

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



FILED

12-07-09
04:59 PM

Application of Pacific Gas and Electric Company for
Approval of the Novation of the California Department
of Water Resources Agreements related to the Calpine
Transaction, and Associated Cost Recovery
(U 39 E)

A.09-10-034
(Filed October 30, 2009)

**JOINT PROTEST OF
THE ALLIANCE FOR RETAIL ENERGY MARKETS AND
THE CALIFORNIA LARGE ENERGY CONSUMERS ASSOCIATION**

William H. Booth
Law Offices of William H. Booth
67 Carr Drive
Moraga, California 94556
Telephone: (925) 376-7370
Email: wbooth@booth-law.com

*Counsel for the California Large Energy
Consumers Association*

Gregory S.G. Klatt
DOUGLASS & LIDDELL
411 E. Huntington Drive, Suite 107-356
Arcadia, California 91006
Telephone: (818) 961-3002
Facsimile: (818) 961-3004
Email: klatt@energyattorney.com

*Counsel for the
Alliance for Retail Energy Markets*

December 7, 2009

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Pursuant to Rule 2.6 of the Commission’s Rules of Practice and Procedure, the Alliance for Retail Energy Markets (“AReM”)¹ and the California Large Energy Consumers Association (“CLECA”) submit this joint protest of certain elements of the Application of Pacific Gas & Electric Company (“PG&E”) filed in the above-captioned docket and published in the Commission’s Daily Calendar on October 21, 2009 (“Application”). AReM and CLECA are referred to hereinafter as the “Joint Parties.”²

I. SUMMARY OF THE APPLICATION

The DWR contracts consist of: (1) the “Calpine 2 Contract,” a contract for 180 megawatts (MW) of energy and capacity for output from the Los Esteros Critical Energy Facility (“LECEF”); and (2) the “Calpine 3 Contract,” a contract for 495 MW of energy and capacity

¹ AReM is a California non-profit mutual benefit corporation formed by electric service providers that are active in the California’s direct access market. This filing represents the position of AReM, but not necessarily that of a particular member or any affiliates of its members with respect to the issues addressed herein.

² Concurrently herewith, the Joint Parties are filing a separate Motion to Dismiss what is referred to as the New MW Agreements portion of the Application. This protest reiterates much of the discussion and argument contained in the Motion to Dismiss.

from the group of 11 peaking units (“Peakers”) identified in said contract through July 2011. The Application requests expedited approval of five contracts (collectively referred to as the “Calpine Transaction”) that it has negotiated with Calpine and the Department of Water Resources (“DWR”). The Calpine Transaction consists of the following documents:

- Novation Agreement executed by DWR, PG&E and Calpine Energy Services, L.P., a Calpine affiliate, that establishes the terms and conditions for novating the Calpine 2 Contract among the parties (“CES Novation Agreement”);
- Replacement Agreement that provides PG&E with additional operational benefits not provided under the Calpine 2 Contract and facilitates an upgrade to the LECEF (“Calpine 2 Replacement Agreement”);
- LECEF Upgrade Power Purchase Agreement (“LECEF Upgrade PPA”)
- Novation Agreement executed by DWR, PG&E and Gilroy Energy Center, LLC, a Calpine affiliate, that establishes the terms and conditions for novating the Calpine 3 Contract among the parties (“GES Novation Agreement”); and
- Replacement Agreement that extends Calpine’s commitment to provide energy, capacity and ancillary services to PG&E under the GES Novation Agreement, and provides PG&E with additional operational and local capacity benefits (“Calpine 3 Replacement Agreement”).

The PG&E Application for the Calpine Transaction states that they are making this application

in response to the Commission’s direction to the utilities to seek novation and/or replacement of the existing contracts entered into by DWR during the 2000-2001 energy crisis. Specifically, in Decision (“D.”) 08-11-056, the Commission set January 1, 2010 as a target goal for the novation of all the DWR contracts, although it

acknowledged that completion could be delayed due to the number of transactions involved.³

The LECEF Upgrade PPA will require Calpine to upgrade the LECEF in return for the 10-year PPA, and will increase the output of the LECEF by 100 MW, from 189 MW to 289 MW. The Calpine 2 Replacement Agreement facilitates the LECEF's upgrade. The Calpine 3 Replacement Agreement extends the term of the GES Novation Agreement for up to 12 years. This Protest concerns the LECEF Upgrade PPA, the CES Replacement Agreement, and the GES Replacement Agreement, collectively referred to as the "New MW Agreements."

