Exh. No. CAL-699

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Public Utilities Commission of the State of California *Complainant,* *v.* Sellers of Long-Term Contracts to the California Department of Water Resources *Respondents.*	)	Docket Nos. EL02-60-007 and EL02-62-006 (Consolidated)
California Electricity Oversight Board *Complainant,* *v.* Sellers of Energy and Capacity under Long-Term Contracts with the California Department of Water Resources *Respondents.*	)	

PREPARED REBUTTAL TESTIMONY OF MICHEL PETER FLORIO
ON BEHALF OF THE CALIFORNIA PARTIES

October 6, 2015

TABLE OF CONTENTS

I. SCOPE OF REBUTTAL TESTIMONY 1

II. RESPONSE TO SHELL, IBERDROLA, AND FERC TRIAL STAFF'S ESTIMATES OF THE RATE AND BILL IMPACTS OF THE SHELL AND IBERDROLA CONTRACTS 2

III. SHELL AND IBERDROLA INCORRECTLY CALCULATE THE AMOUNT OF THE ONGOING BOND CHARGES THAT SHOULD BE ATTRIBUTED CDWR'S COSTS INCURRED IN 2001-2002 FOR THE SHELL AND IBERDROLA CONTRACTS 23

IV. THE RATE IMPACTS OF CONTRACTS THAT FUNDED MARKET-TRANSFORMING RENEWABLE ENERGY PROJECTS DOES NOT JUSTIFY THE EXCESSIVE CONSUMER BURDEN OF THE SHELL AND IBERDROLA OVERCHARGES 28

V. RESPONSE TO SHELL'S WITNESSES ASSERTIONS THAT CDWR HAD STRONG BARGAINING POSITION IN THE LONG-TERM CONTRACT NEGOTIATIONS 31

I. SCOPE OF REBUTTAL TESTIMONY

Q. What is your name and what is your business address?

A. My name is Michel Peter Florio. I am a Commissioner at the Public Utilities Commission of the State of California (CPUC). My principal office is at 505 Van Ness Avenue in San Francisco.

Q. Are you the same Michel Peter Florio who filed direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. I respond to Answering Testimony in this case from Shell's witness Mark Fulmer,[1] Iberdrola's witness William A. Monsen[2], and FERC Trial Staff's witness Daniel L. Poffenberger[3] regarding their assessments of whether the Shell and Iberdrola Contracts impose an excessive burden on consumers compared to what consumers' rates would have been down the line in the absence of each of these contracts. I also respond to criticisms of the direct testimony of John Pacheco[4] and my direct testimony[5] that Mr. Pacheco

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[1] Answering Testimony of Mark Fulmer On Behalf of Shell Energy North America (US), L.P., Exh. No. SNA-256 (Fulmer Answering Testimony).

[2] Prepared Answering Testimony of William A. Monsen On Behalf of Iberdrola Renewables, LLC, Exh. No. IB-246 (Monsen Answering Testimony).

[3] Prepared Answering Testimony of Commission Trial Staff Witness Daniel L. Poffenberger, Exh. No. S-100 (Poffenberger Answering Testimony).

[4] Prepared Direct Testimony of John Pacheco on Behalf of the California Parties, Exh. No. CAL-241 (Pacheco Direct Testimony).

incorrectly calculated, and therefore we both have overstated, the share of the bonds issued by CDWR that are attributable to the Shell and Iberdrola Contracts. Finally, I also respond to claims by Shell's witnesses Lynn A. Lednicky and Edward Brown that CDWR had strong bargaining power in its long-term contract negotiations as the only creditworthy buyer of long-term power in the ISO market at the time.[6]

II. RESPONSE TO SHELL, IBERDROLA, AND FERC TRIAL STAFF'S ESTIMATES OF THE RATE AND BILL IMPACTS OF THE SHELL AND IBERDROLA CONTRACTS

Q. How did the witnesses for Shell, Iberdrola, and FERC Trial Staff evaluate whether the Shell and Iberdrola Contracts imposed an excessive burden on consumers?

A. Instead of evaluating how much IOU customers were overcharged by Shell and Iberdrola, Shell and Iberdrola's witnesses Mr. Fulmer and Mr. Monsen assess customer burden by examining the total average retail rate levels paid by customers to receive reliable electricity services from the IOUs and looking at what percentage of that total reflected the overcharges from the

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[5] Prepared Direct Testimony of Michel Peter Florio on Behalf of the California Parties, Exh. No. CAL-241 (Florio Direct Testimony).

[6] Answering Testimony of Lynn A. Lednicky on Behalf of Shell Energy North America (US), L.P., Exh. No. SNA-228 at 22 (Lednicky Answering Testimony); *see also* Supplemental Answering Testimony of Edward Brown on Behalf of Shell Energy North America (US), L.P., Exh. No. SNA-219 at 37:20-27 (Brown Supplemental Answering Testimony).

Shell and Iberdrola Contracts. The total retail rate level they use for their comparisons includes many large, and legitimate charges, such as the rate components for the distribution system, FERC transmission services, public purpose programs, other cost components of electric utility rates, the Bond Charge, and costs associated with electricity generated or procured by the IOUs, as well as the Power Charge for electricity delivered by CDWR.

