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

Application of Southern California Edison Company)
(U 338-E) to Recover O&M Costs Associated) Application No. 11-04-006
With the San Onofre Nuclear Generating Station) Filed April 15, 2011
Units 2 and 3 On-Going Seismic Program, and New)
Seismic Research Projects and Analyses)

Application of San Diego Gas & Electric Company)
(U-902-E) to Recover Certain Costs of Seismic and) Application No. 11-05-011
Tsunami Studies for the San Onofre Nuclear Generating) Filed May 9, 2011
Station Units Nos. 2 and 3.)

Exhibit No. SDG&E-MLD1
Witness: Michael L. De Marco

**PREPARED REBUTTAL TESTIMONY
OF MICHAEL L. DE MARCO ON BEHALF OF
SAN DIEGO GAS & ELECTRIC COMPANY**

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

**San Diego, California
October 21, 2011**

PREPARED REBUTTAL TESTIMONY
OF
MICHAEL L. De MARCO

Q1. Please state your name for the record.

A1. My name is Michael L. De Marco.

Q2. Are you the same Michael L. De Marco whose testimony was previously filed as an attachment to the Application of San Diego Gas & Electric Company (SDG&E) that commenced this proceeding?

A2. Yes, I am.

Q3. Please summarize the matters this rebuttal testimony will address.

A3. I will address certain portions of the testimony filed by the Division of Ratepayer Advocates (“DRA”) witness Scott Logan, the Alliance for Nuclear Responsibility (“Alliance”) witness Rochelle Becker, and Southern California Edison Company (“Edison”) witness Mark Nelson. Specifically, my testimony addresses the following topics:

- Mr. Logan’s proposal that utility shareholders should bear ten percent (10%) of the costs of the proposed seismic and tsunami studies and risk assessments proposed by Edison for the San Onofre Nuclear Generating Station Units 2 and 3 (“SONGS 2&3”);
- Mr. Logan’s proposal that the Commission should impose a cost cap on the studies and risk assessments;
- Ms. Becker’s proposal that an Independent Peer Review Panel (“Review Panel”) be created to review the scope of the proposed studies and oversee the conduct and results of the studies;
- Mr. Nelson’s proposal to create a Memorandum Account for recording the costs charged to and reimbursed by Edison for the support of an Independent Peer Review Panel, if such a Review Panel is adopted by the Commission for the SONGS 2&3 studies; and,
- Edison’s proposal to create a Memorandum Account in which costs incurred for the performance of the studies, to the extent those costs are incurred prior to receiving authorization from the Commission to proceed with the studies and/or recover the costs of the studies through retail electric rates, would be recorded and, upon the issuance of these authorizations by the Commission, transferred to revenue accounts for recognition in retail electric rates.

1 Q4. Let's discuss each of these topics in order. First, turning to Mr. Logan's proposal to have utility
2 shareholders bear ten percent (10%) of the costs of the proposed seismic and tsunami studies and risk
3 assessments, do you agree that placing financial burdens on utility shareholders for these activities and
4 their costs is appropriate?

5 A4. No, I do not.

6 Q5. Please explain the reasons you disagree with Mr. Logan.

7 A5. Mr. Logan principally relies on his assessment that there are uncertainties regarding the scope of work
8 and costs associated with the performance of the studies to support his ratemaking proposal. I would point
9 out that nothing in his testimony indicates the scope of work proposed for the studies by Edison is
10 unreasonable or the cost estimates related to the scope of work are unreasonable. This indicates to me
11 that, unless the Commission otherwise finds the studies or their costs to be beyond the ordinary and
12 prudent business operations of the utilities, the full costs of the studies should be subject to rate recovery.
13 The point Mr. Logan makes, that the scope of work and the eventual costs of the studies are somewhat
14 uncertain, is correct, but this is among the reasons the cost recovery should be done through a balancing
15 account rather than through general rates. The uncertainties associated with the studies, whose scope
16 could well change over time as discoveries are made, regulatory requirements change, or the technologies
17 or scientific methods that will be used for the studies evolve, can more readily be reviewed under the
18 regulatory practices associated with balancing accounts compared to the setting of a utility's general rates,
19 since the latter are forecasted under known or foreseeable conditions and those forecasts are typically not
20 subject to ongoing review or adjustments (e.g., no "true-ups" would be permitted, generally speaking). If
21 the utilities were recommending the study costs should be included in general rates, Mr. Logan's point
22 regarding uncertainty would be more pertinent, but since both SDG&E and Edison are proposing the
23 reasonable costs of the studies be collected through a balancing account, those uncertainties can be
24 addressed as the studies are conducted under the ratemaking principles applicable to the proposed
25 balancing accounts. Moreover, collecting the costs of the studies through a balancing account is more
26 appropriate for our ratepayers because on the one hand, if the costs of studies were to fall below the levels
27 described in Edison's application, ratepayers would receive the entire benefit of any cost savings. If, on the
28 other hand, costs were to exceed the cost estimates provided by Edison, the utilities have proposed the
29 difference be recorded in a memorandum account and only paid by ratepayers upon further findings by the
30 Commission that the amounts recorded in the memorandum account were reasonable, prudent and
31 justified.

