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BEFORE THE
CALIFORNIA PUBLIC UTILITIES COMMISSION

Application of San Diego Gas & Electric Company (U902M) for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 2012.	**A.10-12-005** (Filed December 15, 2010)
Application of Southern California Gas Company (U904G) for authority to update its gas revenue requirement and base rates effective on January 1, 2012.	**A.10-12-006** (Filed December 15, 2010)

REPLY BRIEF OF

OF THE FEDERAL EXECUTIVE AGENCIES

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Introduction

The United States Department of the Navy representing the consumer interest of the Department of Defense and all other Federal Executive Agencies filed its Opening Brief on April 12, 2012. The positions in FEA's Opening Brief and Reply Brief reflect its final recommendations with regard to the matters addressed in this proceeding.

In the policy section of the Summary of Recommendations of its Opening Brief, the Company stated that:

> Actual 2010 cost data should be given little or no weight absent the opportunity for a complete analysis of all related operational conditions which was not possible in this proceeding. (SDG&E Opening brief at xi)

In many instances, 2010 cost data are the most recent actual information that was made available by the Company. 2011 data were requested for many expenditures but were not provided under the Company's claim that such data were confidential because the Company had not yet filed its financial reports with the SEC. In light of the unavailability of 2011 data for many expenditures, the Company's 2010 cost data must be relied on in evaluating the Company's requested 2012 TY amounts. Comparing the Company's forecasted 2010 amounts to actual 2010 amounts will reveal the degree of variances in the 2010 projections which flow though to the 2012 TY amounts. In other words, if there are large variances in the 2010 amounts, those amounts will be carried through the forecasted 2011 balances and ultimately the 2012 TY amounts.

6. Electric Distribution Operations (SDG&E-Only)

6.2 Capital

The Company's Opening Brief at page 81 states:

> FEA takes a similar broad-based approach suggesting that a 6% annual increase is adequate. However ...FEA provides little support for its claim.

FEA identified several examples in its direct testimony and Opening Brief illustrating that the Company's forecasted 2012 TY electric distribution capital expenditures were overstated. For example: SDG&E's customer growth has been lower than initially forecasted; historic increases to electric distribution plant averaged more conservative levels of approximately 5-7%; and evidence of SDG&E over-budgeting capital expenditures. (Exhibit 578 at 23-30 and FEA Opening Brief at 4-6.)

The Company's statement that 2010 information should be given little or no weight is not valid. (SDG&E Opening brief at xi) In 2010, SDG&E spent approximately 7.6% or $14.431 million less than it had forecasted for the electric distribution plant addition categories identified in its filing. (Exhibit 578 at 26) The Company's level of electric distribution capital expenditures included in the 2012 TY is based on the forecasted spending levels for 2010 and 2011. Since

2010 projections were overstated, this carries through to the 2012 TY, causing it to be overstated as well.

FEA stands by its recommendation that the Commission limit SDG&E's electric distribution plant additions to 6% in deriving the 2012 TY amount. (FEA Opening Brief at 6)

6.4 Smart Grid

SDG&E states it requests full funding of its Smart Grid expenditure portfolio of projects and that the intervenor position of "slow down and wait" is not supported by any data nor the alternatives proffered. (SDG&E Opening Brief at 106) FEA's direct testimony and Opening Brief illustrated recent relevant information regarding Smart Grid by stating;

1) The key points of Maryland Public Service Commission's order rejecting Baltimore Gas & Electric's ("BG&E") request for Smart Grid deployment. (Exhibit 578 at 36)
2) Utility Xcel Energy's smart grid pilot, "Smart Grid City" substantial cost overruns as well uncertainty regarding the materialization of the projected benefit. (Exhibit 578 at 39)

SDG&E has acknowledged some costs and benefits associated with these projects are uncertain. (FEA Opening Brief at 8, 25) FEA stands by its position that the Commission should review the Company's Smart Grid Projects in a separate proceeding. (FEA Opening Brief at 8-9)

15. Corporate Center Costs Allocated to Utilities

15.9 Insurance

15.9 (a) Wildfire Insurance and Reinsurance

The Company states that FEA provides no rationale for its decrease to Wildfire insurance and reinsurance using 2010 recorded levels, other than allegations of fault in two wildfire lawsuits. (SDG&E Opening Brief at 371) The Company was found to be at fault for both of these fires. (FEA Opening Brief at 11-12)

FEA illustrated in its testimony that the Company's forecasted amounts for wildfire insurance and reinsurance for 2010 and 2011 are overstated, which carry through to the requested 2012 TY levels.

