



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

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Application of SAN DIEGO GAS & ELECTRIC
COMPANY (U 902-E) for Adoption of its 2011 Energy
Resource Recovery Account Revenue Requirement
Forecast and Competitive Transition Charge Revenue
Requirement Forecasts

Application 10-10-001
(filed October 1, 2010)

**OPENING BRIEF OF
SAN DIEGO GAS & ELECTRIC COMPANY (U 902-E) IN SUPPORT OF ITS
2011 ERRRA FORECAST APPLICATION**

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2011 ERRA FORECAST APPLICATION**

I. SUMMARY OF RECOMMENDATIONS

Pursuant to the Rules of Practice and Procedure of the California Public Utility Commission (“Commission”) and the briefing schedule adopted by Administrative Law Judge (“ALJ”) Wilson in the above-captioned proceeding, SDG&E hereby files its Opening Brief in support of approval of its Amended 2011 Energy Resource Recovery Account (“ERRA”) forecast application (“Application”). In sum, the Application requests the following relief:

(1) authority to decrease commodity rates applicable to bundled customers by approving as reasonable SDG&E’s 2011 ERRA revenue requirement forecast of \$755.413 million (including franchise fees and uncollectibles) regarding SDG&E’s load, the resources available to meet SDG&E’s load, fuel costs, and costs for SDG&E’s various electric resources;

(2) authority to increase Competition Transition Charge (“CTC”) rates applicable to both bundled and unbundled customers by approving as reasonable SDG&E’s 2011 CTC revenue requirement forecast of \$63.354 million;

(3) approval of new 2011 market benchmark prices of \$42.50/MWH for calculating the CTC and \$44.33/MWH for calculating the Power Charge Indifference Adjustment (“PCIA”), as well as the resulting 2011 PCIA’s; and

(4) approval of SDG&E’s proposal to modify the ERRA trigger mechanism by offsetting the ERRA under/overcollection by the Non-Fuel Generation Balancing Account (“NGBA”) over/undercollection when calculating the monthly ERRA trigger.

Most of the Application remains undisputed. The Division of Ratepayer Advocates (“DRA”) was the only party to file a protest and has generally agreed to all of the foregoing requests for relief.¹ DRA, however, has requested a disallowance as to a specific subset of costs included as part of SDG&E’s ERRA revenue requirement forecast. This cost is related to equity rebalancing associated with SDG&E’s revised power purchase agreement with the Otay Mesa Energy Center (“OMEC PPA”). In September of 2006, following the filing of a Joint Petition (supported by SDG&E and DRA, among others), the Commission approved the OMEC PPA. Contrary to DRA’s disallowance request in this ERRA proceeding, when the Commission approved the OMEC PPA in D.06-09-021, it specifically approved recovery of equity rebalancing costs associated with the impact of Generally Accepted Accounting Principles (“GAAP”) rules requiring SDG&E to consolidate OMEC’s financial statements. As explained in the Rebuttal Testimony of SDG&E witness Kenneth Deremer, according to the relevant GAAP rules, SDG&E is required to consolidate the financial position and results of OMEC and include OMEC’s assets and liabilities, including debt, as if OMEC was either

¹ The Alliance for Retail Energy Markets (“AReM”) did not file a protest in this proceeding, but appeared at the pre-hearing conference to seek party status for the limited purpose of requesting that the scope of the proceeding include the issue of whether or not the PCIA and market price benchmark values should be kept at their current levels pending the Commission’s action in the on-going Direct Access (“DA”) proceeding (R.07-05-025—Direct Access proceeding). Following SDG&E’s Motion to Strike, filed on February 24, 2011, ALJ Wilson ruled that AReM’s testimony, if and when offered into evidence, would be stricken.

legally owned by or a part of SDG&E, which in turn impacts the balance between SDG&E's equity and debt. In light of these GAAP rules, the Commission authorized the recovery of equity rebalancing costs, subject to agreed upon caps, so as to mitigate the financial impact of this consolidation. The equity rebalancing costs were specifically tied to a revenue requirement formula approved by DRA and other parties in the Joint Petition.

Ignoring its prior support of the Joint Petition, upon which SDG&E relied in deciding to execute the OMEC PPA, DRA has decided to reverse course and is refusing to recognize the Commission's approval of recovery for equity rebalancing costs in the ERRRA. DRA's sudden change in position is disturbing because recovery of equity rebalancing costs was part of an integrated agreement that included SDG&E assuming additional ownership obligations to a power plant it did not build nor operate during the first 10 years of operations given the contract structure with OMEC – an arrangement that DRA and the other parties agreed was the preferred alternative to the cost of building another power plant to provide much needed in-basin supplies over the next 30-years (the assumed useful life of OMEC). SDG&E would not have agreed to this arrangement if it had known that DRA would renege on its agreement to support equity rebalancing costs, subject to the agreed upon caps. These costs were a critical component of the overall cost recovery package adopted for the OMEC transaction in D.06-09-021.

Moreover, according to D.06-09-021, the only basis upon which to challenge equity rebalancing costs is if future evidence suggests that consolidation is not required. Despite SDG&E's clear showing that consolidation continues to be required, DRA has refused to withdraw its disallowance request, claiming that a subsequent cost of capital

decision (D.07-12-049) is grounds to deny recovery of equity rebalancing costs. D.07-12-049, however, clearly states that was only applicable on a prospective basis (after the OMEC PPA was approved) and the record in that proceeding is completely void of any facts or conclusions applicable to the OMEC PPA.

DRA's refusal to reasonably consider both the law and facts showing that their disallowance requests lacks any merit should be strongly rejected, especially considering the fact that DRA originally supported the OMEC PPA and understood that SDG&E would not execute the OMEC PPA without approval of recovery of equity rebalancing costs. Moreover, pursuant to the doctrine of collateral estoppel, DRA is prohibited from contesting recovery of equity rebalancing costs in this proceeding because the Commission previously approved SDG&E's 2009 and 2010 ERRA revenue requirement forecasts, which included recovery of such costs. The Commission's approvals of SDG&E's 2009 and 2010 ERRA revenue requirement forecasts were granted well after D.07-12-049, without any DRA objection. DRA's objection to recovery of equity rebalancing costs in this proceeding is reflective of an unreasonable and wasteful approach to litigation. Any signal that such an approach is tolerable will only encourage DRA to feel free to unilaterally ignore prior commitments and rulings, thereby undermining SDG&E's assumption that DRA's negotiations are conducted in good faith.