1 Q6. Mr. Logan's testimony expresses his belief that the studies proposed by Edison "have no mandate by
2 law, regulation, or the body that is responsible for the safety of SONGS, the Nuclear Regulatory
3 Commission" and "could arguably be voluntary". Does this cause you to believe the studies may not fall
4 within what you called the "ordinary and prudent course of business" of the utilities?

5 A6. No, it does not. Conducting seismic and tsunami studies, even if it were done on a "voluntary" basis,
6 to assess and manage environmental and operating conditions relevant to assuring public safety would
7 constitute a reasonable and prudent action of the utilities that benefits the public.

8 Q7. Please explain your reasons for disagreeing with Mr. Logan.

9 A7. I have several reasons to believe the proposed seismic and tsunami studies are within the ordinary
10 and prudent course of the utilities' business. Most important, the Commission approved rate recovery for
11 the costs of similar studies being performed by Pacific Gas & Electric Company for the Diablo Canyon
12 Nuclear Generating Station. I can think of no reason why studies with similar purposes and intent would be
13 within the ordinary and prudent course of business for one nuclear licensee and not another. Beyond the
14 findings I take from the Commission's prior approvals for the Diablo Canyon studies, I am also aware of
15 recent California legislation, certain recommendations of the California Energy Commission made in that
16 agency's Integrated Energy Policy Report processes, correspondence between the President of this
17 Commission and Edison, and the preliminary stages of a process initiated by the Nuclear Regulatory
18 Commission indicating these studies must be performed. These various official acts and processes, of
19 which I have personal knowledge, have the combined effect of imposing a "mandate" on Edison to perform
20 the proposed studies.

21 Q8. Mr. Logan also expresses the view that shareholders will receive "financial benefits" from performing
22 the studies. Did you take this view into account in forming your opinion that assigning ten percent (10%) of
23 the costs to the utilities' shareholders is inappropriate?

24 A8. Yes, I did.

25 Q9. Please explain your assessment of Mr. Logan's views in this regard.

26 A9. In the largest sense, every dollar collected in rates provides a "financial benefit" to a utility's
27 shareholders. That is, the collection of revenues from rates to offset legitimate and necessary costs of
28 service and provide a utility with a reasonable opportunity to receive a fair return on its capital investments
29 is axiomatic to fair and effective utility rate regulation. This renders Mr. Logan's view that shareholders

1 receive a “financial benefit” from ratemaking irrelevant in my opinion. The distinctions he goes on to make,
2 that avoiding a catastrophic event or potentially laying the foundation for the operation of SONGS 2&3
3 beyond their current license periods, are more specific, but equally irrelevant. As I indicated earlier, my
4 opinion is that the reasonable costs of doing business as a utility, whether those costs are related to
5 ordinary and prudent business operations in the provision of utility services, meeting legal or regulatory
6 obligations, protecting the public safety, or serving any other purpose approved by the Commission, should
7 be eligible for rate recovery. Beyond this, I wholeheartedly disagree with Mr. Logan’s specific opinion that
8 utilities should automatically bear the costs of protecting public safety – to the contrary, these are the very
9 kinds of costs for which the Commission must approve rate recognition. My opinion is that Mr. Logan’s
10 proposal is contrary to the public interest and should be categorically rejected by the Commission.