The Company identified 2010 recorded cost for these policies as $65 million. (Exhibit 578 at 67) The Company later stated that this amount was missing one quarter of the payment but did not offer any evidence supporting this claim. (SDG&E Opening Brief at 370-371.)

The Company also states that the actual 2010 costs should not be used as a basis for the forecast as it is not representative of the TY 2012 forecast.

The Company's claim that 2010 information should be given little or no weight is not valid. (SDG&E Opening Brief at xi and 371.) Wildfire reinsurance expense 2010 was first purchased in 2010; as there are no historical amounts to compare this expense to, 2010 information is relevant to the analysis of this expense. (Exhibit 578 at 69)

The Company stated that it forecasted $34.569 million in 2011 for wildfire reinsurance and identified the 2011 renewal premium as $30.6 million. (Exhibit 578 at 69) The Company's level of wildfire insurance included in the 2012 TY is based on the forecasted spending levels for 2010 and 2011. Since 2010 and 2011 projections were overstated, this carries through to the 2012 TY, causing it to be overstated as well.

FEA stands by its recommendation that the Commission should reduce SDG&E request for excess liability and wildfire liability insurance and wildfire liability reinsurance by $13.4 million to reflect 2010 levels. (Exhibit 578 at 70)

15.9 (b) Directors and Officers Insurance

The Company states that D&O insurance is no different from any other type of insurance; it is a risk mitigation tool that protects against catastrophic losses. (SDG&E Opening Brief at 371.) This statement is only partially true, D&O insurance is different from the other property and liability insurance as it primarily protects Directors and Officers from the shareholders or owners of the Company as opposed to unrelated plaintiffs.

SDG&E's brief stated that "FEA cuts $828,000 in D&O insurance for SDG&E's allocations based on an assertion that the insurance <u>only</u> comes into play when and if a shareholder sues the officers and directors. SDG&E mischaracterizes FEA's testimony. FEA's testimony stated, "D&O insurance <u>usually</u> comes into play when a shareholder sues the officers and directors of a publicly traded company, such as SDG&E's parent company, Sempra Energy. (Exhibit 578 at 71)

The Company also states that FEA argues that the costs should be split equally between ratepayers and shareholders. (SDG&E Opening Brief at 372) The Company ignores the fact that the Commission has traditionally allocated this expense evenly between shareholders and ratepayers of other energy utilities subject to its jurisdiction. (D.96-01-011, 64 CPUC.2d 241, Decision in Southern California Edison Company's TY 1996 General Rate Case, at P. 319; D. 00-02-046, Decision in Pacific Gas and Electric Company's TY 1999 General Rate Case, mimeo at p. 309; and D. 04-03-034, Decision in Southwest Gas Corporation's 2003 General Rate Increase Application, mimeo pp. 34-35.)

The Company's Opening Brief states that the Commission should adopt Applicant's more realistic TY 2012 forecast and reject the use of 2010 recorded costs as they are not an accurate basis as proposed by FEA. The Company budgeted $3.950 million for D&O insurance in 2010 but its 2010 results of operations showed this expense to be $3.719 million. The Company's over-budgeted this expense in 2010, which flows through to the 2012 TY amount of $4.231 million. This cost has been steadily declining in recent years and the Company has not substantiated its claim that it will increase to the level it has forecasted for the 2012 TY. (Exhibit 578 at 70-72.)

FEA stands by its recommendation that SDG&E should only be allowed to include 50% of the 2010 level of D&O Insurance expense in its revenue requirement. (FEA Opening Brief at 14)

15.9 (c) Group Executive Umbrella Insurance

The Company's Opening Brief states that:

> FEA confuses commercial liability insurance with personal liability insurance. The executive umbrella liability insurance policy is not in addition to, nor is it a duplication of the insurance afforded by the commercial liability insurance. (SDG&E OpeningBrief at 374)

FEA does not confuse commercial liability with personal liability insurance. SDG&E's employees, including executives, are covered by the Company's liability policies. The executive umbrella policy is a personal liability policy that is provided as an additional benefit to key executives. This personal liability coverage provides no benefit to ratepayers and is not necessary for the provision of service.