II. BACKGROUND

On October 1, 2010, SDG&E submitted its 2011 ERRA Forecast Application, including supporting testimony and exhibits. Pursuant to Rule 1.12 of the Commission's Rules of Practice and Procedure, SDG&E filed an Amendment to its original 2011 ERRA Forecast Application. This Amendment was necessary to update the market benchmark

price used to calculate above or below market costs associated with SDG&E's combined total portfolio. Typically, the Commission's Energy Division provides the updated benchmark price in November and an amended application is filed in December. However, this year, Energy Division did not issue an updated benchmark price. Accordingly, so as to avoid further delay and consistent with ALJ Wilson's adopted schedule requiring that any amendment to the Application be filed by January 14, 2011, SDG&E based its Amendment on an estimated benchmark price. As explained in the Amended Testimony of SDG&E witness Cynthia Fang, this approach is consistent with what the other investor-owned utilities ("IOUs") have done in their most recent ERRA forecast proceedings.

As a result of the Amendment, the 2011 ERRA revenue requirement is \$72.543 million lower than the forecast for 2010. However, with respect to the CTC revenue requirement, the Amendment resulted in an increase of \$16.446 million when compared to the forecast for 2010. Overall, the Amendment resulted in a combined total decrease of \$56.097 million or a 2.06 percent decrease in current system average rates (a decrease of 0.329 cents per kilowatt-hour to the system average rate). Although the combined impact of the Amendment was a decrease in system average rates, because of the increase in Utility Distribution Company rates associated the CTC revenue requirement applicable to unbundled customers, SDG&E complied with the rate increase noticing requirements of Rule 3.2 of the Commission's Rule of Practice and Procedure.

If approved as proposed in the Amendment, a typical monthly summer electric bill (based on 500 kilowatt-hours of electricity) will decrease from approximately \$81.05 to \$80.39 (or 0.8 percent) for inland customers and from approximately \$90.29 to \$88.89

(or 1.6 percent) for coastal customers. A typical monthly bill for residential customers who use 1,000 kilowatt-hours per month will decrease from approximately \$232.83 to \$227.01 (or 2.5 percent) for inland customers and from approximately \$244.00 to \$237.52 (or 2.7 percent) for coastal customers. SDG&E's small commercial customers will see a decrease of approximately \$6.12 on their monthly summer electric bill or 2.0 percent (based on 1,500 kWh of electricity for secondary service).²

III. SDG&E'S ERRR AND CTC REVENUE REQUIREMENTS SHOULD BE APPROVED

On October 29, 2001, the Commission initiated R.01-10-024 (the Procurement OIR) to establish ratemaking mechanisms that would enable IOUs to resume purchasing electric energy, capacity, ancillary services and related hedging instruments to fulfill their obligation to serve and meet the needs of their bundled customers. In so doing, the Commission acknowledged that the utilities should be provided "flexibility in transacting for energy to meet their obligation to serve their customers" so that the utilities "can take advantage of market opportunities that result in the low and stable prices."³ The Commission also acknowledged that the utilities desired assurance of more timely regulatory review and cost recovery for their procurement activities and costs. Such assurance ultimately came in the form of legislation, namely Assembly Bill ("AB") 57.

Section 454.5(d)(3) of the Public Utilities Code ("PUC"), initiated by AB 57, states that a procurement plan approved by the Commission shall accomplish, among other things, the following objectives:

Ensure timely recovery of prospective procurement costs incurred pursuant to an approved procurement plan. The commission shall establish rates based on forecasts of procurement costs adopted by

² Customers' actual bill impacts will vary with usage per month, by season and by climate zone.

³ D.02-10-062 at 2.

the commission, actual procurement costs incurred, or combination thereof, as determined by the commission. The commission shall establish power procurement balancing accounts to track the differences between recorded revenues and costs incurred pursuant to an approved procurement plan. The commission shall review the power procurement balancing accounts, not less than semiannually, and shall adjust rates or order refunds, as necessary, to promptly amortize a balancing account, according to a schedule determined by the commission. Until January 1, 2006, the commission shall ensure that any overcollection or undercollection in the power procurement balancing account does not exceed 5 percent of the electrical corporation's actual recorded generation revenues for the prior calendar year excluding revenues collected for the Department of Water Resources. . . .

In D.02-10-062, the Commission established the ERRA balancing account – the power procurement balancing account required by PUC §454.5(d)(3). Pursuant to D.02-10-062 and D.02-12-074, the purpose of the ERRA is to provide full recovery of SDG&E's energy procurement costs, including expenses associated with fuel and purchased power (including renewable resources), utility retained generation (“URG”), Independent System Operator (“ISO”) related costs and costs associated with the residual net short procurement requirements to serve SDG&E's bundled service customers. The ERRA records revenues from SDG&E's Electric Energy Commodity Cost (“EECC”) rate schedule adjusted to exclude California Department of Water Resources (“DWR”) purchases and commodity revenues assigned to the NGBA.⁴

Consistent with PUC §454.5(d)(3), the Commission also established a semi-annual update process for fuel and purchased power forecasts and the ERRA mechanism.⁵ The balance of ERRA was not to exceed 5% (threshold point) of the electrical utility's actual recorded generation revenues for the prior calendar year, excluding revenues collected for DWR. Accordingly, D.02-10-062 established a trigger

⁴ In compliance with D.03-12-063, the NGBA became effective January 1, 2004.

⁵ See D.02-10-062, at 62.

mechanism designed to avoid the 5% threshold point. Under the provisions of the trigger mechanism, SDG&E is required to file an expedited application for approval to adjust its rates in 60 days from the filing date when its ERRA balance reaches an undercollection or overcollection of 4% and is projected to exceed the 5% trigger.

