Decision 11-12-002 December 1, 2011

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U902E) for Authority to Acquire the CalPeak El Cajon Energy Facility.	Application 11-01-004 (Filed January 5, 2011)

DECISION GRANTING SAN DIEGO GAS & ELECTRIC COMPANY AUTHORITY TO ACQUIRE THE CALPEAK EL CAJON ENERGY FACILITY

1. Summary

This decision grants San Diego Gas & Electric Company (SDG&E) authority to purchase the CalPeak El Cajon Energy Facility (ECEF) from CalPeak Power-El Cajon LLC. The total project cost shall not exceed $16.8 million. SDG&E is authorized to establish a memorandum account to record the ECEF revenue requirement from the date the ECEF is placed in service until the date a decision adopting SDG&E's revenue requirements is issued in Application 10-12-005. The amount to be tracked in this memorandum account shall not exceed $4.4 million. Finally, SDG&E shall file a Tier 3 advice letter after the acquisition process is completed to report final actual costs. This proceeding is closed.

2. Background

On January 5, 2011, San Diego Gas & Electric Company (SDG&E) filed an application for authority to acquire the El Cajon Energy Facility (ECEF) from CalPeak Power-El Cajon LLC (CalPeak). The ECEF is an existing peaker power plant located on SDG&E's property at its El Cajon substation. SDG&E had made this property available for the construction of a generation plant in response to rolling blackouts experienced throughout California in 2000. The land lease agreement between SDG&E and CalPeak, was for a duration of ten years. Upon termination of the lease, SDG&E would have the right to purchase the plant based upon a fair market value assessment of predetermined plant components, less estimated site remediation costs. If SDG&E declines to exercise this right, the facility would be dismantled and the property would be restored as much as possible to the condition that had existed prior to the lease.

The Independent Energy Producers Association (IEP) filed a timely protest to SDG&E's application. Responses to the application were filed by the Division of Ratepayer Advocates (DRA) and the Alliance for Retail Energy Markets.

A prehearing conference (PHC) was held on March 15, 2011. At the PHC, parties stated that they were unsure whether evidentiary hearings would be necessary. Consequently, the scoping memo issued by the assigned Commissioner and Administrative Law Judge (ALJ) on March 24, 2011 stated that evidentiary hearings would be held only if parties requested it. No party requested hearings and none are necessary to resolve this proceeding.

Upon the filing of reply briefs, the proceeding was submitted on July 5, 2011.

3. SDG&E's Application

The ECEF is an existing peaking power plant located on SDG&E's property at its El Cajon substation.[1] SDG&E currently receives generation

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[1] The facility is a 52 megawatt (MW) single unit simple-cycle peaking power plant. It has a California Independent System Operator Net Qualified Capacity rating of 42.2 MW.

produced from this facility pursuant to a contract between the Department of Water Resources (DWR) and CalPeak. The contract is administered by SDG&E on behalf of DWR and expires on January 1, 2012. Upon expiration of the contract, the lease will also terminate. Pursuant to the lease agreement, SDG&E would have the right to purchase the plant based upon a fair market value assessment of predetermined plant components, less estimated site remediation costs upon termination of the lease. If SDG&E declines to exercise this right, the facility would be dismantled and the property would be restored as much as possible to the condition that had existed prior to the lease.

SDG&E proposes to acquire ECEF for a total purchase price of $16.8 million, to be recovered in rates with an annual revenue requirement of $4.4 million in 2012. SDG&E contends that this purchase option represents a "unique opportunity" and is consistent with Commission policy in Decision (D.) 07-12-052.

4. Issues

The March 24, 2011 scoping memo identified the following issues to be determined in this proceeding:

1. Should SDG&E's request to acquire the ECEF be granted?
    a. Did SDG&E comply with the policies articulated in D.07-12-052 concerning utility-owned generation (UOG)?
    b. May SDG&E acquire the ECEF without first exposing it to a competitive solicitation?
    c. Does the ECEF option represent a truly extraordinary circumstance or a unique opportunity?
2. Are the price and terms set forth in the Purchase Option Implementation Agreement just and reasonable and recoverable from SDG&E's bundled ratepayers?