Mr. Fulmer calculates the average retail rates each year for all three IOUs together to develop a system-wide average rate. He estimates the rate impact of the excessive payments under the Shell Contract by subtracting the overcharges as Dr. Celebi calculated them from the total IOU revenues collected each year and calculating a revised average rate. Mr. Monsen takes a more granular approach by estimating the average annual rate for <u>each</u> IOU and within each customer class (*i.e.*, residential, commercial, industrial, and street/highway lighting). Mr. Monsen calculates the rate impact of the <u>total</u> costs of the Iberdrola Contract (the gross impact) as well as the net unavoidable costs after subtracting his own estimates of the value of the energy and capacity provided by the Iberdrola Contract (the net impact).[7] The Trial Staff witness, Mr. Poffenberger, did not expressly present a rate impact analysis in his testimony, but he calculated the percentage of overcharges each year of total IOU revenues collected from

[7] Monsen Answering Testimony, Exh. No. IB-246 at 34, 38.

sales of electricity, using Dr. Celebi's "down the line" estimates of the difference between the contracts' actual rates paid and the forward "post-crisis" rates. This is mathematically equivalent to calculating the percentage impact of overcharges on the IOU's average retail rates.[8]

Second, Mr. Fulmer, Mr. Monsen, and Trial Staff's witness Mr. Poffenberger each estimate the impact of the contracts and overcharges on hypothetical average monthly customer bills for different customer classes. Mr. Fulmer estimates the total average monthly bill impact of the Shell Contract overcharges on different customer classes for all three IOUs over the entire contract term. Mr. Monsen estimates the average annual impact of the Iberdrola Contract and breaks-out the results by year across each IOU and customer class within each IOU. Mr. Poffenberger states a range of bill impacts by customer class over the term of each contract. Further, Mr. Poffenberger's estimates for the Iberdrola Contract differ from Mr. Monsen's estimate because he uses Dr. Celebi's estimates of "post-Crisis" prices, which includes avoidable costs, but Mr. Monsen excluded avoidable costs in his calculation of the excessive burden on consumers.[9]

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[8] The percentage impact of removing overcharges is the same for revenues and rates because the retail rate is calculated as the total revenues ($) divided by total electricity sales (in MWh or kWh). Because only the total revenues collected would have decreased without the excessive payments (overcharges) but total electricity sales would have remained the same, the percentage impact is the same as to the retail rates or the total IOU revenues collected.

[9] Poffenberger Answering Testimony, S-100 at 20.

Q. Do you agree with how these witnesses approached their determination of whether the Shell or Iberdrola Contracts impose an excessive burden on consumers?

A. No. Putting aside the nuances in the differences of how they each calculate and present the rate and bill impacts, their analyses are all off-point to begin with. Looking at rate impacts in terms of $/kWh difference, or as a percentage impact to the IOU's total retail rates[10] from electricity sales is not a meaningful or an appropriate way to assess if the overcharges paid under the Shell and Iberdrola Contracts imposed an excessive burden on California's ratepayers. Nor is assessing the change to a hypothetical average monthly customer bill relevant to assessing the actual consumer burden imposed by the contracts.

In my view, the appropriate measure of consumer burden is best captured by the excessive rates paid under the Shell and Iberdrola Contracts themselves, which add up to over $1.97 billion in nominal payments over the contracts' terms, and over $3 billion including interest. Consumers paid these excessive rates to Shell and Iberdrola but received absolutely no commensurate value for the extra payments. The consumer burden also should include the tens of millions of dollars that Californians must pay

[10] Again, Mr. Poffenberger calculated the percentage impact on total revenues collected by the IOUs, which is the same as calculating the percentage impact on retail rates.

every year through 2022 to service the bond debt attributable to the energy Shell and Iberdrola sold CDWR in 2001-2002 (until January 2003 when the first official Power Charges were instituted). As I concluded in my direct testimony, these charges to rates, whether viewed in total or as an individual contract rate, undoubtedly imposed an excessive burden on consumers.

Q. Please explain why measuring the impact as a percentage of overall IOU retail rates is the wrong way to measure the customer burden imposed by the overcharges CDWR paid under the Shell and Iberdrola Contracts.

A. It is wrong for several reasons. First, "peanut buttering" the $1.97 billion (nominal) in excessive payments out over two billion MWh of electricity sold by the three IOUs from October, 2001 through 2012 is not an appropriate measure of consumer harm, because it makes the determination of whether an excessive customer burden was imposed turn on <u>how many</u> customers were harmed. California is the most populous state, with nearly one in eight U.S. citizens living here. Even a multi-billion dollar excessive charge to rates can be made to look small if it is spread over millions of customers, over multiple years, and over the thousands of kWh of electricity that each customer consumes each year. Spreading a multi-billion dollar charge to rates in that fashion merely hides the size of the

huge burden that has been imposed.

Second, converting the $/MWh impact of overcharges into a percentage contribution to total IOU retail rates, or characterizing the overcharge as causing a small increase to an average monthly bill for a hypothetical customer, is not an appropriate measure of consumer harm. A significant portion of retail rates reflect the costs of distribution, transmission, all other generation, and public purpose programs which are large, but also lawful and appropriate. The fact that the CPUC authorized the IOUs to pay billions of dollars for other legitimate electric power costs over the multi-year term of the Shell and Iberdrola Contracts does not mean that the $1.97 billion (nominal) in unlawful additional charges to rates can be disregarded as insignificant, just because it is only a percentage of the total service costs. This view loses sight of the trees, just because the forest is lush.