The purpose of the Transition Cost Balancing Account (“TCBA”) is to accrue all CTC revenues and recover all CTC-eligible generation-related costs. Pursuant to D.02-12-074 and D.02-11-022, payments to Qualifying Facilities (“QFs”) that are above the market benchmark proxy are charged to the TCBA. Eligible CTC expenses⁶ reflect the difference between the market proxy and the contract price of costs associated with the Portland General Electric and other QF contracts.

As explained in more detail below, as a result of the market benchmark update, SDG&E’s final 2011 ERRA revenue requirement is \$755.413 million (which is \$31.742 million less than what was proposed in the original Application) and its 2011 CTC revenue requirement is \$63.354 (which is \$31.742 more than what was proposed in the original Application), as reflected in Tables 1 and 2 in the Amended Testimony of SDG&E witness Yvonne Le Mieux. Other than the recovery of equity rebalancing costs issue (described further in Section VI below), DRA does not dispute SDG&E’s proposed ERRA and CTC revenue requirements.

⁶ Expenses eligible for CTC recovery are defined by Assembly Bill (“AB”) 1890.

IV. SDG&E'S MARKET BENCHMARK PRICES FOR THE CTC AND PCIA SHOULD BE APPROVED⁷

As more fully explained in Ms. Fang's Amended Testimony, the market benchmark price is an official input value used in the calculation of the CTC and PCIA. The method of calculating the market benchmark price is set forth in D.06-07-030, as modified in D.07-01-030, and must be based on the average of forward energy prices recorded for the entire month of October. As noted above, these prices are usually released by the Commission's Energy Division in November of each year. Since SDG&E files its ERRA/CTC forecast applications annually on October 1, the Energy Division's market benchmark data for the subsequent year is not available at the time of SDG&E's ERRA/CTC forecast filing. Thus, SDG&E, as a general practice, updates its ERRA/CTC forecast applications to reflect the current market benchmark data. However, since the Energy Division has yet to release the updated market benchmark data, SDG&E is using the same CPUC-adopted methodology presented in D.06-07-030, as modified in D.07-01-030, and used by the Energy Division to estimate the market benchmark price. If the Energy Division subsequently calculates a market benchmark price that is different than that calculated by SDG&E, SDG&E will revise the CTC and PCIA in an advice letter filed in compliance with a final Commission decision in this proceeding.

Based on SDG&E's estimates, the benchmark price for calculating the 2011 CTC is \$42.50/MWH and the benchmark price for calculating the PCIA is \$44.33/MWH.⁸

⁷ SDG&E understands that the ALJ in R.07-05-025 issued a Ruling, dated April 14, 2011, that may impact the PCIA rates SDG&E may charge for 2011. According to the Ruling, it will be conformed into a Proposed Decision to be considered by the Commission. Once a final decision is issued, SDG&E will comply accordingly. However, until a decision is final, SDG&E will continue to request approval of PCIA rates consistent with the current rules and decisions of the Commission, as reflected in the Amended Testimony of SDG&E witness Cynthia Fang.

SDG&E's proposed 2011 PCIA's applicable to the respective classifications of departing load (updated for the new estimated benchmark and CTC, 2011 DWR revenue requirements, and Resolution 4226-E) are set forth in Attachment A to Ms. Fang's Amended Testimony. DRA does not contest these benchmark prices. With respect to AReM, as noted above, its testimony regarding benchmark prices has been stricken.

With respect to the timing of the final decision in this proceeding, for purposes of being able to implement the 2011 PCIA at the start of SDG&E's 2011 vintage period (July 1, 2011 through June 30, 2012), SDG&E is requesting that the final decision be issued no later than the June 23, 2011 Commission meeting. Since SDG&E's 2011 vintage period begins on July 1, 2011, SDG&E needs approval of the new 2011 benchmark for the PCIA and resulting 2011 PCIA's by that date in order to be able to properly bill the DA customers to which the 2011 vintage PCIA rates would apply.

V. SDG&E'S PROPOSAL TO MODIFY THE ERRA TRIGGER MECHANISM SHOULD BE APPROVED

Under the current rules, SDG&E's ERRA is subject to a trigger mechanism that requires the filing of a rate change application when SDG&E's monthly forecast indicates that the ERRA will face an undercollection or overcollection in excess of 5% of the prior year's recorded electric revenues, excluding DWR revenue. D.02-10-062 requires that in any month when the balance in the ERRA reaches 4% of the prior year's recorded electric revenues, excluding DWR revenue, SDG&E file an application that will ensure timely recovery of the projected ERRA over or undercollected balance. Furthermore, D.07-05-008 modified the trigger mechanism and established a new process which

⁸ The difference between \$42.50/MWH and \$44.33/MWH is due to the adjustment for distribution line losses (i.e., since the CTC is calculated at the ISO level there is no adjustment for distribution lines losses, but both benchmarks are based on the exact same forward prices).

authorizes SDG&E to notify the Commission through an advice letter filing, instead of an application, when the ERRA balance exceeds its 4% trigger point and SDG&E does not seek a change in rates, if the ERRA balance will self-correct below the trigger point within 120 days.

SDG&E is proposing to modify the ERRA trigger mechanism by offsetting the ERRA under/overcollection by the NGBA over/undercollection when calculating the monthly ERRA trigger. Specifically, SDG&E is proposing to modify the ERRA trigger mechanism to allow offsetting of (1) an ERRA undercollected balance with a NGBA overcollected balance and (2) an ERRA overcollected balance with a NGBA undercollected balance, when performing the monthly ERRA trigger calculation. Currently, SDG&E calculates the trigger percentage by taking the month-end ERRA balance and dividing it by the prior year's annual recorded electric revenues, excluding DWR revenue. SDG&E is proposing to offset the ERRA balance with the NGBA balance prior to dividing it by the prior year's annual recorded electric revenues, excluding DWR revenue. Applying the NGBA balance to the ERRA balance, when calculating the trigger, would only occur if the account balances are offsetting and resulted in reducing the ERRA under/overcollection. An NGBA-offset, when calculating the trigger, would not occur if the balances in NGBA and ERRA are both overcollected or both undercollected since these scenarios would increase the ERRA under/overcollection and cause the ERRA to trigger more quickly. SDG&E proposes to advise the Commission that it has implemented a NGBA-offset by including both the standard ERRA trigger calculation and the NGBA-offset trigger calculation in SDG&E's monthly ERRA compliance report to the CPUC.