II. SUMMARY OF PROTEST

The Joint Parties urge the Commission to reject that portion of the Application dealing with the New MW Agreements for the following reasons:

- The New MW Agreements cause PG&E's new generation procurement to exceed the new generation procurement authority granted to it pursuant to Decision ("D.") 07-12-052 issued in Rulemaking ("R.") 06-12-013. Allowing this excess procurement is not authorized under D.08-11-056 issued in R.07-05-025, and if permitted, will have harmful impacts on competitive markets and ultimately impose unnecessary costs on customers.
- D.08-11-056 does not authorize avoidance of the competitive procurement process for the New MW Agreements.
- D.07-12-052 sets forth the competitive procurement policies and procedures. That decision plainly contemplates a competitive solicitation for long term PPA procurement by the Investor Owned Utilities ("IOUs"). Therefore, the New MW

³ Application, p. 3.

Agreements are nothing more than yet another attempt by PG&E to overtly disregard the Commission's competitive procurement policies.

- Finally, the contract novation process authorized by D.08-11-056 that has spawned the New MW Agreements has been rendered moot by new legislation, Senate Bill 695 ("SB 695"), Chapter 337, Statutes of 2009, that was signed into law before the Application was filed.⁴ Therefore, D.08-11-056 may no longer provide the appropriate framework for evaluation of bilaterally negotiated New MW Agreements.⁵

As explained more fully below, these reasons justify the Commission's rejection of the New MW Agreements portion of the Application.

III. PROTEST

A. The New MW Agreements Exceed PG&E's LTPP Authority

In D07-12-052, PG&E was authorized to procure 800 - 1200 MW of new generation. On September 30, 2009, PG&E submitted Application 09-09-021 ("A.09-09-021") for approval of 1,305 MW of new natural gas fired resources. PG&E offers no analysis in the subject Application demonstrating that the facilities for which it seeks approval in A.09-09-021, which resulted from the Commission's approved competitive procurement process, will be in any way insufficient to serve the needs of PG&E customers. Therefore, the New MW Agreements are simply not needed. As such, there is no reason to burden ratepayers with the costs of the New

⁴ AREM has commenced discussions with the Energy Division staff to determine whether and how to sever the DWR contract novation process from R.07-05-025.

⁵ The Joint Parties do not object to the CES Novation Agreement or the GES Novation Agreement, both of which are part of the Calpine Transaction.

MW Agreements, and on this basis alone the associated portion of the Application should be dismissed.

To the extent that PG&E seeks to secure these resources covered by the New MW Agreements as a contingency against other contract failures, that question has been asked and answered. In D.07-12-052, the Commission states:

We agree with Aglet's position that discounting existing contracts based on questionable viability is inconsistent with historic Commission practices and we do not adopt such a contingency for PG&E in this decision.⁶

Moreover, if there were any reason to reverse Commission policy with respect to over procurement in the name of contingency planning, that would not justify doing so outside the competitive procurement process. There is simply no reason or authorization to turn the DWR contract novation process into a series of new "unique fleeting opportunities".

B. PG&E's Reliance on D.08-11-056 To Provide an Exemption to Competitive Procurement Policies Is Misplaced.

PG&E's reliance in the Application on the authority granted to it in D.08-11-056 to justify the New MW Agreements is inapposite (even aside from the fact that the rationale underlying DWR contract novations in the context of R.07-05-025 may now be moot as discussed in Section D below). While in D.08-11-056 the Commission made it clear that it would evaluate replacement contracts on a case-by-case basis, this policy most certainly does not give PG&E free rein to enter into new long term PPAs for resources that it does not need and/or that circumvent competitive procurement policies.

In fact, a review of D.08-11-056 indicates that the Commission did not contemplate that negotiation of the replacement contracts in the context of the DWR novations would result in the

⁶ D.07-12-052, p. 96.

same type of long-term PPAs for which IOUs conduct RFOs pursuant to authorities granted in the long-term procurement plan (“LTTPP”) proceedings. For example, the Commission declined in D.08-11-056 to provide explicit guidance as to the types of terms and conditions that could or could not be included in the replacement Agreements in the course of the contract novation discussion; and explained its rationale for doing so as follows:

[I]n D.03-12-062, the Commission authorized IOUs to enter into negotiated bilateral contracts for short term transactions of less than 90 days duration and with delivery beginning less than 90 days forward and negotiated bilateral contracts for longer-term products provided the IOU include justification in quarterly compliance filings. Therefore, as the Commission has implemented Pub. Util. Code § 454.5, it has given each IOU explicit authority, subject to proper conditions and justifications, to contract on a bilateral basis. As the Commission stated in D.07-12-052, it prefers that long term procurement be conducted via competitive procurement mechanisms, however it by no means removes bilateral contracts from the IOUs’ options to meet its residual net short positions.⁷

The decision neither authorizes nor contemplates that long-term PPAs would be the subject of replacement agreement negotiations. The reason is obvious; to allow the IOUs to use the novation process to enter into new long-term PPAs on a bilateral basis, with no competitive procurement process, conflicts with the policies that guide the IOUs’ procurement pursuant to the authority they are granted in the LTTPPs. Accordingly, the New MW Agreements should be rejected, and PG&E’s attempt to sidestep Commission policy by adopting re-interpretations of those policies should also be rejected as well.

