 5

PREPARED DIRECT TESTIMONY OF

KENNETH J. DEREMER

ON BEHALF OF

SAN DIEGO GAS & ELECTRIC COMPANY

****PUBLIC VERSION****

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

July 15, 2010

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1 **PREPARED DIRECT TESTIMONY OF**

2 **KENNETH J. DEREMER**

3 **ON BEHALF OF SDG&E**

4
5 **I. INTRODUCTION**

6 The purpose of my testimony is to describe the ratemaking and cost recovery proposals of
7 the NaturEner Rim Rock tax equity transaction. In summary, my testimony will provide a
8 description of the following: 1) SDG&E’s current mechanisms for the recovery of electric
9 commodity costs, including those costs associated with utility owned generation (“UOG”) and
10 purchase power agreements (“PPA”), 2) the costs components and credits that comprise the
11 revenue requirement to be applied to ratepayers associated with the tax equity investment, and 3)
12 SDG&E’s proposal for the ratemaking treatment of the purchase power costs and revenue
13 requirement.

14 Details of the tax equity transaction are provided for in the direct testimonies of
15 Witnesses Mike McClenahan, Amir Moftakhar and Ragan Reeves. My testimony supports their
16 proposals by providing the regulatory accounting and ratemaking framework for which SDG&E
17 will record the costs and benefits associated with the tax equity investment.

18 **II. ELECTRIC COMMODITY COST RECOVERY MECHANISMS**

19 SDG&E currently recovers the costs associated with its electric commodity transactions,
20 including electric fuel, purchase power, and capital and operation and maintenance (“O&M”)
21 expenses associated with UOG through its electric commodity rate component. Pursuant to
22 D.02-10-062 and D.02-12-074, the Energy Resource Recovery Account (“ERRA”) provides for
23 full recovery of SDG&E’s energy procurement costs associated with fuel and purchased power
24 (including renewable resources), UOG, Independent System Operator (“ISO”)-related costs and

1 costs associated with the residual net short procurement requirements to serve SDG&E's bundled
2 service customers. The ERRA includes revenues from SDG&E's Electric Energy Commodity
3 Cost ("EECC") rate schedule adjusted to exclude California Department of Water Resources
4 ("CDWR") revenues for energy provided by CDWR to SDG&E customers. For non-fuel costs
5 associated with UOG, SDG&E records the associated revenue requirement, including capital-
6 related costs (depreciation, return and taxes) and O&M expenses to the Non-fuel Generation
7 Balancing Account ("NGBA"). Currently, this includes SDG&E's investment in San Onofre
8 Nuclear Generating Station ("SONGS"), Palomar Energy Center and the Miramar Energy
9 Facilities I and II. The fuel expenses associated with these facilities are recorded to the ERRA.

10 **III. TAX EQUITY INVESTMENT**

11 **A. Background**

12 On May 29, 2009, SDG&E filed Advice Letter 2088-E, requesting Commission approval
13 of a renewable PPA with Naturener Rim Rock Wind Energy, LLC¹. As part of this transaction,
14 the Green Attributes associated with the power produced by the wind facility will be rebundled
15 with firm power to be delivered into California from the El Dorado gas-fired generating facility
16 in Nevada.² As part of the advice letter, SDG&E requested that the costs associated with
17 payments made under the PPA are recoverable through the ERRA.³ In Resolution E-4277, the
18 CPUC approved Advice Letter 2088-E as a separate-party PPA. However, as described in the
19 testimonies of Mr. McClenahan and Mr. Moftakhar, SDG&E is seeking in this application to
20 become a tax equity investor in the Rim Rock project in order to reduce the overall cost of the re-
21 priced PPA, which would otherwise be higher with the involvement of a non-utility investor that
22 would require a higher return.

¹ Approved by CPUC via Resolution E-4277 dated November 20, 2009.

² In D.07-11-046, the CPUC approved SDG&E's request to exercise an option to purchase firm energy from El Dorado Beginning in October 2011.
















³ See page 22, Advice Letter 2088-E.

1 **B. Green Attributes**


2 To secure the Green Attributes associated with the power generated by the Naturener
3 Rim Rock wind facility, SDG&E will pay the project company the flat cost differential between
4 the “green” energy produced by the wind facility and the “null” power it simultaneously resells
5 to the project at the bus bar. This incremental cost is reflected as part of the PPA and represents
6 the net cost to ratepayers associated with the NaturEner transaction. As described in the
7 testimony of Mr. Moftakhar, the cost of the Green Attributes will not exceed the proposed cap
8 during the life of the contract.