Third, focusing on the percentage impact to the average system rates for each IOU's rates completely ignores the fact that CDWR is a separate entity with its own retail rate imposed on customers via the Power Charge. None of the witnesses even addresses this critical distinction between CDWR and the IOUs, they simply lump the overcharges CDWR paid to Shell and Iberdrola onto the IOU's total revenue requirements. Although mixing the overcharge borne by CDWR with other legitimate charges

incurred by the IOUs helps Shell and Iberdrola make the overcharges look smaller, it serves no valid purpose.

These witnesses' opinions that the excessive charges to rates did not burden consumers boil down to this lesson for sellers: so long as the harm to the public in billions of dollars of overcharges from a grossly overpriced power contract is spread out across enough consumers, the obvious excessive burden on consumers somehow melts away, and there is no public interest in preventing the overcharge. That notion does not comport with my understanding, as a regulator, of how to assess consumer burdens of electric utility costs or the public interest. And I do not believe it is required or appropriate under the public interest exception to the *Mobile-Sierra* doctrine set out in the *Morgan Stanley* decision.[11]

Q. Please explain what you mean when you say that "peanut buttering" the overcharges is inappropriate because it would make the determination of excessive customer burden turn on the number of consumers harmed.

A. Spreading out the costs of one or two contracts over every kWh of retail electricity sold means the question of whether the contract poses an excessive burden will turn primarily on the number of consumers forced to shoulder the excess weight of the overcharges, not whether the contract

[11] *Morgan Stanley Capital Grp., Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.*, 554 U.S. 527 (2008).

rates are so onerous as to harm the public. Under this perverse theory, the greater the number of consumers harmed, the less of a burden the contract becomes, because the harm to each individual consumer becomes proportionally smaller, even though the excessive charges to rates may exceed hundreds of millions of dollars per year in some years. Table 1 below shows the total above-market costs of the Shell and Iberdrola Contracts for October-December 2001 and each year thereafter (which were all ultimately passed on to consumers as part of retail rates) alongside the total MWh of electricity sold statewide by the three IOUs.

Table 1: Above-Market Costs of Shell and Iberdrola Contracts and Total Electricity Sold by Three IOUs

Year	IOU's Energy Billed MWh	Shell Excess Charges (nominal) $ M	Iberdrola Excess Charges (nominal) $ M	Total Excess Charges (nominal) $ M	Total Excess with interest $ M
Oct - Dec 2001	43,802,323*	26	13	39	75
2002	174,937,283	178	59	238	429
2003	180,125,257	358	34	392	676
2004	184,649,211	141	53	194	321
2005	186,073,507	152	83	235	372
2006	192,595,612	115	66	181	268
2007	194,552,738	117	78	195	267
2008	197,844,188	165	88	252	319
2009	190,908,761	33	46	79	96
2010	186,275,358	48	50	99	116
2011	186,832,810	29	30	58	66
2012	191,951,010	5		5	6
Total	**2,066,745,735**	**1,367**	**601**	**1,968**	**3,011**

Data for energy billed is the total for all three IOUs as presented by Shell's witness Mr. Fulmer in his workpapers, Exh. No. SNA-260 (corrected). Overcharge amounts shown in the table are from Dr. Celebi's workpapers, Exh. No. CAL-653.
* Oct - Dec 2001 sales are estimated as one-quarter of annual sales for 2001.

The Shell, Iberdrola, and Staff's perspectives espouse the view that these enormous above-market charges to rates are inconsequential simply because many bore the pain. Take 2003, for example. Shell collected almost $358 million in excess revenues from California's ratepayers, and Iberdrola over $34 million. I cannot think of any other context where paying over $390 million (nominal) in a single year above the market price for a comparable replacement product would be considered inconsequential

and not an excessive burden for consumers to bear. I can tell you that ratepayer advocates in California would jump at the chance to reduce the IOU's collective revenue requirement by nearly $400 million in a single year.

Watering down the consumer impacts by viewing the excess rates of the Shell and Iberdrola Contracts as a percentage of total IOU retail rates is not the right way to look at consumer burden. While nearly $2 billion nominal (and over $3 billion with interest) in excess payments may seem like chump change to Shell, Iberdrola, and Staff when spread out over the total revenue requirement of the IOUs who serve 70 percent of the electricity demand in the country's most populous state, the impacts are immense. Ratepayers paid every penny of the overcharges that added up to nearly $2 billion, and as a former ratepayer advocate and now a Commissioner I know first-hand that these kinds of dollar amounts truly matter to consumers even if they are spread out over a large consuming public. It cannot logically be the rule that the burdensomeness of a charge to rates depends upon the number of consumers who can be forced to absorb a proportional share of it.

Q. Please explain what you mean when you say that measuring overcharges as a percentage of the total retail rate waters down the consumer impacts?

A. Viewing $1.97 billion (nominal) in enourmous excessive charges to rates as merely a percentage contribution to the IOUs total retail rates waters them down by pouring them into the sea of lawful costs needed to deliver electricity to millions of consumers. Utilities recover a myriad of expenses and authorized rate base components that are required to furnish reliable electricity service and achieve California's ambitious policy mandates such as low-income customer programs, energy efficiency improvements, renewable and other preferred resource procurement mandates, and other public policy goals.