FEA stands by its recommendation that SDG&E should not be allowed to recover group executive insurance coverage for select executives from ratepayers. (FEA Opening Brief at 15)

15.9 (d) Escalation of Insurance

The Company states that FEA recommends reducing the escalation rate to be consistent with CPI escalation used for other expenses, but provides no calculations, recommended reductions, nor what baseline to use. (SDG&E Opening Brief at 367) FEA recommended using the CPI to escalate insurance expense to be consistent with its testimony regarding escalation of costs in this GRC. (FEA Opening Brief at 24) FEA noted in its direct testimony, that per Commission D. 89-01-040, 30 CPUC 2d 576, Schedules for the Rate Case Plan and Fuel Offset Proceedings, the escalation factors are to be updated after hearings and before implementation, based on the same indexes used in the original presentation in the hearing. (Exhibit 578 at 6)

The Company's Opening Brief states that, "The 3.5% escalation factor used by Applicants reflects pressures unique to the insurance market and is conservative." (SDG&E Opening Brief at 367) However, despite numerous requests, the Company provided no support for the 3.5% rate, other than the statement that it was based on management discretion. (FEA Opening Brief at 16, Exhibit 578 at 77)

FEA stands by its recommendation that the Commission should require that SDG&E utilize the CPI to escalate property and liability insurance. (FEA Opening Brief at 16)

23. Regulatory Accounts

23.3 (a) Tree-trimming Balancing Account

The Company states in its Opening Brief that, "UCAN's and FEA's tree trimming proposals should be rejected as uneconomic and impractical. SDG&E's two way balancing account should be adopted." (SDG&E Opening Brief at xii)

SDG&E did not utilize the full authorized level of tree trimming expense in prior years, then exceeded authorized levels in 2009 and 2010 due to hazard work. The Company's increase level of tree trimming is based on maintaining that level of hazard work in future years. (Exhibit 578 at 42, 43)

The Company's statement that 2010 information should be given little or no weight is not valid. (SDG&E Opening Brief at xi) The Company projected $26.822 million for tree-trimming expense in 2010 but only spent $23.283. (Exhibit 578 at 45) The Company's level of tree trimming expense included in the 2012 TY is based on the forecasted spending levels for 2010 and 2011. Any overstatements in 2010 and 2011 flow through to the 2012 TY, causing it to be overstated as well.

The Company's Opening Brief also states:

> However, conditions beyond SDG&E's control warrant change. SDG&E is now held to more stringent environmental and regulatory requirements than in years past. Disease and continued tree mortality associated with pests has increased over the last few years. These are some of the contributors to ongoing change in the vegetation management program in San Diego County.
>
> ...
>
> These uncertainties regarding the management of tree trimming fully support SDG&E's request for a two-way treatment of these costs. (SDG&E Opening Brief at 74)

Tree trimming expenses are not a volatile cost that the Company has no control over. The Company boasts in its Opening Brief that "SDG&E managed its tree trim program cost to within approved budget in previous years, by means of exceptional work practices, contract worker education, and cost savings secured in contract renegotiations." (SDG&E Opening Brief at 74) There is no reason it cannot utilize these same practices to manage this expense while providing safe electric service to customers.

FEA stands by its original recommendation that the Commission should reduce the Company's requested level of tree trimming expenses by $3.156 million, exclude pole brushing expenses, and deny the Company's request to change the existing one-way balancing account to a two-way balancing account. (FEA Opening Brief at 18)

23.3 (b) Pole Brushing Expenses

SDG&E states that DRA, UCAN and FEA oppose a two way balancing account for pole brushing. SDG&E states that the purpose of a two-way balancing account is to precisely address uncertainty, providing enough funding for the utility to administer the appropriate trimming activities, as needed, to ensure a safe reliable system, while at the same time ratepayers reap the rewards of efficiencies, savings, or favorable weather conditions. Pole brushing expenses are not a volatile cost that the Company has no control over. In fact, the Company went on to state that it recently secured strong, long term contracts with vendors for the pole brush program. (SDG&E Opening Brief at 76) The Company's pole brushing expenses have remained steady over the past five years, which was illustrated in FEA's Opening Brief. (FEA Opening Brief at 19)

FEA stands by its original recommendation that Commission reduce the Company's 2012 TY request for pole brushing expense by $1.502 million. (FEA Opening Brief at 19)

23.3 (c) New Environmental Regulation Balancing Account

Footnote 1071 of the Company's Opening Brief states that DRA, UCAN and FEA offered testimony in opposition of SDG&E's proposed NERBA.