⁷ D.08-11-056, p. 52.

C. PG&E Has Failed to Demonstrate That the New MW Agreements Meet the Requirements in D.07-12-052 for Competitive Procurement of Long-Term PPAs.

D.08-11-056 provides even more explicit direction about the relationship of the DWR contract novation process and its competitive procurement policies:

[A]ny replacement agreement that would extend the term of a contract should also be reviewed by the Commission for consistency with long-term procurement planning criteria, pursuant to Section 454.5.⁸

The procurement criteria called for by Section 454.5 were implemented in D.07-12-052. Those criteria clearly contemplate that long-term PPAs should be executed via a competitive process. More specifically, while D.07-12-052 provides explicit guidance for IOUs for new Utility Owned Generation (“UOG”) outside the competitive RFO process, it provides no such guidance for long-term PPAs.

In discussing the circumstances for UOG outside the RFO process, the Commission stated:

We want to make it clear that we continue to believe in a “competitive market first” approach. As such we believe that all long-term procurement should occur via competitive procurements, rather than through preemptive actions by the IOU, except in truly extraordinary circumstances.⁹

The Commission then went on in the same decision¹⁰ to describe the circumstances under which new UOG may be permissible if the IOU has made showing that holding a competitive RFO is infeasible:

⁸ D.08-11-056, p. 81.

⁹ D.07-12-052, pp. 212-213.

¹⁰ In D07-12-052, the Commission specified five circumstances in which the IOUs could petition for new UOG if the IOU had made a showing that an RFO was infeasible. On rehearing, in Decision 08-11-008, one of those circumstances (Expansion of Existing Facilities) was eliminated.

- Market Power Mitigation – the IOU must make a strong showing that as a result of some attribute of the desired resource, a private owner would have the ability to exert significant influence over the price of its development or of the price and quantity of its output (energy, capacity, or ancillary services);
- Preferred Resources – while we continue to rely on markets to deliver efficiently priced products for ratepayers, we see no reason to limit our options and intend to continue to deploy all resources available to us, including utility development and ownership, to meet California’s vital environmental policy objectives;
- Unique Opportunity – an attractively priced resource resulting from a settlement or bankruptcy proceeding (we anticipate that these opportunities will diminish over time); and
- Reliability - resources needed to meet specific, unique reliability issues (particularly under circumstances in which it becomes evident that reliability may be compromised if new resources are not developed, and the only means of developing new resources in sufficient time is via UOG.

While the New MW Agreements are not intended to result in utility ownership, it is instructive to note that the Application cannot meet any of the standards established in D.07-12-052 for circumventing the competitive procurement process that is required when the utilities make an application for a utility-owned project:

- PG&E makes no showing that an RFO for the New MW is infeasible. In fact, as described in more detail below, the Application comes before the Commission just shortly after PG&E’s Application for approval of projects selected in its long term RFO, in which it describes a “robust” RFO from which it selected “three projects from a pool of 48 offers received in response to the LTFRO, totaling almost 13,000 MW.”¹¹

¹¹ A.09-09-021, PG&E September 29, 2009 Public Testimony, p. 5.

- There is no evidence to suggest that the New MW Agreements addresses any market power mitigation issue.
- The contract does not represent a preferred resource.
- The DWR novation process is not a unique opportunity stemming from a settlement because the existing DWR contract contains a provision that requires GWF to enter into replacement agreements.
- There is no demonstrated specific or unique reliability issue that these facilities will address that could not have been addressed in the competitive procurement process.

In summary, while Commission policy on the demonstrations that the utilities must make to circumvent competitive procurement in favor of utility-owned projects are not directly relevant to this Application, it is instructive to note that this Application fails in every respect to meet the standards for circumvention of the competitive procurement process that our required of utility-owned projects. There is simply no justification for PG&E to have bilaterally negotiated the New MW Agreements outside the competitive procurement process. Commission policy discourages it and the DWR contract novation process does not require it.