The graphic below (Figure 1) shows the key rate components that were rolled up into the IOUs' rates in 2008, presented in the CPUC's Report on Regulated California Electric and Gas Utility Ratepayer Costs published in February 2009. Exh. No. CAL-700 at 5. A similar report issued in 2012 describes in more detail the numerous different key components of utility revenue requirements that are allocated as generation, distribution, and transmission costs as well as other CPUC-approved costs like nuclear decommissioning and public purpose programs. Exh. No. CAL-701 at 7-9 (Excerpts from CPUC 2011 Gas & Electric Utility Cost Report).

Figure 1:

2008 Electric Revenue Requirement by Key Component

(in millions)

Electric Revenue Component	PG&E		SCE		SDG&E	
	Revenue Requirement	% of Total	Revenue Requirement	% of Total	Revenue Requirement	% of Total
Generation (including Purchased Power)	4,962	45%	5,514	44%	1,094	39%
Ongoing CTC	258	2%	381	3%	30	1%
DWR Power Charges	792	7%	1,927	15%	465	17%
DWR Bond Charges	378	3%	398	3%	88	3%
Transmission	678	6%	482	4%	148	5%
Distribution	3,254	29%	3,364	27%	826	29%
Nuclear Decommissioning	24	0%	52	0%	9	0%
Public Purpose Programs	504	5%	340	3%	124	4%
AB 1890 Rate Reduction Bonds	-68	-1%	-	0%	0	0%
Energy Recovery Bonds (PG&E only)	273	2%	-	-	-	
Franchise Fee Surcharge (not provided by each IOU)	4	0%	-	-	27	1%
TOTALS	11,057	100%	12,459	100%	2,812	100%

7 2008 Gas & Electric AB 67 Report

Evaluating the overcharges as a percentage of the total utility rates masks the huge burden imposed by the Contract charges. The fact that the costs described in these reports for distribution, transmission, public purpose programs, and reasonably priced power are large simply reflects the real cost of furnishing reliable electric service to millions of retail customers consistent with California's environmental and other statutory requirements. It does not legitimize saddling those consumers with massive additional overcharges.

Q. Please explain what you mean when you say that the Shell, Iberdrola, and Staff witnesses improperly focus on the IOU's retail rates?

A. One reason why the comparison to the overall IOU retail rate is the wrong approach is because CDWR is a separate and distinct entity from the IOUs and has a separate CPUC-approved revenue requirement. As I described in my Direct Testimony, CDWR's Long-Term contract costs were broken out into a separate charge per kWh sold by CDWR.[12] While the IOUs were not required to show the total amount charged for CDWR power as a separate line item on customer bills, they always show the separate rate for CDWR power. Mr. Fulmer, Mr. Monsen, and Mr. Poffenberger all wholly ignore this critical distinction in their efforts to water down the rate impacts by pouring the $1.97 billion of nominal overcharges that Shell and Iberdrola pocketed over time into the larger body of total electric revenues collected by California's three largest IOUs.

Q. Did you present an analysis of the consumer rate impacts of the Shell and Iberdrola Contracts?

A. Yes. Contrary to Mr. Fulmer's accusation, I presented the impacts of the overcharges on the contract rates in Tables 4 and 5 of my direct testimony.[13] The total rate impacts are shown in Table 1 above, based on

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[12] Fulmer Answering Testimony, Exh. No. SNA-256 at 17; Florio Direct Testimony, Exh. No. CAL-241 at 41-42.

[13] Florio Direct Testimony, Exh. No. CAL-241 at 64-65.

Dr. Celebi's estimates, as the almost $2 billion in nominal excess payments, which with interest exceeds over $3 billion over the term of the Shell and Iberdrola Contracts. In my view these are the rates consumers paid that were impacted and that would have been lower "down the line" in the absence of the Shell Contract and Iberdrola Contract, using substitute power from comparable long-term contracts. There is clearly a substantial increase in most years between the rates consumers paid for power delivered under the Shell and the Iberdrola Contracts, versus what they would have paid for substitute power using Dr. Celebi's forwards-based "post-crisis" rates.

Q. Did you conclude based on this analysis that the increases between what consumers paid for the Shell and Iberdrola Contracts, compared to what they would have paid absent the contracts, impose an excessive burden on consumers?

A. Yes. The overcharges that Shell and Iberdrola pocketed, and that were passed through in rates to consumers, amounted to enormous sums of money that provided no benefit to those consumers. They also diverted Californians' economic resources from other legitimate electric assets and services. One way to demonstrate the burden imposed on customers of overcharges of $1.97 billion nominal and $3.01 billion with interest is to look at what other benefits the overcharges could have provided for

consumers.

One important use of funds collected through electric rates is California's Public Purpose Programs. These public purpose programs fund low income ratepayer assistance programs, energy efficiency programs and other programs that support California's energy goals. *See* Exh. No. CAL-701 at 2-6 (excerpts from 2011 Electric and Gas Utility Cost Report). The average annual revenue requirement for public purpose programs from 2008-2012 was just over $1 billion. *See id*. at 7-9; Exh. No. CAL-700 at 9-11. California ratepayers could have funded almost two additional years of these programs if they had not instead carried the burden of the $1.97 billion in total nominal overcharges from late 2001 through the end of the Shell Contract in 2012.