11 Q10. Mr. Logan also expresses a view that his proposal is necessary in order to provide an incentive for
12 the utilities to contain the costs of the studies. Do you agree with that view?

13 A10. No, I do not.

14 Q11. Please explain your reasons for disagreeing with Mr. Logan.

15 A11. As I have already explained, costs related to the protection of public safety are not among the kinds
16 of costs where “cost containment” should be the first priority. And, as I have also previously explained, the
17 balancing account mechanisms proposed by SDG&E and Edison will permit greater regulatory oversight of
18 the costs incurred in the performance of the proposed studies than would be the case for other costs of
19 service recovered through a utility’s base rates. Next, I expect that regulatory agencies, rather than Edison
20 or SDG&E, will ultimately define the scope of work that must be performed as part of these studies. Having
21 read the recent filing by Pacific Gas & Electric with respect to the Diablo Canyon seismic studies, my
22 understanding is the various public agencies participating on the Commission-mandated Independent Peer
23 Review Panel recommended the scope of those studies be increased significantly. This resulted in a
24 significant increase in the costs of those studies, too. Placing any limitations on the ability of the utilities to
25 recover the costs of complying with the recommendations of interested or jurisdictional agencies will
26 encourage confrontations rather than foster collaboration. Finally, Mr. Logan’s proposal is simply
27 misplaced with respect to SDG&E. As a minority owner, SDG&E has little, if any, control over the
28 performance or costs of the studies. SDG&E did not participate in the design of the studies, did not
29 develop any of the cost estimates, does not expect that Edison would modify its conduct of the studies to
30 comport with any recommendations received by SDG&E, and generally has no authority to require Edison

1 to modify anything related to these studies. As the majority owner, plant operator and reactor licensee,
2 Edison has a superior authority in making decisions related to the operation of SONGS 2&3 and over these
3 studies. As I said, I believe the notion that there should be an incentive for the utilities to contain the costs
4 of these studies is inappropriate, but in the case of SDG&E the proposal also incorrectly presupposes that
5 SDG&E has an ability to influence the design and management of the studies or contain their costs.

6 Q12. Let's turn to Mr. Logan's testimony regarding the imposition and operation of a cost cap. His
7 recommendation is that, if the costs of the proposed studies exceed \$50.1 million to Edison and \$12.6
8 million for SDG&E, the utilities should be required to file new applications. Do you agree with this
9 recommendation?

10 A12. No, I do not.

11 Q13. Please explain your reasons for disagreeing with Mr. Logan.

12 A13. Mr. Logan apparently agrees the current estimate of the study costs is an appropriate starting point
13 for ratemaking purposes. It is only when costs exceed that estimate that Mr. Logan and I differ. SDG&E
14 has proposed that costs above the current estimates and allocated to SDG&E by Edison be recorded in a
15 memorandum account. Those amounts would be subject to further review by the Commission using the
16 Tier 3 advice letter process and applicable procedures described in Commission General Order 96-B.
17 Essentially, under SDG&E's proposal, study costs that are incurred above those authorized by the
18 Commission in this proceeding would be subject to a filing, served upon all interested parties, including
19 those receiving all advice letters filed by SDG&E, describing the extent of the increased costs and an
20 explanation of those increased costs. Any party may file a protest to that advice letter or request
21 evidentiary hearings and, following the disposition of the advice letter by Commission resolution, aggrieved
22 parties have the right to file applications for rehearing and/or judicial review. Thus, in many key respects, a
23 Tier 3 advice letter goes through processes fundamentally similar to the application process Mr. Logan is
24 recommending. The advantage to SDG&E's proposal is that approvals, where the utility filing is
25 uncontested, are likely to be more timely than would be the case for a new application. SDG&E believes
26 the materials and support filed by the utilities would be very similar in substance under either of the two
27 procedural paths and the substantive reviews conducted by the Commission, the DRA and other interested
28 parties would also be very similar in nature. If any questions persisted or protests were filed, SDG&E
29 believes the procedures that would be followed, *i.e.*, action pending further review, discovery and perhaps
30 even hearings, would be identical. But in the event there were no protests to the advice letter filing, which

1 SDG&E expects could likely be the case if the cost increases were the result of changes to the scope of
2 work required by regulatory agencies (e.g., by an Independent Peer Review Panel), timely approvals could
3 be received, saving valuable time in the completion of the studies. I appreciate Mr. Logan's sense that
4 there should be appropriate regulatory oversight over these studies and their costs, but I believe there are
5 safeguards and procedures in place under SDG&E's proposal to assure adequate transparency regarding
6 the studies to address his concerns.