5. SDG&E's Application Complies with the Policies in D.07-12-052

As part of our commitment to developing a functional competitive energy market in California, we have emphasized our preference for competitive solicitations for generation. However, as stated in D.07-12-052, there may be "unique circumstances in which UOG outside of a competitive [Request for Offer] RFO may be the most attractive option for ratepayers for resource development."[2] In D.07-12-052, we identified the following circumstances in which UOG outside of a competitive RFO may be the most attractive option to ratepayers:[3]

1) the proposed UOG is necessary to mitigate market power by a private owner;
2) the proposed UOG is a preferred resource;
3) the proposed UOG is a unique opportunity; or
4) the proposed UOG is necessary to ensure system reliability.

Although we identified these categories in D.07-12-052, we noted that they were not permanent. "As our procurement experience grows and processes evolve[,] the needs highlighted in these five categories may change."[4]

As discussed below, we find that SDG&E's application to acquire ECEF complies with Commission policies in D.07-12-052 and should be approved. The

[2] D.07-12-052 at 210.

[3] D.07-12-052 at 210-212. D. D.07-12-052 had originally identified five categories of unique circumstances. However, the category "Expansion of Existing Facilities" was deleted in D.08-11-008.

[4] D.07-12-052 at 210, fn. 239.

ECEF acquisition represents a unique opportunity and results in significant cost-savings to ratepayers.

5.1. Parties' Positions

SDG&E states that the option to purchase the ECEF is a unique opportunity. It notes that ECEF is a fully-constructed, operational facility that is currently included in SDG&E's portfolio. The facility is consistent with SDG&E's portfolio needs and could be used for to meet local and system resource adequacy requirements, as well as to mitigate the impacts of intermittency associated with renewable generation.[5]

Although the ECEF option did not undergo a competitive solicitation process, SDG&E compared it with the results of existing generation resources, or Product 5, from its 2009 RFO. SDG&E contends that since bidders into the 2009 RFO are currently in the process of negotiating Power Purchase Agreements (PPAs), the results from the RFO provide an adequate market test to demonstrate that the ECEF is attractively priced. SDG&E further notes that Product 5 of the 2009 RFO requested 10-year power purchase agreements for existing units to meet local and system resource adequacy requirements.

SDG&E notes that the ECEF is comparable to Product 5. It states that in comparison to the bids received, the total cost of owning the ECEF facility outright is substantially less than the bid price of all PPAs for comparable resources.[6] In addition, SDG&E states that the proposed purchase of ECEF is intended to fill some of the need SDG&E targeted for Product 5 in its 2009 RFO.

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[5] SDG&E Opening Brief at 3-4.

[6] SDG&E Opening Brief at 7.

Therefore, SDG&E asserts that if it were unable to purchase the ECEF, it would be required to sign a PPA, at a greater cost to ratepayers, to meet this need.

IEP argues that the ECEF purchase option is not a "unique opportunity" because the ECEF option is not the result of a settlement or a bankruptcy (or similar circumstances).[7] It further asserts that the Commission requires a competitive solicitation process for UOG and that the comparison of the ECEF option with the results of the Product 5 solicitations from SDG&E's 2009 RFO do not provide an adequate market test as the results are outdated, and that the market conditions in 2011 are different and warrant a new RFO.[8] IEP further asserts SDG&E's methodology to compare the ECEF purchase option for 15 years with adjusted 10-year PPAs from results of the 2009 RFO does not constitute a robust methodology for determining the viability of the proposal.[9] IEP also argues that SDG&E had conducted a competitive solicitation in a similar circumstance. For example, in 2007, SDG&E's acquisition of the 480 MW El Dorado power plant was subjected to an RFO process and received one other competing offer.[10] IEP also points out that the Commission dismissed Pacific Electric & Gas Company's (PG&E) application to acquire the Tesla facility because PG&E did not show that a competitive solicitation process was infeasible.[11]

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[7] IEP Opening Brief at 3-4.

[8] IEP Opening Brief at 4-6.

[9] IEP Opening Brief at 4-6.

[10] IEP Opening Brief at 7.

[11] IEP Protest at 8-9.

DRA opines that the comparison of the ECEF purchase option with the results from SDG&E's 2009 RFO provides a satisfactory market test.[12]

5.2. Discussion

As previously stated in D.07-12-052, while our preference is for competitive solicitation of generation, there are circumstances under which UOG outside of a competitive RFO may be the most attractive option to ratepayers.[13] One of these circumstances is when the utility is presented with a "unique opportunity," which was described as "an attractively priced resource resulting from a settlement or bankruptcy proceeding."[14] IEP relies on this statement to conclude that these are the *only* situations that would present a unique opportunity.