SDG&E's ERRA and NGBA are both components of SDG&E's electric commodity rate that is applied to its bundled service customers. The purpose of the NGBA⁹ is to provide recovery of approved non-fuel electric generation costs not being recovered by another component of SDG&E's rates. As explained in Ms. Le Mieux's Amended Testimony, the ERRA records revenues from SDG&E's Electric Energy Commodity Cost ("EECC") rate schedule adjusted to exclude the commodity revenues assigned to the NGBA, using the calculated NGBA rate. Since the revenues for the NGBA and ERRA are both percentages of the total commodity revenues, the two accounts are closely related. As revenues increase in the NGBA balancing account, the revenues decrease in the ERRA balancing account.

Offsetting an ERRA under/overcollection with an NGBA over/undercollection promotes rate stability by potentially minimizing the size and the number of rate changes customers will endure during the year, and potentially minimizing the number of ERRA trigger-related filings. SDG&E's ERRA trigger proposal would also potentially reduce the impact to future electric commodity annual rate updates for the amortization of the NGBA. This would promote rate stability for customers. Further, even when a filing is triggered using the proposed ERRA trigger mechanism, the revised calculation could lower the potential rate impact to customer rates. DRA is supportive of SDG&E's offsetting proposal.

⁹ SDG&E is authorized to transfer the year-end balance in the San Onofre Nuclear Generating Station O&M Balancing Account ("SONGSBA") to the NGBA. SONGSBA records the difference between SDG&E's share of costs allocated from Southern California Edison and the authorized revenue requirement.

VI. EQUITY REBALANCING COSTS ASSOCIATED WITH THE OMEC PPA ARE PROPERLY INCLUDED IN SDG&E'S ERRRA REVENUE REQUIREMENT FOR 2011

As noted above, DRA is challenging SDG&E's recovery of equity rebalancing costs associated with the OMEC PPA. DRA's challenge is without merit for several reasons. These reasons are explained in detail in the Rebuttal Testimony of Kenneth Deremer and summarized below.

A. Background Regarding the Commission's Approval Of The OMEC PPA, Including Recovery of OMEC Equity Rebalancing Costs

DRA's challenge of equity rebalancing costs associated with the OMEC PPA ignores the extensive record that was developed in the Joint Petition of SDG&E, DRA, The Utility Reform Network, and the Utility Consumers Action Network ("Joint Petition"), which led to the Commission's approval of the OMEC PPA in D.06-09-021. The Joint Petition requested the approval of a revised 10-year PPA between SDG&E and OMEC, a wholly owned subsidiary of Calpine, for output from a 583 MW natural gas plant. The provisions of the revised OMEC PPA provided substantial benefits to ratepayers.¹⁰ The revised OMEC PPA included explicit reference and a condition precedent that the CPUC approve rate recovery for additional equity required to maintain SDG&E's authorized capital structure resulting from consolidation of OMEC on SDG&E's balance sheet utilizing a substantially higher debt structure – i.e. 75% debt, rather than SDG&E's 45% authorized debt level. These equity costs were included in the economic analysis yielding the greatest value to customers under the revised OMEC PPA structure. The revised OMEC PPA structure and benefits were thoroughly addressed during the proceeding and were analyzed against the applicable costs, including the

¹⁰ These benefits are mentioned throughout D.06-09-021, and more specifically Findings of Fact 10.

equity rebalancing costs associated with consolidation. This resulted in the development and submittal of the Joint Petition, to which DRA was a party.

The Joint Petition identified cost savings and other benefits that could be achieved through the inclusion of a put and call option that would allow SDG&E to take ownership of the plant in 2019. As fully explained in the Joint Petition¹¹, this provision would require SDG&E to take on additional risk, which would come at a cost if OMEC met the criteria of a variable interest entity (“VIE”) and if SDG&E were determined to be the primary beneficiary of OMEC. Under these circumstances, according to a GAAP rule known as Financial Accounting Standards Board Interpretation No. 46 (“FIN 46 (R)”), SDG&E would be required to consolidate the financial position and results of OMEC in SDG&E’s financial statements. As stated in the Joint Petition, absent a recovery provision for the additional costs incurred from equity rebalancing, SDG&E would not have entered into the revised transaction:

Receiving authorization for cost recovery for these financial effects [referring to the impacts of consolidation] is, however, an essential aspect of this Joint PFM for SDG&E, and SDG&E will not proceed with the Revised PPA without Commission approval of SDG&E’s recovery of these accounting costs, subject to the agreed-upon caps.¹²

Thus, equity rebalancing was an integral part of a mutually beneficial commercial arrangement involving ownership obligations with a third-party independent generation company (OMEC) that yielded the most beneficial economic outcome to SDG&E’s customers. In addition, the inclusion of a put and call option in the revised OMEC PPA, which gave rise to the consolidation requirements, were needed to ensure expedient

¹¹ See Section V of the Joint Petition and Section VI of Appendix B (Decl. of Michael Schneider) to the Joint Petition, attached as Exhibit A to the Rebuttal Testimony of K. Deremer.

¹² Joint Petition at p. 3, attached as Exhibit A to the Rebuttal Testimony of K. Deremer.

bankruptcy court approval of the disposition of the OMEC asset and allow Calpine to secure financing to construct OMEC.

The Joint Petition and the final decision clearly acknowledged the fact that FIN 46 (R) could require consolidation and provided specific recovery for the equity rebalancing costs associated with such consolidation (not simply cost caps) in future ERRA proceedings. Indeed, the cost caps represented a condition put forth by the settling parties (DRA, TURN and UCAN) and accepted by SDG&E to both limit the recognized rate recovery of equity rebalancing in case of higher than projected construction costs of OMEC and to acknowledge that FIN 46 (R) was a relatively new GAAP rule and that DRA, TURN, and UCAN were not prepared “to take a position on one aspect of SDG&E’s analysis regarding costs associated with the financial accounting effects due to certain features” of the revised OMEC PPA.¹³ This “one aspect of SDG&E’s analysis” concerned the issue of consolidation, but despite this concern, DRA supported the revised OMEC PPA, including the cost recovery associated with FIN 46 (R):

As noted above, although DRA, TURN, and UCAN are not taking a position at this time on SDG&E’s FIN 46(R) analysis, they remain supportive of the transaction overall, including the revenue requirement that includes the dollars associated with FIN 46(R), subject to the agreed-upon caps.¹⁴

The annual revenue requirements associated with FIN 46 (R) were identified in Exhibit 2 of the supporting declaration of Michael Schneider, which is Appendix B to the Joint Petition (attached as Exhibit A to the Rebuttal Testimony of K. Deremer).