7 Q14. Turning to the testimony of Ms. Becker, you indicated you had some concerns regarding her
8 recommendation for the formation and operation of an Independent Peer Review Panel for the SONGS
9 2&3 seismic and tsunami studies and risk assessments. Can you explain your concerns?

10 A14. Yes. I am concerned that, if charged with reviewing the scope of work and cost estimates, the
11 Review Panel could unduly delay the commencement and completion of the studies, and I have concerns
12 with the manner in which the operation of the Review Panel would interact with Mr. Logan's proposals
13 allocating ten percent (10%) of the costs of the studies to utility shareholders and imposing a cost cap.

14 Q15. Turning to your first concern, could you explain how the creation and operation of the Review Panel
15 could unduly delay the commencement and completion of the studies?

16 A15. Yes. I have reviewed the decision issued by the Commission approving the similar studies proposed
17 by Pacific Gas & Electric Company for the Diablo Canyon facilities. In that decision, the Commission
18 convened an Independent Peer Review Panel to review and comment on the study plan and completed
19 study findings. Ms. Becker recommends the Commission do the same for the SONGS 2&3 studies. I do
20 not have any opinion on whether the Commission should create a Review Panel for the SONGS 2&3
21 studies, but I do have concerns that, if such a Review Panel were created and charged with reviewing and
22 commenting on the scope of work and cost estimates, the Review Panel should be convened and required
23 to report its findings on this task within a specified period of time. It is important to proceed with these
24 studies on a timely basis and, to the extent the Review Panel has responsibility for "approving" the scope of
25 work or the costs of the studies, delays in receiving their recommendations would disrupt timely completion
26 of the work. In part, my concerns are addressed by Edison's proposal, which I will discuss later, to
27 commence the studies in advance of this Commission's decision in this proceeding. Nevertheless,
28 providing the Review Panel with vague (and unlimited) authority to review the proposed scope of work
29 introduces considerable uncertainties to the study process.

1 Q16. Do you have a recommendation as to how your concerns should be addressed?

2 A16. Yes. I recommend, if the Commission creates an Independent Peer Review Panel for the SONGS
3 2&3 studies and charges the panel with reviewing and commenting on the proposed scope of work and
4 cost estimates provided by Edison, the Review Panel should be required to report any exceptions to Edison
5 within thirty (30) days of the effective date of the Commission decision creating the Review Panel and, if
6 those exceptions are unresolved within fifteen (15) days after they are provided to Edison, the Review
7 Panel should be required to file the unresolved exceptions with the Commission within sixty (60) days after
8 the Commission's decision for disposition by the Commission. I believe these time periods are reasonable
9 given the participating agencies' experience with the Diablo Canyon studies. I am assuming the agencies
10 participating on the Independent Peer Review Panels will be the same for both sets of studies and that the
11 agencies' prior work on the Diablo Canyon studies will be beneficial in completing the review of the SONGS
12 2&3 scope of work and cost studies. I would also recommend the Commission provide similar guidance to
13 the Review Panel as to the procedures the Review Panel should use in overseeing the conduct of the
14 studies and in reviewing the study results, but my initial and most important concerns are with the
15 completion of any reviews of the scope of work and cost estimates the Commission would expect the
16 Review Panel to conduct.

17 Q17. Turning to your second concern, could you explain your concerns regarding the interaction between
18 the Review Panel and Mr. Logan's recommendations?