Alternatively, the value of the overcharges could have been used instead to add significant amounts of nameplate capacity—actual **new steel in the ground**—inside California and in the locations that would have provided the greatest value for meeting local and flexible capacity needs. Using data for just the mid-case and high-case of reported costs for new merchant developer-built plants from the California Energy Commission, Californians could have built **four to five** 550-MW new Combined Cycle Gas Turbine (CCGT) or **fifteen to twenty-three** 100-MW Combustion Turbine (CT) peaking power plants, for a total of new installed (nameplate)

capacity ranging from 1,500 to 2,800 MW, depending on the technology.[14] Table 2 shows what new capacity Californians could have installed based on the mid-case cost data using just the Shell or Iberdorola overcharges, as well as the total overcharges (including interest through May 2015).

Table 2:
Possible Alternative Capacity Additions Using Overcharges
(With Interest Through May 2015)
Based on CEC Study, Mid Case Cost Data

Number of Plants:	Shell	Iberdrola	Total
CCGT @ 550 MW	3.6	1.5	5
CT @ 100 MW	16.4	6.7	23
Nameplate Capacity (MW):	Shell	Iberdrola	Total
CCGT @ 550 MW	2,000	819	2,819
CT @ 100 MW	1,637	670	2,307

I have been an assigned Commissioner in several applications involving utility requests for approval of power purchase agreements (PPAs) to finance the construction of new gas-fired power plants. While they are often opposed for many reasons, including environmental and community concerns, cost is often a hotly-contested issue and a finding of need for the plant is always necessary to justify imposing the high costs of

[14] *See* Exh. No. CAL-702. The data I used for these calculations are from the CEC report *Estimated Cost of New Renewable and Fossil Generation in California* (California Energy Commission Final Staff Report, March 2015). The full report is reproduced at Exh. No. CAL-796, but the data I relied upon is reproduced in Exh. No. CAL-703. I have not escalated the costs presented in the report, which are in $/kWh for these technologies, from 2013 to 2015 dollars, but by presenting the range of outcomes for the mid- and high- cost results I have also likely captured the impact of escalating the costs to 2015 dollars.

new plants onto ratepayers.

Q. On what basis have you formed your conclusion that the Shell and Iberdrola Contracts imposed an excessive consumer burden?

A. My conclusion is based on my decades of experience as a consumer advocate, and more recently as a Commissioner of the CPUC. In these roles I have both litigated and decided what utility costs are reasonable to authorize for recovery in general rate cases, in individual utility applications for approval of cost recovery, and in fuel and purchased power cost recovery proceedings.

Q. Do you understand that the issue regarding the Shell and Iberdrola Contracts is whether the difference between what consumers rates were given the contracts, and what they would have been down the line in the absence of the contracts, imposes an excessive burden on consumers?

A. Yes.

Q. Does that change your opinion of what is the relevant rate to evaluate for that inquiry?

A. No. The ultimate issue in any of these inquiries boils down to whether the proposed charge to rates is justified based on the benefits provided, or is that cost excessive and unduly burdensome. It is critical to keep the cumulative revenue requirement of each utility as low as possible while

providing enough revenue to provide reliable electricity service and maintain the IOUs financial health and stability. Every component—from market power purchases to employee compensation to major capital assets—is important.

Q. Shell's witness Mr. Fulmer asserts that, "Simply because a contract is more expensive than another or causes an increase in rates does not make it excessively burdensome. All contracts cannot be below average in cost."[15] Do you agree?

A. I agree that some contracts are more expensive than others, but my conclusions are not based on a simplistic assessment of whether the costs of these contracts are more expensive than average. My conclusion that the Shell Contract and Iberdrola Contract each impose an excessive burden on rates charged to consumers is not based on a simple comparison showing the contract costs are higher than the average cost of other comparable contracts. Rather, I relied on Dr. Celebi's "down the line" analysis to demonstrate the total excess rate consumers paid under each of the Shell and Iberdrola Contracts compared to what they would have paid absent the contracts.[16] It is the magnitude of these excessive contract rates, and the resulting billions of dollars in excess payments pocketed by Shell and Iberdrola, which leads me to conclude that the contracts imposed an

[15] Fulmer Answering Testimony, Exh. No. SNA-256 at 4.

[16] Florio Direct Testimony, Exh. No. CAL-241 at 64.

excessive burden that seriously harms the public interest.[17]

Q. Shell's witness Mr. Fulmer also asserts that the CPUC does not find a contract to be unreasonable or excessively burdensome just because it may be more expensive than similar ones in the market.[18] Do you agree?

A. Again, this is irrelevant. I do not claim that a contract poses an excessive burden simply if it is more expensive than the average cost of its "cohort" or similar ones or the general market. I am not suggesting that long-run marginal costs are the standard for determining if a contract rate imposes an excessive burden.

Q. Mr. Fulmer opines "the magnitude of the cost of a power contract on the customers of a utility can be better seen by examining the impact of that contract on retail rates."[19] Do you agree?

A. I agree that one should look at the charges that will be passed to consumers, but as I discussed above I disagree that merely comparing the impact of a contract on a percentage basis to the overall rate paid by consumers provides a meaningful analysis of whether the charges are reasonable or excessive. The magnitude of the costs of a power contract can be best seen by looking at the total contract costs. To determine if those contract costs

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[17] Florio Direct Testimony, Exh. No. CAL-241 at 62-65.

[18] Fulmer Answering Testimony, Exh. No. SNA-256 at 25.

[19] Fulmer Answering Testimony, Exh. No. SNA-256 at 17.

are an unreasonable burden to consumers, they are usually weighed against and considered in light of the benefits provided by the product, such as satisfying reliability or other regulatory requirements like renewable portfolio standard requirements or other specific procurement mandates.