¹³ Joint Petition at pp. 2-3, attached as Exhibit A to the Rebuttal Testimony of K. Deremer.

¹⁴ Joint Petition at p. 18, attached as Exhibit A to the Rebuttal Testimony of K. Deremer.

Thus, as reflected in the Joint Petition, DRA has already agreed to recovery of the OMEC equity rebalancing costs. Based on this agreement, DRA is judicially stopped from taking a different position in this proceeding.¹⁵

B. DRA Erroneously Asserts That The OMEC Decision Merely Approved Cost Caps for Equity

DRA claims that SDG&E does not have the authority to recover equity rebalancing costs associated with the Otay Mesa project because:

D.06-09-021 merely adopted cost caps in the event the Securities and Exchange Commission required SDG&E to consolidate its financial statements with OMEC, and if that consolidation resulted in the need for SDG&E to increase the amount of equity in its capital structure.¹⁶

This conclusion ignores the following Findings of Fact, Conclusion of Law and Ordering Paragraphs of D.06-09-021, ruling that unless future evidence suggests that consolidation is not required, SDG&E is entitled to recover the costs associated with such consolidation, subject to agreed-upon caps:

Finding of Fact 14:

We find the other revisions to the original PPA, *including the rate recovery to cover any filing and reporting requirements SDG&E might have with the SEC pursuant to FIN 46 (R), with the agreed upon maximum amount eligible for recovery*; the performance and heat incentive mechanisms with the agreed upon caps; and option for SDG&E to elect the superior cost-sharing mechanism for the allocation of the local area reliability costs *to all be reasonable, in the interest of SDG&E ratepayers, and positive enhancements to the original PPA*.¹⁷

Finding of Fact 15:

If future evidence suggests that FIN 46 (R) does not require consolidation of the Otay Mesa plant with SDG&E financials, then TURN and UCAN reserve the right to petition for an appropriate

¹⁵ See D.07-12-021 at pgs. 7-8 (“Judicial estoppel prevents a party from asserting a position in one legal proceeding that is contrary to a position previously taken in the same or some other proceeding.”)

¹⁶ DRA Testimony of Cynthia Walker at p. 4.

¹⁷ D.06-09-021 at p. 17 (emphasis added).

adjustment to SDG&E's capital structure. The agreed upon caps are as follows:

2009 - \$16.0 million // 2010 - \$15.5 million // 2011 - \$15.0 million // 2012 - \$14.4 million // 2013 - \$13.9 million // 2014 - \$13.4 million // 2015 - \$12.8 million // 2016 - \$12.3 million // 2017 - \$11.8 million // 2018 - \$11.2 million.¹⁸

Conclusion of Law 1:

The Revised Otay Mesa PPA is reasonable, is in the public interest, and should be approved. The Revised Otay Mesa PPA includes the Put and Call Options at the expiration of the ten-year period; the changed in-service date from January 2008 to May 1, 2009; performance and heat incentives, with caps; limited cost recovery for SDG&E if it has increased costs for filing and reporting obligation under FIN 46(R); and the option for the utility to choose between RMR treatment or the cost sharing mechanism set forth in D.04-12-048, for the local area reliability costs.¹⁹

Ordering Paragraph 3:

SDG&E is authorized to record the costs of this Revised PPA in the Electric Resource Recovery Account and other appropriate accounts, depending on the cost allocation mechanism that is ultimately adopted for the Otay Mesa plant.²⁰

Ordering Paragraph 4:

SDG&E is authorized to recover the costs, subject to the agreed upon caps and potential future adjustment to SDG&E's capital structure, associated with the equity re-balancing SDG&E deems necessary due to filing and reporting requirements of FIN 46(R) and the consolidation of the OMEC financial data with SDG&E's quarterly and annual financial statements to the Securities and Exchange Commission.²¹

Since consolidation of OMEC is still required for SDG&E to comply with GAAP (a fact DRA has ignored), cost recovery of the equity rebalancing costs, subject to the caps listed in D.06-09-021, remains valid. DRA's claim that only the cost caps were adopted, absent approval of recovery of the costs themselves, makes no sense and is not

¹⁸ D.06-09-021 at p. 17 (emphasis added).

¹⁹ D.06-09-021 at p. 18.

²⁰ D.06-09-021 at p. 19 (emphasis added).

²¹ D.06-09-021 at pp. 19-20 (emphasis added).

supported by the Joint Petition (to which DRA was a party) or the final decision approving the Joint Petition.

Accordingly, DRA's attempt to re-litigate the equity rebalancing cost recovery issue in this proceeding should be rejected as an inappropriate collateral attack on a prior Commission decision.²² Moreover, recovery of OMEC equity rebalancing costs was approved in the Commission's 2009 and 2010 ERRRA revenue requirement forecast decisions (i.e., the Commission approved ERRRA forecasts for 2009 and 2010 which included the OMEC equity rebalancing costs), without objection by DRA. Accordingly, DRA is barred by collateral estoppel from re-litigating this issue.²³

C. To Comply With GAAP, SDG&E Continues To Be Required To Consolidate The Financial Statements Of OMEC And Therefore SDG&E Is Entitled To Continue Recovering The Costs Associated With The Impact Of Such Consolidation

DRA's challenge to OMEC costs does not dispute the fact that to comply with GAAP, SDG&E is required to consolidate OMEC's financial statements. Indeed, contrary to Finding of Fact 14, DRA does not identify any "future evidence" indicating that SDG&E is not required to consolidate. Putting aside the fact that DRA's position is inconsistent with the Commission's rulings in D.06-09-021, SDG&E has shown that consolidation is required and that such consolidation had real consequences to the equity in SDG&E's capital structure.