9 **C. Tax Equity Investment Revenue Requirement**

10 A summary of the components of the tax equity investment annual revenue requirements
11 for the first five years based on the costs and other financial assumptions presented in the
12 testimony of Mr. Moftakhar is provided in the table below (\$ millions)⁴:

Description	2012	2013	2014	2015	2016
Investment Costs					
Cash Flows					
PTC					
TOTAL ⁵	3.4	18.2	(22.5)	(18.3)	(27.2)

- 13
- 14 • **Investment Costs** - As described in the testimony of Mr. Moftakhar, SDG&E plans
15 to invest up to \$600 million in the project as a purchase of shares in the project
16 holding company (up to 79.99% of project costs), contributed at project completion.
17 SDG&E intends to treat this investment as an intangible capital asset on its books
18 with a useful life of 20 years. Since the tax equity investment does not reflect a

⁴ Assumes  million investment. Excludes franchise fees & uncollectibles (FF&U).

1 traditional investment in utility plant in service, it will not actually be placed into
2 SDG&E's rate base as compared to a generation plant (e.g. Palomar), where
3 SDG&E actually owns and operates the physical assets. Despite this difference in
4 accounting treatment, the tax equity investment in the Rim Rock project is similar to
5 a traditional investment in utility plant given that it represents a significant capital
6 outlay by SDG&E on behalf of its ratepayers with an extended useful life (20 years).
7 Accordingly, it is appropriate that the recovery of the U.S. dollar tax equity
8 investment receive similar cost recovery treatment as a traditional utility capital
9 investment with the calculation of a revenue requirement associated with the equity
10 investment that includes depreciation, return⁶ and applicable taxes associated with
11 the investment.

12 The tax benefits associated with the depreciation of the production assets under
13 the Modified Accelerated Cost Recovery System ("MACRS") will be applied as a
14 credit to the rate-based investment for purposes of calculating the revenue
15 requirement. Under the project holding company LLC Agreement, SDG&E will
16 receive [REDACTED] of the tax benefits (described below) in the first 10 years (or after
17 SDG&E reaches its 7.36% after tax return – whichever occurs first) and not less than
18 [REDACTED] thereafter.

- 19 • **Cash Flows** – The project will generate operating income and pre-tax cash flows of
20 which, through its ownership of shares in the project holding company, SDG&E is
21 allocated to receive [REDACTED] of the cash flows during the "cash sweep" period (which

⁵ Project is assumed to commence production in 4th quarter 2012. For ratemaking purposes, SDG&E would combine 2012 and 2013 revenue requirements for a consolidated rate change effective January 1, 2013.

⁶ Consistent with the return used in the commercial transaction, the overall rate of return (ROR) applied to the investment is set at 8.40% (pre-tax) and 7.36% (after-tax) based on SDG&E's current authorized ROR established in D.07-12-049.

1 will not exceed 3 years)⁷, [REDACTED] from the end of the cash sweep period to the “flip
2 date” (forecast to occur at the end of year 10), and then not less than [REDACTED]
3 thereafter until the end of the partnership. SDG&E’s share of the cash flows from
4 the project will be applied separately against the revenue requirement.

5 As described in the testimony of Mr. Moftakhar, when combined with the
6 production tax credits (“PTCs”) discussed below, the net present value of SDG&E’s
7 allocation of the cash flows and tax benefits is expected to fully offset the revenue
8 requirement associated with the equity investment such that there would be no
9 incremental charge to ratepayers over the life of the investment.

- 10 • **Production Tax Credits** – As described in Mr. Moftakhar’s testimony, as part of
11 the tax equity investment, SDG&E, through its ownership of shares in the project
12 holding company, will be entitled to receive federal PTCs from the project based on
13 the output of renewable energy for the first 10 years. The estimated PTCs are
14 reflected as a credit to the revenue requirement associated with the equity investment
15 costs.

16 **IV. RATE RECOVERY**

17 The recovery mechanism proposed herein is consistent with the provisions of Assembly
18 Bill (AB) 57 which facilitates the development of a diverse procurement portfolio and the
19 utility’s prospective recovery of costs that are consistent with an approved procurement plan. As
20 described in the testimony of Mr. McClenahan, the costs associated with the Naturener Rim
21 Rock PPA and the tax equity investment in the project serve to the benefit of SDG&E’s bundled
22 customers in providing Green Attributes to meet California’s renewable portfolio standards. To

⁷ Cash sweep period will be the lesser of 3 years or when developer recovers at least [REDACTED] of its investment, including developer fee.

