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California Energy Commission
1516 Ninth Street
Sacramento, CA 95814-5512

RE: Docket No. 08-IEP-1D 2008 Integrated Energy Policy Report

Dear Commissioners:

San Diego Gas & Electric Company (SDG&E) respectfully submits the following comments on the August 18, 2008 workshop related to various electric procurement issues. SDG&E appreciates this opportunity to provide these comments for consideration by the California Energy Commission (Energy Commission).

I. 2008 Long Term Procurement Plan

SDG&E believes that providing affordable and reliable energy to its customers in a carbon constrained world will take extraordinary efforts. This will require substantial collaboration and actions from all parties involved. Accordingly, SDG&E welcomes the Energy Commission's involvement in the Long-term Procurement Plan (LTPP) proceeding at the California Public Utilities Commission (CPUC). Input on how best to incorporate considerations of future greenhouse gas (GHG) regulations into procurement planning will benefit from the Energy Commission's past work on standardized assumptions and scenario analysis. However, SDG&E does believe that in this period of severely constrained government and utility resources, duplication of effort should be avoided. The Energy Commission has successfully collaborated with the CPUC in the GHG proceeding, and that should be the model for Energy Commission involvement in the CPUC's LTPP.

It is also important that the Energy Commission, as the entity with broad responsibility for energy analysis for all of California, ensure that any analysis and subsequent policies apply equally and consistently to all energy suppliers in California. As in the GHG proceeding, analysis and policy treatment for investor-owned utilities (IOUs) and publicly-owned utilities (POUs) should be similar. Noticeably absent from the workshop was any discussion of the long-term planning processes of other load serving entities (LSEs) (other than SDG&E, Southern California Edison [SCE] and Pacific Gas & Electric [PG&E]), even though other LSEs constitute 35 percent of electricity procured and 47 percent of GHG emissions in the electric sector.[1] In the 2007 Integrated Energy Policy Report (IEPR), there was a noticeable lack of information on POU procurement planning processes, and sketchy information at best on actual POU energy efficiency, demand response, and renewables procurement. The Energy Commission should remedy this deficiency in conducting a comparable analysis of POU and water agency long-term procurement, as the LTPP proceeding will do, to insure environmental impacts are

[1] E3 GHG model, SummaryCalcs tab, reference case, for 2008. Besides POUs, the group includes small IOUs and water agencies. Onsite Combined Heat Power (CHP) generation was excluded in the calculation of percentages.

adequately considered across all LSEs in California. If the Energy Commission fails to apply comparable analysis to all LSEs, it will ignore almost half the carbon generated by electric procurement in the state.

Finally, in the workshop, both PG&E and SCE indicated they would welcome Energy Commission participation in their respective Procurement Review Groups (PRGs). SDG&E would likewise welcome Energy Commission expertise in its PRG group.

II. Social Discount Rate

Both the discussion paper, "Discounting Future Fuel Costs at a Social Discount Rate" (Discussion Paper) and the presentation by Mr. Ringer (Staff Presentation) highlighted the numerous problems with using a risk-adjusted discount rate to account for the risks related to future natural gas prices. The problems with such an approach were further amplified by Mr. Marcus of The Utility Reform Network (TURN) and Mr. Silsbee of SCE at the workshop.

The serious problems with the risk-adjusted discount rate approach are summarized briefly below:

- Adjusting the discount rate to compensate for risk is widely agreed to be theoretically incorrect (Discussion Paper, page 13, Stokey and Zechhauser);
- Uncertainty drives the portfolio's cost risk. If uncertainties are also internalized via different discount rates, there is double-counting (Discussion Paper, page 12, Woo);
- Adjusting the discount rate defeats the purpose of portfolio analysis which is to find an efficient frontier that shows the tradeoff between cost and risk. A portfolio with many uncertain cost streams would not have cost variance, as all uncertainties would have been resolved by varying the discount rate (Staff Presentation, page 8, Discussion paper, page 11, Woo);
- Ad hoc manipulation of the discount rate to achieve long-term goals is a poor substitute for policies that focus directly on the ultimate objective (Discussion Paper, page 14, Nordhaus);
- Uncertainty is not related to time in a way that is implied by the use of a single rate in the discount factor (Staff Presentation, page 9, Pearce and Turner);
- There is no inherent reason why uncertainty about the amount of future payoffs should affect the way we are willing to trade off one year's payoff against the following year's payoff. The correct analytical approach is to separate the question of risk-free discount rates from how we value risky outcomes (Discussion Paper, page 13, Stokey and Zeckhauser);
- A social discount rate may be theoretically better for a case where a decision is irreversible. Procurement of electricity from a natural gas plant is not in that category. Future renewables expansion may simply change the function of a CCGT from energy production to needed regulation ancillary service (TURN Presentation);
- Use of a social discount rate quickly becomes subjective (TURN Presentation, Discussion Paper, page 8, SCE);
- Since the social discount rate is less than opportunity cost of capital, projects picked using a social discount rate will "crowd out" projects with higher benefits and society will be worse off. A social discount rate gives more weight to future costs, but ignores the future income benefits of the "crowded out" projects (TURN Presentation, SCE comments).

SDG&E agrees with many of these criticisms of the use of a social or risk-adjusted discount rate. The use of scenarios or sensitivity analysis is a much preferred strategy for accounting for the risks of natural gas price uncertainty, rather than attempting to alter the discount rate. And if scenarios or sensitivity analysis is undertaken, using risk-adjusted discount rates would double-count risk and muddy the trade-off analysis. SDG&E recommends that the Energy Commission affirm the superiority of the scenario/sensitivity approach and discontinue work on a risk-adjusted discount rate approach.

SDG&E looks forward to working further with the Energy Commission and Staff on this issue.

Yours sincerely,

Bernie Orozco