²² P.U. Code §1709 ("In all collateral actions or proceedings, the orders and decisions of the commission which have become final shall be conclusive.")

²³ See D.09-06-019 at p. 16 ("Once an adjudicating body has decided an issue of fact or law necessary to its judgment, collateral estoppel precludes relitigation of the issue in a different cause of action involving a party to the first proceeding.")

1. GAAP Requires Consolidation

In accordance with GAAP, the OMEC contract was and continues to be analyzed under both FIN 46 (R) and FAS 167 (also referred to as ASU 2009-17), which amended FIN 46 (R). Both analyses concluded that OMEC is a VIE and that SDG&E is the primary beneficiary, which results in the requirement that SDG&E consolidate the financial statements of OMEC within SDG&E's financial statements to comply with GAAP and SEC reporting requirements. Moreover, as required by the SEC, SDG&E has its financial statements audited annually by an external auditor for independence and to give reasonable assurance that the financial statements present fairly, in all material respects, in conformity with GAAP. The auditor's report is included in SDG&E's 10-K Annual Report which is submitted to the SEC. The 2009 and 2010 10-K's include both Sempra Energy's Consolidated Financial Statements and SDG&E's Consolidated Financial Statements, both of which include the consolidation of OMEC.²⁴ The SEC requires registrants, such as SDG&E, to present their audited financial statements in accordance with GAAP. The SEC reviews the statements and reserves the right to identify any accounting or disclosure irregularities. Neither SDG&E nor Sempra Energy has received any deficiency letters from the SEC with regards to the consolidation of OMEC in their financial statements filed with the SEC. DRA's testimony completely ignores these facts.

During the discovery phase of this 2011 ERRR forecast proceeding, DRA questioned SDG&E's procedure for determining whether the OMEC PPA was required

²⁴ SDGE-5 (excerpts from 2009 10-K) and SDGE-6 (excerpts from 2010 10-K): see the sections entitled "Principles of Consolidation" and "Variable Interest Entities." The 10-K for 2011 will not be filed until next year, but as indicated above and in the Rebuttal Testimony of K. Deremer, the analysis regarding consolidation of OMEC remains unchanged.

to be consolidated under FIN 46 (R). In response, SDG&E provided DRA the most recent comprehensive analysis performed by SDG&E and audited by Deloitte & Touche, SDG&E's external auditor. This analysis concluded that OMEC met the strict criteria requiring consolidation, including the determination that it was a VIE and that SDG&E was the primary beneficiary of the VIE. Again, DRA ignores these facts.

2. Consolidation Of OMEC Has Resulted In Impacts To SDG&E's Capital Structure

Regarding SDG&E's need to increase equity costs, SDG&E has been maintaining a recorded CPUC common equity ratio above authorized since 2007, in part to reflect that its consolidated balance sheet (as analyzed by credit agencies) reflects the higher proportional debt as a result of the consolidation of OMEC. The equity rebalancing cost associated with FIN 46 (R) consolidation is included as part of the cost of maintaining the higher equity ratio. This was well documented and addressed in the Joint Petition approved in D.06-09-021.

Since 2007, when SDG&E first starting consolidating OMEC, the cost SDG&E has incurred for retaining excess equity beyond its authorized equity level has exceeded the cap put in place in D.06-09-021. More specifically, for 2009 – 2010, SDG&E's common equity as a percent of total capitalization was 53% (compared to 49% authorized). This has a cost to SDG&E shareholders since SDG&E only recovers in rates the equity costs up to its authorized capital ratios (currently 49% of its capital structure), absent the equity rebalancing cost recovery. Since the cost of common equity (11.1% authorized) is higher than the cost of debt (5.62% authorized), SDG&E is incurring higher overall costs by increasing equity and reducing debt by a corresponding amount to

rebalance its capital structure with the consolidation of OMEC. Equity rebalancing provides cost recovery for a portion of these additional capital financing costs.

For purposes of establishing the forecasted ERRR revenue requirement for this cost, SDG&E uses the methodology approved in D.06-09-021 and reflected in Exhibit 2 to the declaration of Michael Schneider.²⁵ Indeed, during the discovery period preceding its rebuttal testimony in this ERRR proceeding, DRA asked SDG&E how it calculated the equity rebalancing revenue requirement, and SDG&E explained that it used the method approved in D.06-09-021 and provided DRA with a copy of the Excel spreadsheet that constitutes Exhibit 2 to Michael Schneider's declaration.²⁶ DRA does not raise an objection to the appropriateness of using this methodology, as well it can't, since DRA approved of the methodology in the Joint Petition and it was approved by the Commission, subject to the caps listed in D.06-09-021.

D. The Commission's Decision in SDG&E's Most Recent Cost Of Capital Proceeding (D.07-12-049) Is Not Applicable To The Commission's Approval Of Cost Recovery In The OMEC Decision (D.06-09-021)

Another erroneous DRA argument is that:

The adoption of SDG&E's cost of capital in D.07-12-049 resulted from a comprehensive analysis, including SDG&E's PPA with OMEC. It would be inconsistent with D.07-12-029 [sic] for the Commission to allow SDG&E to recover equity rebalancing costs as part of its ERRR forecast revenue requirement.²⁷

As explained in more detail in Mr. Deremer's Rebuttal Testimony, this is a specious argument because the record that resulted in D.07-12-049 is void of any analysis of the OMEC PPA. Indeed, no party submitted testimony regarding the appropriateness of the recovery of equity rebalancing costs associated with the previously approved

²⁵ Attached as Appendix B to the Joint Petition (attached as Exhibit A to the Rebuttal Testimony of K. Deremer).

²⁶ This spreadsheet is attached to the Rebuttal Testimony of K. Deremer as Exhibit B.

²⁷ DRA Testimony of C. Walker at p. 4, lines 14-18.

OMEC PPA. Moreover, the Commission stated that D.07-12-049 was intended to apply on a “prospective basis” (i.e., to PPAs presented well after the OMEC PPA was approved).²⁸ Clearly, if the Commission had intended that it apply on a retroactive basis to the OMEC PPA, D.07-12-049 would have included a conclusion of law or ordering paragraph to that effect. The fact that the OMEC PPA is not even mentioned in D.07-12-049 is clear evidence that it was never intended to apply to the OMEC PPA. Moreover, as noted above, the Commission approved SDG&E’s ERRA revenue requirement forecasts for 2009 and 2010, which included recovery of OMEC equity rebalancing costs. If DRA’s interpretation of D.07-12-049 is correct, the Commission would not have approved recovery of such costs in those ERRA proceedings.