1 that end, it is appropriate that the costs described in Section III above be recovered through
2 SDG&E's electric commodity rates ("Schedule EECC") applied to bundled service customers.
3 As provided for in Advice Letter 2088-E, SDG&E proposes to recover the cost differential
4 associated with the Green Attributes payment under the PPA with Naturener Rim Rock through
5 the ERRA consistent with its existing purchase power contracts, including renewable energy
6 contracts.

7 In order to separately track the costs and benefits associated with tax equity investment in
8 the project, SDG&E proposes to establish a separate regulatory account, the Tax Equity
9 Investment Balancing Account ("TEIBA"). On a monthly basis, the TEIBA will record the
10 authorized revenue requirement associated with the tax equity investment, including
11 depreciation, return and taxes against the actual revenue requirement. The actual revenue
12 requirement is based on the following: 1) the calculation of the recorded depreciation, return and
13 taxes based on recorded rate-based investment, which will be adjusted for the depreciation tax
14 benefits allocated to SDG&E from the project; 2) the offsetting cash flows received from the
15 project; and, 3) the offsetting PTCs received from the project. As described in Mr. Moftakhar's
16 testimony, SDG&E intends to elect a limited deficit restoration obligation ("DRO") such that the
17 tax benefits continue to be allocated in the manner prescribed by the partnership agreement if
18 SDG&E's capital account becomes negative. Under this scenario, ratepayers will be able to
19 receive the maximum tax benefits possible. In the unlikely event of liquidation, the contingent
20 liability associated with the DRO shall be recorded to the TEIBA.

21 The cost recovery mechanism for the tax equity investment will ensure that SDG&E
22 shareholders receive full recovery of the investment at its current authorized after-tax return of
23 7.36%. The return is fixed at this rate such that any residual returns above or below the fixed
24 return will be applied to ratepayers. As described in Mr. Moftakhar's testimony, the financial

1 structure of the tax equity transaction is designed such that the ratepayers' contribution in
2 reimbursing SDG&E for the revenue requirement associated with the investment is expected to
3 be fully offset by allocations of cash flows, tax benefits and PTCs from the project to achieve
4 ratepayer neutrality.

5 The authorized revenue requirement for the tax equity investment will be placed into
6 electric commodity rates and updated on an annual basis in SDG&E's NGBA update advice
7 filing submitted in November of each year to become effective January 1 of the subsequent year.
8 The recorded costs (i.e. revenue requirement adjusted for the recorded project cash flows, tax
9 benefits and the actual value of the PTCs) will be compared to the authorized revenue
10 requirement recovered through rates and tracked in the TEIBA. At the end of each year,
11 SDG&E will transfer the balance in the TEIBA to the NGBA such that any differences between
12 the authorized tax equity investment revenue requirement placed into rates and the actual
13 revenue requirement based on cash flows and tax benefits allocated from the project and actual
14 PTCs will be trued-up to ratepayers on an annual basis. The TEIBA will be provided for review
15 in SDG&E's annual ERRA Review proceeding filed by June 1 each year.

16 **V. CONCLUSION**

17 As described above, SDG&E requests to recover the costs associated with the tax equity
18 investment in the Rim Rock project holding company through its electric commodity rates. As
19 previously requested in Advice Letter 2088-E, the costs associated with the Green Attributes
20 payments will be recovered through the ERRA. The revenue requirement associated with the tax
21 equity investment should be recovered via a new balancing account – TEIBA, which will be
22 transferred to the NGBA on an annual basis and reviewed as part of SDG&E's annual ERRA
23 compliance proceedings. SDG&E's rate recovery proposal described herein is reasonable and
24 consistent with AB 57 and the ratemaking mechanisms previously adopted by the Commission.

1 A declaration regarding confidentiality of certain data is attached to this testimony as

2 Exhibit A.

3 This concludes my direct testimony.

4

1 **VI. QUALIFICATIONS OF KENNETH J. DEREMER**

2 My name is Kenneth J. Deremer and my business address is 8330 Century Park Court,
3 San Diego, California 92123. I am currently employed by San Diego Gas & Electric as the
4 Director of Financial Analysis & Assistant Treasurer. My responsibilities include overseeing the
5 development, analysis and implementation of revenue requirements, regulatory accounts and
6 financing strategies for SDG&E. I assumed my current position in January 2009 after serving as
7 the Director of Tariffs and Regulatory Accounts since May 2007, where my responsibilities
8 included the implementation and oversight of the utilities' tariffs and regulatory accounts,
9 including the preparation of testimony in the ERRA and other regulatory proceedings. Prior to
10 May 2007, I served as the Regulatory Accounts Manager since April 2002. In that position, I
11 managed the process for implementing and maintaining regulatory accounts, including serving
12 testimony in ERRA proceedings.