Q. Does that mean that, unlike Mr. Fulmer, you do not take the actual rate impacts into account when considering the cost of a power contract to consumers?

A. In my experience the total rate impact, looked at in isolation, is not the important or critical factor in regulatory decisions to allow or disallow IOU recovery of specific costs. Other benchmarks are relied upon to assess cost reasonableness.

For example, when a utility files an application seeking CPUC approval of a proposed long-term power purchase agreement (PPA) it must calculate and file the rate impact as part of the application. But in my experience the calculated rate impact is not used as the basis for deciding if the PPA should be approved, rejected, or if the proposed costs and rate recovery mechanisms should be amended as a condition of approval. The relevant inquiry starts by asking if there is a demonstrated need, which is generally a reliability-based need or a statutorily-based requirement; this is a prerequisite to justify imposing <u>any</u> additional costs on ratepayers. In short, there must be a benefit provided for the additional cost.

Once need is established then the scope of issues generally focuses on determining if the proposed costs are reasonable using an appropriate benchmark for the situation. For a PPA the Commission will generally consider if the contract resulted from a fair and competitive solicitation and was adequately negotiated, and how it compares on a least-cost, best-fit assessment to other bids submitted into the solicitation. This process accounts for differences in the value of a specific PPA that may justify higher costs, such as whether it is a renewable or other environmentally-preferred resource versus conventional generation, locational attributes, or other utility needs to satisfy regulatory requirements. I cannot think of any application in which I, as an advocate or as a Commissioner, considered the total retail rate impact of a proposed PPA to be the material factor for purposes of determining if it was reasonable to burden ratepayers with the costs.

The process undertaken in a utility's general rate case also demonstrates the preposterousness of looking at the overall rate impact of any proposed cost to determine if the cost should be approved, disallowed, or reduced. In a general rate case the parties scour every individual category of expenses and proposed capital projects, and look at each component separately using appropriate cost benchmarks. They do not evaluate the rate impact of each separate line item or project and approve

the cost if it is, for example, less than one percent. A good example is the evaluation of an IOU proposed infrastructure project. The CPUC evaluates if the proposed project is needed to ensure safe and reliable service to ratepayers and if the proposed project is a reasonable solution from a cost-benefit perspective. The cumulative impacts of various proposed expenses and projects matter, but the goal is to provide safe, reliable service and meet regulatory and statutory requirements, while ensuring reasonable rates. Indeed, parties often hotly contest the costs of executive salaries and/or dues paid to trade associations, even though these expenses have a *de minimus* impact on the ultimate rates paid by consumers.

III. SHELL AND IBERDROLA INCORRECTLY CALCULATE THE AMOUNT OF THE ONGOING BOND CHARGES THAT SHOULD BE ATTRIBUTED TO CDWR'S COSTS INCURRED IN 2001-2002 FOR THE SHELL AND IBERDROLA CONTRACTS

Q. Why did Mr. Fulmer and Mr. Monsen assert that Mr. Pacheco overstated the amount of the ongoing Bond Charges payments made by CDWR under the Shell and Iberdrola Contracts in 2001 and 2002?

A. Mr. Fulmer and Mr. Monsen both contend that only the payments CDWR made to Shell and Iberdrola during the time when CDWR was sinking faster and farther into debt in 2001 should count as their contribution to the bonds issued in late 2002. They claim that once the IOUs began remitting

payments to CDWR that allowed CDWR to function without resorting to additional private loans or more advances from the State General Fund, then all monies collected thereafter went directly to pay for CDWR's contemporaneous costs incurred under the CDWR Long-Term Contracts and were not "captured" in the liabilities financed by the bonds issued in late 2002. They contend this occurred in September or October 2001.

For example, Mr. Fulmer asserts that after October, 2001, "the direct remittances fully covered the cost of the CDWR procurement," and therefore Mr. Pacheco "should have only include the costs of the [Shell] Contract when it overlapped with times when the CDWR was purchasing power though the General Fund advances or from the private loans."[20] Mr. Monsen asserts that "CDWR started to receive sufficient remittances from the IOUs after September 2001 such that the amount needed to be borrowed…stopped increasing," and therefore "the bonds were only needed to repay costs incurred through September 2001."[21]

Q. Are their criticisms valid?

A. No. Mr. Fulmer's and Mr. Monsen's attempts to re-write CDWR's revenue accounting processes, and the realities of the IOU's financial situation and ratemaking possibilities in 2001 and 2002 should be

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[20] Fulmer Answering Testimony, Exh. No. SNA-256 at 7, 12.

[21] Monsen Answering Testimony, Exh. No. IB-246 at 19.

disregarded. Their optimistic views of how CDWR's finances could have worked does not comport with reality.

Mr. Pacheco's Rebuttal Testimony will explain the technical accounting reasons why Shell and Iberdrola's witnesses are inaccurate, but at a higher level and based on my experience from the time, the Shell and Iberdrola witnesses are wrong to accuse Mr. Pacheco of not considering "the timing of when the liabilities that were eventually included in the CDWR bond principal were incurred." He considered exactly the right time-frame: which was the entire time period from January 2001 when CDWR began incurring debt, until late 2002 when CDWR determined the total liabilities that were to be financed through the bonds. Mr. Pacheco's analysis assumes that all of CDWR's costs incurred in 2001-2002 had a dollar-for-dollar impact on the amount of bond financing, which is correct. If the IOUs' remittances over the whole period had covered more of CDWR's outstanding debts, or if the total costs paid to Shell and Iberdrola over the 2001-2002 period had been less, all of that would have been reflected in the size of the total bond issuance and, in turn, in the amount of the Bond Charge required each year through 2022. Counting only the liabilities for the Long-Term Contracts that CDWR paid with funds from advances from the General Fund or short-term loans is neither feasible nor sufficient. Their contrary analyses should be disregarded.