Thus, D.07-12-049 does nothing to support DRA’s objection to recovery of the OMEC equity rebalancing costs. Any reversal of the approval of recovery of equity rebalancing costs associated with the OMEC PPA would require a separate Petition for Modification of D.06-09-021.

VII. THE FACTUAL EVIDENCE SUPPORTS APPROVAL OF SDG&E’S APPLICATION.

SDG&E is submitting its evidence in the form of the following testimony, including attachments, and excerpts from its 2009 and 2010 10-K’s filed with the SEC. For ease of reference, SDG&E’s evidence, by proposed exhibit numbers, is listed below. The testimony is then briefly summarized.

- SDGE-1: Public Version of Amended Direct Testimony of Tony Choi, including Attachments A-D, dated January 14, 2011;

²⁸ D.07-12-049 at Section 5.5.2, p. 39.

- SDGE-1C: Confidential Version of Amended Direct Testimony of Tony Choi, including Attachments A-D, dated January 14, 2011;
- SDGE-2: Public Version of Amended Direct Testimony of Yvonne Le Mieux, January 14, 2011;
- SDGE-2C: Confidential Version of Amended Direct Testimony of Yvonne Le Mieux, dated January 14, 2011;
- SDGE-3: Public Version of Amended Direct Testimony of Cynthia Fang, including Attachments A-B, dated January 14, 2011;
- SDGE-3C: Confidential Version of Amended Direct Testimony of Cynthia Fang, including Attachments A-B, dated January 14, 2011;
- SDGE-4: Public Version of Rebuttal Testimony of Kenneth Deremer, including Exhibits A-C, dated March 4, 2011;
- SDGE-4C: Confidential Version of Rebuttal Testimony of Kenneth Deremer, including Exhibits A-C, dated March 4, 2011;
- SDGE-5: excerpts from 2009 10-K filed with the SEC; and
- SDGE-6: excerpts from 2010 10-K filed with the SEC.

Mr. Choi's amended testimony forecasts the procurement costs SDG&E expects to record in 2011 to the ERRA. Mr. Choi also describes the supply resources that SDG&E will use to meet its bundled customer load in 2011.

Ms. Le Mieux's amended testimony describes SDG&E's ERRA and TCBA and sets forth SDG&E's forecasted 2011 ERRA and CTC revenue requirements. Ms. Le Mieux also discusses the SDG&E's proposal to modify the ERRA trigger mechanism by using the NGBA as an offset, when appropriate, to reduce overcollections and undercollections, thereby avoiding trigger applications and promoting rate stability.

Ms. Fang's amended testimony presents the (1) 2011 market benchmark prices for calculating the CTC and for calculating the PCIA and (2) resulting 2011 PCIA's consistent with D.08-09-012, including the 2011 updates to the 2009 and 2010 vintages as well as the addition of the 2011 vintage of the PCIA for 2011.

Mr. Deremer's rebuttal testimony addresses DRA's challenge to recovery of equity rebalancing costs associated with the OMEC PPA.²⁹

VIII. MOTION TO SEAL PORTIONS OF THE EVIDENTIARY RECORD

As indicated above, the testimony and attachments of SDG&E witnesses contain information that is confidential pursuant to P.U. Code §§454.5(g) and 583; General Order 66-C; D.06-06-066; and D.08-04-023. As explained in the declarations attached to the testimony, confidential treatment and redaction of certain information is necessary in this proceeding to protect against inappropriate disclosure of confidential, commercially sensitive information pertaining to SDG&E's electric procurement resources and strategies. With respect to length of confidential treatment, based on D.06-06-066, SDG&E requests that the confidential testimony of Ms. Le Mieux, Ms. Fang and Mr. Deremer be sealed and remain sealed for three years from the date of the final decision in this proceeding.

²⁹ Note that this version of Mr. Deremer's rebuttal testimony is identical to the version served on March 4, 2011, except for the correction of a typographical error at page KJD-3, line 24: 49% was changed to 45%.

As to the confidential testimony of Mr. Choi (SDGE-1C), the IOU Matrix (Appendix 1 of D.06-06-066) requires that certain bilateral contract related information be treated as confidential for “for three years, or until one year following expiration, whichever comes first.”³⁰ Accordingly, for some of the confidential bilateral contract-related information in Mr. Choi’s testimony, SDG&E requests the following time periods for confidential treatment:

Confidential Information	Matrix Reference	Length of Confidentiality
TC-6 lines 26-29	IV, F	confidential until 1/1/2013
Attachment B (Encina Data)	IV, F	confidential until 1/1/2013

For the remaining portions of Mr. Choi’s confidential testimony, SDG&E requests that it be sealed for three years from the date of the final decision in this proceeding.

IX. PROPOSED FINDINGS OF FACT

SDG&E proposes the Commission adopt the following Findings of Fact:

1. SDG&E’s proposed 2011 ERRA revenue requirement is \$755.413 million.
2. SDG&E’s proposed 2011 CTC revenue requirement is \$63.354 million.
3. Using estimated market benchmark data based on the formula used by Energy Division, SDG&E’s proposed 2011 market benchmark prices are \$42.50/MWH for calculating the CTC and \$44.33/MWH for calculating the PCIA.
4. SDG&E proposes to modify the ERRA trigger mechanism by offsetting the ERRA under/overcollection by the NGBA over/undercollection when calculating the monthly ERRA trigger. This proposal promotes rate stability by potentially minimizing the size and the number of rate changes customers will endure, and potentially minimizing the number of ERRA trigger-related filings.

³⁰ D.06-06-066, Appendix 1 (IOU Matrix) at p. 77, category IV, F.

5. DRA is supportive of SDG&E's requested relief, but disputes recovery of equity rebalancing costs associated with the OMEC PPA.