We find IEP's interpretation to be too narrow. Our intent to support a "competitive market approach" first is to benefit ratepayers by selecting the least-cost best-fit options in procurement. The ECEF is a fully constructed, operational facility located in SDG&E's property. The ECEF is an attractively priced, existing resource that provides local and system resource adequacy for SDG&E's bundled customers. SDG&E serves a locally-constrained area that requires SDG&E to contract with most of the available resources in the area in order to meet is local resource adequacy requirements. The lease agreement between CalPeak and SDG&E indicates that if the purchase option is not exercised, the ECEF will be dismantled, in which case will further reduce available resources in SDG&E's locally constrained area and SDG&E's ability to

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12 DRA Testimony at 4.

13 D.07-12-052 at 210-212.

obtain local capacity at an economical price. Based on these considerations, we find that the ECEF purchase option is a unique opportunity.

We also agree with DRA and SDG&E that the 2009 RFO results provide an adequate market test with which to evaluate the competitiveness of the ECEF purchase option. To evaluate the ECEF purchase option for the remainder of the projected plant life of 15 years, SDG&E analyzed three scenarios that extended the Product 5 10-year PPA offers to 15 years. The scenarios are:

1) Replace with a new PPA - SDG&E enters into a 10-year PPA. At the end of the 10-year term, SDG&E enters into a 5-year PPA with the same facility, with the same price terms as the 10-year PPA.

2) Operating and Maintenance (O&M) cost replacement - SDG&E enters into a 10-year PPA. At the end of the 10-year term, SDG&E enters into a new 5-year PPA with the same facility, with price equal to the cost of maintaining the facility for an additional five years.[15]

3) Replace with a new plant - SDG&E enters into a 10-year PPA. At the end of the 10-year term, SDG&E pays for a new facility for five years, and sells it at the end of the five years.

The result of the analysis shows that the ECEF purchase option is the most cost-effective choice. Although the market data is two years old, SDG&E is continuing negotiations with the shortlisted PPAs and has current price information with which to compare the ECEF purchase option. The first scenario provides a benchmark to show that the ECEF purchase option is more

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[14] D.07-12-052 at 212.

[15] SDG&E, the Independent Evaluator Van Horn Consulting, and DRA concur that the possibility of SDG&E contracting resources at the generator's O&M cost is extremely small.

economical than PPAs of the same duration. We conclude that SDG&E has performed due diligence to demonstrate that the ECEF purchase option results in the greatest cost savings to ratepayers compared to the three scenarios. Therefore, we find SDG&E's methodology to evaluate the ECEF purchase option with the PPAs to be valid.

We disagree with IEP's conclusions that SDG&E must conduct a competitive solicitation because it had done so in a prior situation. The fact that SDG&E conducted an RFO to acquire the El Dorado power plant does not obligate SDG&E to do so in all instances of proposed UOG. As discussed above, SDG&E has demonstrated that the ECEF purchase option presents a unique opportunity and that comparison of the purchase price to the Product 5 bids from 2009 RFO provides an adequate market test.

We also find IEP's arguments regarding D.08-11-004 unpersuasive. In that decision, we dismissed PG&E's application to acquire the Tesla facility because PG&E failed to demonstrate that conducting a competitive solicitation was infeasible.[16] In that proceeding, PG&E had argued that the RFO process was infeasible due to the lengthy period of time involved in conducting an RFO, not that the Tesla facility acquisition was subject to a recent market test. That is not the situation here, where there is a recent RFO for purposes of a market test.

In light of these considerations, we find that SDG&E's application to acquire the ECEF presents a unique opportunity, consistent with the policies articulated in D.07-12-052, and should be approved. This conclusion, however, should not be considered precedential or expanding the circumstances under

[16] D.08-11-004 at 2, 24.

which UOG would be allowed in lieu of a competitive solicitation. SDG&E and CalPeak entered into the land lease agreement in 2001, well before D.07-12-052 was issued. Moreover, the circumstances leading up to the agreement cannot be considered typical procurement practices. Accordingly, while we approve SDG&E's application to acquire the ECEF, this approval is limited to the facts presented in this application.

6. Cost Recovery and Cost Containment Mechanism

SDG&E estimates the total cost for the ECEF to be $16.8 million, with an annual revenue requirement of $4.4 million in 2012. This revenue requirement includes estimated O&M costs of $679,000 for 2012, $701,000 for 2013, $723,000 for 2014 and $745,000 for 2015. SDG&E proposes to recover this revenue requirement in a manner consistent with utility generation assets. As such, the facility would be included as part of SDG&E's general rate case (GRC) base margin, and costs recovered in electric commodity rates charged to bundled customers. SDG&E states that since the date for the transfer of plant ownership of the ECEF would likely coincide with the effective date of a decision resolving SDG&E's next GRC revenue requirement application (Application (A.) 10-12-005), the ECEF revenue requirement should be rolled into the base margin revenue requirement that is adopted in a decision in that proceeding.