Q. Mr. Fulmer states that the amount that can be attributed to the Coral Contribution to the Bond Charge is not only wrong, it is "irrelevant" because it equates to a very small portion of average retail rates. Do you agree?

A. No. First, Mr. Fulmer uses an artificially deflated number to estimate how much California's ratepayers continue to pay every single year, and will continue to pay until 2022, just to finally pay off the debt they incurred for power CDWR purchased in over a decade ago in 2001 and 2002! Whether one assumes that the total of the Bond Costs attributable to Shell is $98.6 million in total (of which $35.6 million is interest) or $253 million in total as Mr. Pacheco correctly calculated (of which $93 million is interest), either way it is a huge additional cost for no commensurate benefit delivered to California's ratepayers.

Further, Mr. Fulmer's attempt to translate the portion of the Bond Charge attributable to Coral actually supports my conclusion, even though he used an inappropriately low number for his calculation. The fact that *any* percentage of the IOU customers' retail rates is being directed to pay for electrons last generated in 2002 is indeed astounding, in my book.

Q. Mr. Fulmer claims you should not be astounded by this point because in standard ratemaking there are many costs that customers pay associated with assets no longer in service, or for assets that are not

benefitting the customer.[22] Does this change your opinion that the bond charges are fundamentally unfair to consumers who are still paying them?

A. No. Mr. Fulmer is wrong on two counts. First, the bond charges are not associated with any capital assets owned by the utility, they are mere operating expenses. With the exception of the Crisis, in general power procurement expenses are passed directly through to consumers in rates in the year in which they are incurred, or possibly in the following year through a true-up mechanism if the approved rates did not fully cover them in the year in which they were incurred.

Second, his statement that customers "in older areas served by fully depreciated distribution assets would pay much less than those in new developments" is also irrelevant because (a) he addresses the depreciation of a utility's capital assets, not mere expenses like the Shell Contract, and (b) retail rates, including the distribution component, are determined based on the entire IOU service territory and not sub-areas. This is a policy decision and balances fairness and simplicity. Finally, Mr. Fulmer is also incorrect by referencing plant decommissioning costs, because in general they are collected from the customers who benefitted from plant operations, contrary to Mr. Fulmer's claim. For example, each of the California IOUs has

[22] Fulmer Answering Testimony, Exh. No. SNA-256 at 27.

collected costs in rates to pay for the future decommissioning of nuclear facilities.

IV. THE RATE IMPACTS OF CONTRACTS THAT FUNDED MARKET-TRANSFORMING RENEWABLE ENERGY PROJECTS DO NOT JUSTIFY THE EXCESSIVE CONSUMER BURDEN OF THE SHELL AND IBERDROLA OVERCHARGES

Q. Mr. Fulmer and Mr. Monsen compare the rate impacts of the Shell and Iberdrola Contracts with renewable energy contracts approved pursuant the California renewable portfolio standard (RPS).[23] Do you find this comparison to be relevant?

A. No, I do not find it to be a remotely relevant comparison. First, as discussed above, rate impact alone is not a materially determinative factor in the CPUC's evaluation of a proposed renewable PPA (or any PPA for that matter). The CPUC first determines if there is a need for the renewable PPA and then determines if the proposed terms and conditions of the PPA, including cost, are reasonable.

Second, this is an "apples to oranges" comparison due to the additional ratepayer benefits provided by renewable PPAs. Renewable PPAs are completely different from the Shell and Iberdrola Contracts in that they provide compliance with California's statutory RPS, which

[23] Fulmer Answering Testimony, Exh. No. SNA-256 at 23; Monsen Answering Testimony, Exh. No. IB-246 at 44.

requires the IOUs to procure a certain percentage of retail electricity sales from qualified renewable resources. California's current statutory RPS requirement is 33% of retail electric sales by 2020, with pending legislation raising the requirement to 50% of retail by 2030. It is also important to note that California has undertaken aggressive RPS goals as a policy choice, and the early days of the RPS encompassed a period of concerted effort by California to transform the renewable generation market. Although the initial costs of some renewable PPAs were high, that market transformation effort has been remarkably successful, with renewable energy costs now close to or on par with the costs of conventional generation.

Q. Mr. Monsen presents a ratio of the net rate impacts associated with the Iberdrola Contract to the rate impacts associated with the RPS program.[24] Is this a reasonable comparison?

A. No, it is an unreasonable and misleading comparison. In addition to the problems with basing a PPA evaluation on rate impacts or comparing conventional versus renewable PPAs, the comparison is misleading because it provides no context. Mr. Monsen compares the impact of <u>one</u> contract to the <u>entire</u> RPS program, which includes multiple, if not dozens, of renewable PPAs. Mr. Monsen's testimony does not provide the number of

[24] Monsen Answering Testimony, Exh. No. IB-246 at 44.

renewable PPAs included in the comparison or the total energy generation provided by the renewable PPAs included in his comparison, but I cannot conceive of a situation where the ratio of the net rate impacts of a single contract compared to the rate impacts of a dozen, if not more, energy contracts would not result in a tiny impact for that lone contract.