FEA stands by its original recommendation that the Commission deny the Company's request with regard to NERBA and its alternative that if the Commission does decide to accept the Company's request for the NERBA, it should be structured as a one-way account, with underspending returned to ratepayers. (FEA Opening Brief at 22)

24. Escalation

The Company's Opening Brief states that FEA specifies explicitly that it prefers the CPI-U's "lower escalation factors," and provides a citation to FEA's direct testimony at page 12. FEA's direct testimony did not state that it "preferred the CPI-U's lower escalation factors." FEA's testimony stated:

> DRA adopted SDG&E's escalation proposal, with the exception of the labor cost factors. The Company's labor escalation factor included 3.5% union increases for 2010 & 2011. DRA states Global insight's First Quarter Power Planner currently shows lower labor factors for the different labor categories for 2010 and 2011. DRA recommends the 3.5% union increases be replaced with the most recent GI forecast for all utility workers.
>
> ...
>
> . . . I agree with DRA's recommendation to use the lower labor escalation factors, (Exhibit 578 at 12, footnotes omitted)

FEA stands by its original recommendation that the Commission require SDG&E to use the Consumer Price Index ("CPI") for purposes of escalating costs in this GRC. (FEA Opening Brief at 24)

27. Post Test Year Revenue Requirement Issues

FEA stands by its original recommendation that the Commission reject the Company's PTY ratemaking mechanism. If the Commission adopts the Company's PTY ratemaking mechanism, FEA also stands by its original recommendations as discussed below.

27.1 Term of Rates Adopted

In its Opening Brief the Company states:

> ...significant benefits result from a longer GRC term, and that these should be the primary determining factor in deciding upon the length of the rate case cycle (although workload and other GRCs are relevant.) (SDG&E Opening Brief at 13)

The Company has forecasted substantial investments in the PTYs, in which the costs and benefits are uncertain. The Company even acknowledged in its Smart Grid Plan, that the further out the cost forecast, the higher degree of inaccuracy. (FEA Opening Brief at 25)

The Company's Opening Brief also states:

> Applicants would never have an incentive to invest in projects with a payback period beyond three years. (SDG&E Opening Brief at 14.)

This statement is inaccurate. Utilities regularly make investments in between rate cases. For example, if the utility determined in the second year following a rate case that a portion of the boiler needs to be replaced, it would make that investment. When the next rate case is filed, the investment is included in the utility's rate base (plant in service) and the utility would earn the authorized return as well as recover the related depreciation expense.

In its Opening Brief the Company also stated:

> A three-year GRC term encourages a short-term focus on cost savings. (SDG&E Brief at 15) The traditional three year GRC allows for a periodic review of the utility's rates, how the utility decides to manage its investments and expenditures between rate cases is at its own discretion.

FEA stands by its original recommendation that the Commission adopt the traditional three year GRC cycle. (FEA Opening Brief 25)

27.2 Earnings Sharing

The Company's Opening Brief states that,

> ...asymmetrical sharing increases the likelihood that the utility will not earn their authorized ROR during the PTY period since low cost years will result in sharing with customers but high costs years will have no sharing. This creates a negative earnings bias." (SDG&E Opening Brief at 463)

One of the goals of an earnings sharing mechanism is to encourage utilities to improve performance and efficiencies by providing additional incentives. There is a greater incentive for the Company to manipulate its earnings to the detriment of customers under a symmetrical plan. If earnings fall below the authorized ROR, ratepayers will share in the losses. (FEA Opening Brief at 26)

The Company's Opening Brief also stated that:

> Furthermore, DRA's proposal provides a disincentive to make investments unless they have certainty of net benefits. If the financial outcome of a business decision is uncertain, the existence of asymmetric sharing could lead to rejecting opportunities with positive net benefits due to the "heads we win, tails I lose" sharing. (SDG&E Opening Brief at 463)

Basic criteria used by management in making a decision whether an investment is prudent is that the benefit outweighs the cost. If the financial outcome of an investment is uncertain, the prudency test has not been met. Ratepayers should not be held responsible for investment decisions that yield unfavorable results which did not provide any benefit to them.

FEA stands by its original recommendation that the earnings sharing component be asymmetrical. (FEA Opening Brief at 26)

FEA urges the Commission to adopt the recommendations contained in its direct testimony (Exhibit 578) and as further elaborated upon in its Opening and Reply Briefs.

Respectfully submitted,

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