19 A17. Yes. As I said previously, my understanding from my review of the recent filing by Pacific Gas &
20 Electric Company regarding the Diablo Canyon studies is the Independent Peer Review Panel
21 recommended changes in the scope of work for those studies that resulted in increases in the costs of the
22 studies. Assuming the Review Panel created for the SONGS 2&3 studies would have similar
23 responsibilities to the Diablo Canyon panel, it is possible Edison would be required to expand the scope of
24 work in response to the recommendations of the Review Panel, with a commensurate increase in the costs
25 of the studies. Under Mr. Logan's proposals, the utilities' shareholders would bear some portion of the cost
26 increases, and it would become more likely that a new application, with the delays attendant to that
27 process, would need to be filed with the Commission. My concern here is, while the Review Panel and
28 Edison are expected to act collaboratively and cooperatively, Mr. Logan's recommendations create both
29 financial and procedural tensions between the Review Panel and Edison. The Commission either should
30 reject Mr. Logan's recommendations or, if it adopts Mr. Logan's recommendations, make special provisions

1 exempting any costs attributable to the recommendations and operation of the Review Panel from the
2 effects of Mr. Logan's proposals.

3 Q18. Turning to Mr. Nelson's proposal to create a new memorandum account in which the costs of the
4 Review Panel would be recorded, do you agree with his recommendations?

5 A18. I do in part.

6 Q19. Please provide your opinions regarding Mr. Nelson's proposals.

7 A19. I agree with Mr. Nelson that a memorandum account is an appropriate regulatory mechanism by
8 which the costs of the Review Panel chargeable to Edison can be collected and ultimately recovered
9 through rates. In his Supplemental Testimony, Mr. Nelson indicates the costs recorded in the
10 memorandum account related to the Review Panel are expected to be around \$250,000 per year and that
11 amounts billed to and recorded by Edison in the proposed memorandum account would be "reviewed
12 annually" by the Commission in Edison's Energy Resource Recovery proceeding. If the Commission
13 adopts the proposal to create an Independent Peer Review Panel for the SONGS 2&3 studies, I have two
14 recommendations regarding the associated memorandum account. First, while Mr. Nelson indicates the
15 amounts that could be billed to Edison by the Review Panel are expected to be "no more than \$250,000 per
16 year", I recommend the memorandum account be approved without any limitations on the amounts that can
17 be recorded in the memorandum account in any given annual period. That is, the \$250,000 noted by Mr.
18 Nelson should not be used to either set an annual "budget" or impose a limitation on the amounts that may
19 be recorded in the memorandum account in any given year. Edison will not have any control over the
20 amounts being billed to it or the timing of the billings, so there should be no limitations on the accruals in
21 the memorandum account. Second, I recommend the Commission authorize that all amounts recorded in
22 the memorandum account be "included for rate recovery", rather than "reviewed", annually in an
23 appropriate ratemaking proceeding. As I stated previously, Edison will have no control over the billed
24 amounts and I would not expect Edison will be provided with the authority to dispute or reject any charges.
25 Further, I have no reason to believe the costs related to the operation of an Independent Peer Review
26 Panel require regulatory oversight by the Commission. I would not expect the Commission, as the creator
27 of the panel and the agency to which the panel is responsible, would find any amounts billed to Edison by
28 participating local, state or federal agencies to be unreasonable. Public agencies have rules and
29 regulations governing expenditures and billings -- my assumption is the agencies participating on the
30 Review Panel would conform their activities and charges to these rules and regulations. A second review

1 by the Commission, implied by the “annual review” to which Mr. Nelson alludes, would be superfluous.
2 These costs should be considered self-regulating. For these reasons, I do not believe there should be any
3 annual limit on the costs that may be recorded in the proposed memorandum account or that the
4 Commission should reserve any right to “review” the costs recorded in the memorandum account prior to
5 the transfer of the recorded amounts to a ratemaking account.

6 Q20. Let’s turn to Edison’s proposal to create a Memorandum Account in which costs incurred for the
7 performance of the SONGS 2&3 studies, to the extent those costs are incurred prior to receiving
8 authorization from the Commission to proceed with the studies and/or recover the costs of the studies
9 through retail electric rates, would be recorded and, upon the issuance of these authorizations by the
10 Commission, transferred to revenue accounts for recognition in retail electric rates. Do you agree with this
11 proposal?