Furthermore, it remains perplexing why this Application comes so close on the heels of PG&E's LTPP authorized RFO and why it results in procurement of resources in excess of those authorized by the Commission in D. 07-12-052. Were these resources excluded from the RFO or did they simply not participate in the RFO? Certainly, further elucidation of the relationship between the RFO and this Application should be explored by the Commission. Specifically, the Commission should seek specific answers from PG&E regarding the following aspects of the novation negotiations:

- Was the project covered by the New MW Agreements bid into the recent RFO? If so, why were these additional megawatts not selected in that RFO?
- If the project covered by New MW Agreements was bid into the recent RFO, why is this project now attractive in the context of the DWR contract novations yet was not attractive in the context of the of RFO offers?
- Is the price being paid under this agreement less than or the same price that was offered in the RFO?

D. The DWR Novation Process Authorized in D.08-11-056 Has Been Superseded By New Legislation, And Therefore the Framework for Novation Has Changed.

R.07-05-025 was initiated on May 30, 2007, to “consider whether, or under what conditions, the current suspension on ‘direct access’ should be lifted.”¹² In D.08-02-033, the Commission ruled that it did not have the authority to permit the reopening of direct access under existing statutory language requiring that “direct access suspension must continue until DWR ‘no longer supplies power’ under the provisions of AB1X as codified in Water Code § 80110.”¹³

However, while the Commission concluded that under applicable statutory provisions, it did not have the authority to lift the direct access suspension, the decision also ruled that, “we remain committed to exploring proactive alternatives whereby the legal conditions allowing for the lifting of the suspension could be satisfied.”¹⁴ As a result, D.08-11-056 required the IOUs to work with DWR staff and the DWR contract counterparties to secure novations of the existing contracts in order to facilitate a reopening of direct access.

¹² See, *Order Granting Petition For Rulemaking and Instituting Rulemaking As To Whether, When, Or how Direct Access Should Be Restored*, issued May 30, 2007 in R.07-05-025, p. 2.

¹³ D.08-02-033, p. 6.

¹⁴ *Id.*, p. 2.

On October 11, 2009, Governor Schwarzenegger signed SB 695 into law. Among other things, SB 695 amended Water Code § 80110(e) to eliminate the requirement that the suspension of direct access continue until DWR no longer supplied power pursuant to the applicable Water Code provisions. Therefore, the effort to novate the DWR contracts is no longer required as a prerequisite for the reopening of direct access, and reliance on D.08-11-056 as the reason that novation should be pursued is no longer necessarily linked to R.07-05-025, logically or practically. Indeed, in its recent Assigned Commissioner's Ruling On Procedures to Address Senate Bill 695 Issues Relating to Direct Access Transactions, issued in R.07-05-025 on November 18, 2009, the Commission has suspended the schedule for further Working Group Progress Reports effective immediately. In short, while DWR, the IOUs and the contractual counterparties may decide to continue pursuing novation of the DWR contracts, the reliance on D.08-11-056 to justify the New MW Agreements is not an adequate framework for doing so.

IV. CONCLUSION

The Joint Parties protest this Application and request that the Commission reject the portion thereof pertaining to the New MW Agreements for the following reasons:

- The New MW Agreements cause PG&E's new generation procurement to exceed the new generation procurement authority granted to it pursuant to D.07-12-052 and as such will have harmful impacts on competitive markets and ultimately impose unnecessary costs on customers.
- D.08-11-056 does not authorize avoidance of the competitive procurement process for the New MW Agreements.
- The portion of the Application associated with the New MW Agreements clearly conflicts with the Commission's competitive procurement policies and procedures

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the *Joint Protest of the Alliance for Retail Energy Markets and the California Large Energy Consumers Association* on all parties of record in proceeding *A.09-10-034* by serving an electronic copy on their email addresses of record and by mailing a properly addressed copy by first-class mail with postage prepaid to each party for whom an email address is not available.

Executed on December 9, 2009, at Woodland Hills, California.



Michelle Dangott

SERVICE LIST – A.09-10-034

alr4@pge.com
bcragg@goodinmacbride.com
cbk@eslawfirm.com
crmd@pge.com
filings@a-klaw.com
jeffgray@dwt.com
jspence@water.ca.gov
jw2@cpuc.ca.gov
klatt@energyattorney.com
kdw@woodruff-expert-services.com
liddell@energyattorney.com
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s2sc@PGE.COM
sas@a-klaw.com
sean.beatty@mirant.com
shi@cpuc.ca.gov
steven@iepa.com
tim@cpuc.ca.gov
todd.edmister@bingham.com
vidhyprabhakaran@dwt.com
william.kissinger@bingham.com