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

16 I received a Bachelors of Science in Business Administration from the University of
17 California, Riverside in June 1987. I also received a Masters in Business Administration, with
18 an emphasis in Finance, from the University of California, Riverside in December 1989.

19 I have previously testified before this Commission. The purpose of my testimony
20 is to sponsor the cost recovery and ratemaking aspects of this application.

Exhibit A

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

**DECLARATION OF KENNETH DEREMER
REGARDING CONFIDENTIALITY OF CERTAIN DATA**

I, Kenneth Deremer, do declare as follows:

1. I am the Director of Financial Analysis and Assistant Treasurer for San Diego Gas & Electric Company (“SDG&E”). I have reviewed my provided direct testimony for SDG&E’s Application to Amend Renewable Energy Power Purchase Agreement with NaturEner Rim Rock Wind Energy, LLC and For Authority to Make a Tax Equity Investment in the Project, dated July 15th, 2010. In addition, I am personally familiar with the facts and representations in this Declaration and, if called upon to testify, I could and would testify to the following based upon my personal knowledge and/or belief.

2. I hereby provide this Declaration in accordance with D.06-06-066^{8/} and D.08-04-023 to demonstrate that the confidential information (“Protected Information”) provided in the Report submitted concurrently herewith (described below) falls within the scope of data protected as confidential pursuant to the IOU Matrix attached to the Commission’s confidentiality decision, D.06-06-066 (the “IOU Matrix”) and/or under relevant statutory provisions.^{9/}

^{8/} As amended by D.07-05-032.

^{9/} The Matrix is derived from the statutory protections extended to non-public market sensitive and trade secret information. (See D.06-06-066, *mimeo*, note 1, Ordering Paragraph 1). The Commission is obligated to act in a manner consistent with applicable law. The analysis of protection afforded under the Matrix must always produce a result that is consistent with the relevant underlying statutes; if information is eligible for statutory protection, it must be protected under the Matrix. (See *Southern California Edison Co. v. Public Utilities Comm.* 2000 Cal. App. LEXIS 995, *38-39) Thus, by claiming applicability of the Matrix, SDG&E relies upon and simultaneously claims the protection of applicable statutory provisions including, but not limited to, Public Utilities Code §§ 454.5(g) and 583, Govt. Code § 6254(k) and General Order 66-C.

3. In D.06-06-066, the Commission adopted rules governing confidentiality of certain categories of electric procurement data submitted to the Commission by investor owned utilities (“IOUs”) and energy service providers (“ESPs”). The Commission established two matrices – one applicable to IOUs, the other to ESPs – setting forth categories and sub-categories of data and providing a confidentiality designation for each.^{10/}

4. To the extent information matches a Matrix category, it is entitled to the protection the Matrix provides for that category of information. In addition, the Commission has made clear that information must be protected where “it matches a Matrix category exactly . . . or consists of information from which that information may be easily derived.”^{11/} In order to claim the protection afforded by the relevant Matrix, the party seeking confidential treatment must establish:

- 1) That the material it is submitting constitutes a particular type of data listed in the Matrix,
- 2) Which category or categories in the Matrix the data correspond to,
- 3) That it is complying with the limitations on confidentiality specified in the Matrix for that type of data,
- 4) That the information is not already public, and
- 5) That the data cannot be aggregated, redacted, summarized, masked or otherwise protected in a way that allows partial disclosure.^{12/}

^{10/} See, D.06-06-066, as amended by D.07-05-032, *mimeo*, Appendices 1 and 2.

^{11/} See, *Administrative Law Judge’s Ruling on San Diego Gas & Electric Company’s April 3, 2007 Motion to File Data Under Seal*, issued May 4, 2007 in R.06-05-027, p. 2 (emphasis added).

^{12/} D.06-06-066, as amended by D.07-05-032, *mimeo*, p. 81, Ordering Paragraph 2.