12 A20. I believe this ratemaking mechanism would reduce any financial disincentives Edison would
13 otherwise have in commencing and conducting the activities in advance of a Commission decision in this
14 proceeding. To the extent this is true, I would agree with Edison the proposal is in the public interest. I
15 recommend, however, to the extent the Commission might ultimately prohibit Edison from transferring any
16 amount from this memorandum account to a revenue account for ratemaking purposes, Edison be barred
17 from billing SDG&E for the otherwise allocable share of the amounts subject to the prohibition.

18 Q21. Please explain your reasons for placing the financial risks of proceeding on an expedited basis
19 entirely on Edison.

20 A21. I have two principle reasons for my recommendation. First, as I explained previously, SDG&E has
21 little, if any, control over the decisions made by Edison regarding operations and maintenance activities for
22 SONGS 2&3. This has especially been the case with respect to the proposed seismic and tsunami studies.
23 Apart from the usual circumstances regarding the relative authorities over decision-making held by Edison
24 (*i.e.*, superior and ultimate) and SDG&E (*i.e.*, inferior and advisory), SDG&E has very little expertise in the
25 areas of seismology or geology and could not substantively contribute to the design, management or
26 performance of the studies. Creating that expertise would be an expensive proposition and would likely
27 hinder the timely progress of the studies in any event. Thus, Edison will have complete control over how to
28 proceed, when to proceed and how much to spend prior to receiving authorizations from the Commission
29 regarding the study design and the recovery of expenditures through rates. Without comparable levels of
30 control, SDG&E should not be placed at risk for the decisions made by Edison. Second, by proposing to

1 establish the memorandum account and, presumably electing to proceed with only the memorandum
2 account in place, Edison has voluntarily assumed the regulatory risk there could be a prohibition on the
3 transfer of entries in the memorandum account to its revenue accounts. SDG&E was not consulted prior to
4 Edison's filing and, unless my recommendation here is adopted, SDG&E would be placed in the position of
5 accepting risks unilaterally initiated, created and assumed by Edison without SDG&E's consent.

6 Q22. Your recommendation appears to be inconsistent with your views that proceeding quickly would be in
7 the public interest. How do you reconcile your recommendations in this regard?

8 A22. My fundamental belief is the proposed studies are in the public interest and they should be completed
9 as soon as possible. This belief drives my recommendations in this proceeding. In order that the studies
10 can proceed as soon as possible, I recommend the Review Panel be required to do its work promptly and
11 under a schedule. I am comfortable with deferring issues related to the study design, cost estimates and
12 management of the studies to Edison rather than insisting Edison stop all activities until the SONGS
13 minority owners conduct an independent due-diligence evaluation of and approve the details associated
14 with the studies and study costs. I recommend the Commission adopt ratemaking procedures consistent
15 with completing the studies as soon as possible. SDG&E has assisted Edison in performing certain
16 precursor activities as quickly and inexpensively as possible – as an example, SDG&E granted Edison no-
17 cost easements to place seismologic equipment on SDG&E's properties and rights-of-way. And I
18 recommend, if Commission approval of the memorandum account facilitates earlier action on Edison's part
19 to commence the proposed studies, the Commission should authorize Edison to establish such an account.
20 Nevertheless, I believe Edison, given free license and pursuant to its willingness to accept the financial
21 risks of proceeding without prior Commission authorities, should bear the entirety of the financial risks of its
22 own decisions. My belief is further buttressed by the fact Edison is not only assuming the risk the
23 Commission might find that it has not properly designed its studies, but is also assuming that none of the
24 activities it would undertake prior to receiving Commission authorizations will be rendered superfluous,
25 wasteful, unnecessary, superseded, or unreasonable by the recommendations or actions of the proposed
26 the Review Panel. Given the apparent facts of the Diablo Canyon studies, that risk could be considerable
27 and not one SDG&E would assume given the probable role of the Review Panel. To the extent Edison is
28 willing to accept those risks, it can manage those risks by controlling its activities and expenditures, limiting
29 its financial exposure to a level tolerable to its management, or, with respect to any recommendations of
30 the Review Panel, choosing to accept rather than contest them. As I have said previously, SDG&E is
31 without any ability to manage these risks and therefore should not be forced to accept them.

1 Q23. Does this conclude your rebuttal testimony?

2 A23. Yes, it does.