X. PROPOSED CONCLUSIONS OF LAW

SDG&E proposes adoption of the following Conclusions of Law:

1. As shown in its application, supporting testimony (including attachments to testimony), and filings, SDG&E's (a) forecasted 2011 ERRA revenue requirement of \$755.413 million; and (b) forecasted 2011 CTC revenue requirement of \$63.354 million are reasonable and should be adopted.
2. SDG&E's proposed 2011 market benchmark prices of \$42.50/MWH for calculating the CTC and \$44.33/MWH for calculating the PCIA are based on benchmark data generated by a methodology adopted in D.06-07-030, as modified in D.07-01-030. Accordingly, SDG&E's proposed 2011 market benchmark prices and resulting 2011 PCIA's are reasonable and should be adopted.
3. SDG&E's proposal to modify the ERRA trigger mechanism by offsetting the ERRA under/overcollection by the NGBA over/undercollection when calculating the monthly ERRA trigger should be adopted as a reasonable approach to promoting rate stability.
4. DRA's objection to inclusion of equity rebalancing costs in SDG&E's revenue requirement forecast for 2011 is without merit. Recovery of such costs was approved in D.06-09-021. Pursuant to D.06-09-021, since consolidation of OMEC continues to be required, SDG&E is entitled to recover equity rebalancing costs associated with OMEC, subject to the approved caps.

5. SDG&E's motion to receive its prepared testimony, including attachments, and excerpts from its 2009 and 2010 10-K's filed with the SEC into evidence as Exhibits SDGE-1, 1C, 2, 2C, 3, 3C, 4, 4C, 5, and 6 should be granted.
6. SDG&E's motion to seal the confidential information in SDGE-1C, 2C, 3C, and 4C, pursuant to PUC §§454.5(g) and 583; General Order 66-C; D.06-06-066; and D.08-04-023 should be granted.
7. An evidentiary hearing was not necessary in this proceeding.

XI. PROPOSED ORDERING PARAGRAPHS

In light of the forgoing, SDG&E proposes the following Ordering Paragraphs:

1. San Diego Gas & Electric Company ("SDG&E")'s 2011 Energy Resource Recovery Account ("ERRA") revenue requirement forecast of \$755.413 million shall be adopted and SDG&E is authorized to decrease commodity rates applicable to bundled customers accordingly.
2. SDG&E's 2011 Competition Transition Charge ("CTC") revenue requirement forecast of \$63.354 million shall be adopted and SDG&E is authorized to increase CTC rates applicable to both bundled and unbundled customers accordingly.
3. SDG&E's 2011 market benchmark price of \$42.50/MWH for calculating the CTC, market benchmark price of \$44.33/MWH for calculating the Power Charge Indifference Adjustment ("PCIA"), and the resulting PCIA's for 2011 shall be adopted.
4. SDG&E's motion to receive its prepared testimony, including attachments, and excerpts from its 2009 and 2010 10-K's filed with the SEC (as Exhibits SDGE-1, 1C, 2, 2C, 3, 3C, 4, 4C, 5, and 6) into the record is granted.

5. SDG&E’s motion to seal confidential information in SDGE 1C, 2C, 3C, and 4C is granted. Such testimony and attachments shall remain sealed for a period of three years from the effective date of this decision, except as to the following portions of Tony Choi’s testimony, which shall remain sealed as follows:

Confidential Information	Matrix Reference	Length of Confidentiality
TC-6 lines 26-29	IV, F	confidential until 1/1/2013
Attachment B (Encina Data)	IV, F	confidential until 1/1/2013

If SDG&E believes further protection is needed after that time, it may file a motion stating the justification for further withholding of the material from public inspection at least 30 days before the expiration of this order.

6. The ERRA trigger mechanism adopted in D.02-10-062 shall be modified to allow SDG&E to offset the ERRA under/overcollection by the Non-Fuel Generation Balancing Account (“NGBA”) over/undercollection when calculating the monthly ERRA trigger. Specifically, SDG&E has authority to offset an ERRA undercollected balance with a NGBA overcollected balance or offset an ERRA overcollected balance with a NGBA undercollected balance, when performing the monthly ERRA trigger calculation if the account balances are offsetting and results in reducing the ERRA under/overcollection.
7. SDG&E shall file a Tier 1 compliance Advice Letter to implement the revenue requirement adopted in this order within 14 days of the date of this decision for rates effective the first of the month following the filing of this advice letter, subject to Energy Division determining they are in compliance with this order. Implementation of the change in rates due to the revenue requirement adopted in

this order shall occur on or before September 1, 2011, which is the date of SDG&E's next scheduled rate change.

8. DRA's request for a disallowance of equity rebalancing costs associated with the revised Otay Mesa Energy Center Power Purchase Agreement approved in D.06-09-021 is denied.
9. The Administrative Law Judge's February 25, 2011 ruling that the testimony of the Alliance for Retail Energy Markets should be stricken is confirmed.
10. Application 10-10-001 is closed.

XII. CONCLUSION

For all the forgoing reasons, SDG&E respectfully requests that the Commission grant the relief requested by SDG&E's in this proceeding and adopt the proposed findings of fact, conclusions of law and ordering paragraphs as set forth herein.

Respectfully submitted,

By: /s/ John A. Pacheco

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DATED at San Diego, California, this 20th day of April 2011

CERTIFICATE OF SERVICE

I hereby certify that, pursuant to the Commission's Rules of Practice and Procedure, I have this day served a true and correct copy of the foregoing **OPENING BRIEF OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902-E) IN SUPPORT OF ITS 2011 ERRA FORECAST APPLICATION** to each party of named in the official service list for proceeding A.10-10-001 by electronic mail. Those parties without an email address were served by placing copies in properly addressed and sealed envelopes and depositing such envelopes in the United States Mail with first-class postage prepaid. Copies were also sent via Federal Express to the assigned Commissioner and Administrative Law.

Executed this 20th day of April 2011, at San Diego, California.

/s/ Jenny Norin
Jenny Norin



CALIFORNIA PUBLIC UTILITIES COMMISSION Service Lists

PROCEEDING: A1010001 - SDG&E - FOR ADOPTION
FILER: SAN DIEGO GAS & ELECTRIC COMPANY
LIST NAME: LIST
LAST CHANGED: MARCH 15, 2011

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