Q. Do you find Mr. Fulmer's comparison of rate impact of the overcharge by the Coral contract to the impact of two renewable PPAs approved by the CPUC valid?[25]

A. No, I do not. As discussed above, this is an unreasonable comparison. The PPAs cited by Mr. Fulmer, Genesis Solar and Topaz Solar Farms, are for renewable energy and are distinguishable because PG&E can satisfy its statutory RPS requirement with the energy provided by the PPAs. Furthermore, the renewable energy provided by these PPAs has a high value compared to other renewable PPAs generally since it qualifies as a "Category 1" resource under Section 399.16(b) of the California Public Utilities Code. Section 399.16(c)(1) mandates that from 2017 on, no less than 75% of renewable energy resources in PG&E's RPS portfolio must consist of "Category 1" resources.

Additionally, Mr. Fulmer erroneously compares early renewable PPAs to contracts executed many years later and without accounting for

[25] Fulmer Answering Testimony, Exh. No. SNA-256 at 23.

differences among renewable resource technology types. The Genesis Solar and Topaz Solar Farms were part of PG&E's 2007 RPS solicitation and the contracts were executed in 2009 and 2008, respectively. Mr. Fulmer compares the costs of these two PPAs for solar resources with the average cost of all RPS-eligible contracts approved in 2014. The costs of Genesis Solar and Topaz Solar Farm relative to a 2014 benchmark is not relevant at all, because by 2014 there was significant market transformation in the renewables sector that had not yet occurred by 2008 or 2009. These two PPAs were more expensive because they were signed earlier relative to the total market development. The situation does not translate at all to brown power, let alone to the Crisis.

V. RESPONSE TO SHELL'S WITNESSES ASSERTIONS THAT CDWR HAD STRONG BARGAINING POSITION IN THE LONG-TERM CONTRACT NEGOTIATIONS

Q. What do Shell's witnesses say about CDWR's bargaining power in the long-term contract negotiations?

A. Edward Brown, the Shell officer who negotiated the Shell Contract with CDWR, claims that CDWR "possessed substantial bargaining power" and could walk away from the Shell Contract in May 2001.[26] Lynn Lednicky, a

[26] Brown Supplemental Answering Testimony, Exh. No. SNA-219 at 37:20-27.

Dynegy officer who negotiated Dynegy's long-term contract with CDWR, claims:

> As the only creditworthy buyer for the State's net short position, and with the legal and political backing of the State as the prescribed path through highly uncertain times in California's electricity markets, CDWR was in a strong bargaining position. Simply put, the job of purchasing electricity for California's consumers fell to CDWR and, for the immediate future, all prospective sellers would need to reach agreement with CDWR.[27]

Q. Do you agree with these witnesses assessment of the strength of CDWR's bargaining position?

A. No. Shell's witnesses claims that CDWR had a strong bargaining position is completely out of touch with the reality, which I described in my Direct Testimony, of how the citizens, businesses and government struggled to cope with unprecedented system emergencies, power outages, and suffered a year of exorbitant electricity prices. In May 2001 the State, and CDWR in particular, braced for a second summer of rolling blackouts and extremely high wholesale energy prices. CDWR was negotiating with its back up against the wall as it had the ultimate responsibility as the buyer of last resort to keep the electric grid stable in California. In light of the worsening predictions of significant summer shortfalls in needed power,

[27] Lednicky Answering Testimony, Exh. No. SNA-228 at 22.

Shell's ability to sell power in the summers of 2001 and 2002 gave it all the bargaining chips.

Q. Do you agree that CDWR's position as the "only creditworthy buyer" in 2001 gave it the upper hand in bargaining with Shell?

A. No. The assertion is nonsensical, as it completely ignores the financial straits the energy crisis imposed on California. The price of being the buyer of last resort was enormous: the State's $6 billion dollar budget surplus bled out at a rate of $1 billion per month to pay for electricity, even as system emergencies and power outages continued. The CPUC had to impose substantial rate hikes on ratepayers in early 2001—but that only covered some of the debts and CDWR had to issue bonds that ratepayers will pay back until 2022. And most significantly California consumers were burdened with $ 37.5 billion dollars that CDWR expended on long-term contracts. The careless use of the term "only creditworthy buyer" by Shell's witnesses assumes that the state of California was sitting on Fort Knox's tons of gold and it was free to spend it however it chose on long-term contracts. The grim reality was that CDWR knew that every dollar it spent on long-term contracts was spending money the State didn't have and was mortgaging California's future.

Further, to characterize CDWR as the "only creditworthy buyer" with substantial bargaining power is pure fiction and ignores the elephant in

the room in the spring of 2001 – that California was in the middle of the worst energy crisis in modern times. CDWR was literally bargaining for the health and welfare of the citizens of California. The major difference between the bargaining position of CDWR and Shell was that CDWR absolutely had to buy power at whatever cost necessary, and if CDWR said no to long-term contracts the reliability of the State's electric grid remained in serious jeopardy. Shell, on the other hand, could walk away from any contract that did not provide significant profits to its business.

Q. Does this conclude your Rebuttal Testimony?

A. Yes.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on October 2, 2015 in San Francisco, CA.

Michel P. Florio