5. SDG&E's Protected Information: The Protected Information, consisting of the information described below, is protected pursuant to the following Matrix categories:

Description of Data	Matrix Category	Period of Confidentiality
Section III: Subsection C: Page KD-3: Table after Line 12	VIII.B	Confidential for three years after winning bidders selected
Section III: Subsection C: Page KD-3: Footnote 4	VIII.B	Confidential for three years after winning bidders selected
Section III: Subsection C: Page KD-4: Line 16	VIII.B	Confidential for three years after winning bidders selected
Section III: Subsection C: Page KD-4: Line 18	VIII.B	Confidential for three years after winning bidders selected
Section III: Subsection C: Page KD-4: Line 21	VIII.B	Confidential for three years after winning bidders selected
Section III: Subsection C: Page KD-5: Lines 1, 2	VIII.B	Confidential for three years after winning bidders selected
Section III: Subsection C: Page KD-5: Footnote 7	VIII.B	Confidential for three years after winning bidders selected
Section III: Subsection C: Page KD-5: Line 2	VIII.B	Confidential for three years after winning bidders selected

6. The Commission previously considered and approved application of IOU Matrix confidentiality protection to project development status data in its *Administrative Law Judge's Ruling Granting San Diego Gas & Electric Company's May 21, 2007 Amendment to April 3, 2007 Motion and May 22, 2007 Amendment to August 1, 2006 Motion*, issued June 28, 2007 in R.06-05-027.

7. SDG&E intends to comply with the limitations on confidentiality specified in the Matrix for the type of data that is provided herewith.

8. I am not aware of any instance of public disclosure of the Protected Information.

9. The Protected Information cannot be provided in a form that is further aggregated, redacted, or summarized and still provide the level of detail requested and expected by the Energy Division.

10. As an alternative basis for requesting confidential treatment, SDG&E submits that the project status information provided in the Report is material, market sensitive, electric procurement-related information protected under §§ 454.5(g) and 583, as well as trade secret information protected under Govt. Code § 6254(k), and that the disclosure of this information would place SDG&E at an unfair business disadvantage, thus triggering the protection of G.O. 66-C.^{13/}

11. Public Utilities Code § 454.5(g) provides:

The commission shall adopt appropriate procedures to ensure the confidentiality of any market sensitive information submitted in an electrical corporation's proposed procurement plan or resulting from or related to its approved procurement plan, including, but not limited to, proposed or executed power purchase agreements, data request responses, or consultant reports, or any combination, provided that the Office of Ratepayer Advocates and other consumer groups that are nonmarket participants shall be provided access to this information under confidentiality procedures authorized by the commission.

12. General Order 66-C protects “[r]eports, records and information requested or required by the Commission which, if revealed, would place the regulated company at an unfair business disadvantage.”

^{13/} This argument is offered in the alternative, not as a supplement to the claim that the data is protected under the IOU Matrix. California law supports the offering of arguments in the alternative. See, *Brandolino v. Lindsay*, 269 Cal. App. 2d 319, 324 (1969) (concluding that a plaintiff may plead inconsistent, mutually exclusive remedies, such as breach of contract and specific performance, in the same complaint); *Tanforan v. Tanforan*, 173 Cal. 270, 274 (1916) (“Since . . . inconsistent causes of action may be pleaded, it is not proper for the judge to force upon the plaintiff an election between those causes which he has a right to plead.”)

13. Under the Public Records Act, Govt. Code § 6254(k), records subject to the privileges established in the Evidence Code are not required to be disclosed.^{14/} Evidence Code § 1060 provides a privilege for trade secrets, which Civil Code § 3426.1 defines, in pertinent part, as information that derives independent economic value from not being generally known to the public or to other persons who could obtain value from its disclosure.

14. Public Utilities Code § 583 establishes a right to confidential treatment of information otherwise protected by law.^{15/}

15. If disclosed, the Protected Information could provide parties with whom SDG&E is currently negotiating insight into SDG&E's procurement options, which would unfairly undermine SDG&E's negotiation position and could ultimately result in increased cost to ratepayers. In addition, if developers mistakenly perceive that SDG&E is not committed to assisting their projects, disclosure of the Protected Information could act as a disincentive to developers. Accordingly, pursuant to P.U. Code § 583, SDG&E seeks confidential treatment of this data, which falls within the scope of P.U. Code § 454.5(g), Evidence Code § 1060 and General Order 66-C.

16. In accordance with the statutory provisions described herein, SDG&E hereby requests that the information set forth in the Report be protected from public disclosure.

^{14/} See also Govt. Code § 6254.7(d).

^{15/} See, D.06-06-066, *mimeo*, pp. 26-28.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct to the best of my knowledge.

Executed this 15th day of July, 2010, at San Diego, California.

 /s/ Kenneth Deremer
Kenneth Deremer
Director of Financial Analysis and Assistant
Treasurer