SDG&E further proposes that in the event a final decision is not adopted in A.10-12-005 by January 1, 2012, it be authorized to establish a memorandum account to record the ECEF revenue requirement from the time the facility is placed in SDG&E's service until the date a decision adopting SDG&E's revenue requirements is issued in A.10-12-005. Once the final costs for the ECEF are accumulated, SDG&E would then transfer the accrued costs and associated revenue requirement to the Non-Fuel Generation Balancing Account (NGBA) via an advice letter filing in November, 2012, for rates effective January 1, 2013.[17]

DRA recommends that if a memorandum account is authorized, a cost cap be placed on the total projected capital cost and O&M costs, such that the costs associated with the ECEF would not exceed the proposed cost estimates presented in the application.[18] DRA also recommends that the Commission order SDG&E to submit an annual Tier 3 advice letter to compare actual expenditure to the $16.8 million capital cost cap.[19]

In response to DRA's recommendation, SDG&E states that it is willing to accept a project-specific cost cap only for the period prior to the issuance of a decision in A.10-12-005. It explains that because the GRC cost recovery methodology does not contemplate project-specific price caps, adoption of DRA's cost cap proposal would be problematic once the ECEF revenue requirement is rolled into the base margin revenue requirement. SDG&E notes that under its GRC cost recovery methodology, ratepayer risk is capped on an aggregate basis rather than a project-specific basis. The O&M revenue requirement, for example, is expressed in total amount that covers all O&M costs. As a result, an O&M cost on one project that is below forecasted amount may offset a cost overrun on a different project. If aggregate costs exceed the O&M revenue requirement, shareholders are at risk for the excess O&M amount. Capital costs are recovered in a similar manner. Therefore, SDG&E argues that

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[17] SDG&E Rebuttal Testimony at 9.

[18] DRA Opening Brief at 2.

[19] DRA Opening Brief at 2-3.

the GRC, by its nature, imposes cost caps insofar as revenue requirements are fixed per year.[20]

While SDG&E does not object to a cost cap prior to the issuance of a decision adopting its revenue requirements for January 1, 2012 through December 31, 2015, it requests that it be permitted to file an application if capital costs exceed $16.8 million to demonstrate that additional capital costs are reasonable and should be recovered in rates.[21] SDG&E also requests that it be permitted to file a one-time advice letter after the acquisition process has been completed to report final actual costs to the Commission.[22]

6.1. Discussion

The Assigned Commissioner and Administrative Law Judge's Scoping Memo and Ruling issued in A.10-12-005 on March 2, 2011 anticipated that a final decision on SDG&E's revenue requirement would be adopted in March 2012. As this would be after the date that the ECEF would be placed in SDG&E's service, we grant SDG&E's request to establish a memorandum account to record the ECEF revenue requirement from that until the date a final decision adopting SDG&E's revenue requirements is issued in A.10-12-005. SDG&E would then transfer the accrued costs and associated revenue requirement in the memorandum account to the NGBA via a Tier 3 Advice Letter filing in November, 2012, for rates effective January 1, 2013. We agree with DRA that

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[20] SDG&E Rebuttal Testimony at 9-10.

[21] SDG&E Reply Brief at 14.

[22] *Id*.

there should be a cap on the costs tracked in the memorandum account until the Commission adopts a final decision on SDG&E's revenue requirement in A.10-12-005. This amount is set at SDG&E's 2012 estimated revenue requirement of $4.4 million.

We authorize total project costs of $16.8 million. However, SDG&E may file an application to seek recovery of any costs incurred above this authorized amount. As part of its application, SDG&E shall demonstrate that the additional capital costs are reasonable and should be recovered in rates.

We also adopt SDG&E's proposal to file a one-time advice letter after the acquisition process is completed to report final actual cost to the Commission. Accordingly, SDG&E shall file a Tier 3 advice letter once the acquisition process is complete. This filing shall compare actual expenditures to the $16.8 million cost estimated in this application.

7. Categorization and Need for Hearings

In Resolution ALJ 176-3267, dated January 13, 2011, the Commission preliminarily categorized this application as Ratesetting and preliminarily determined that hearings were necessary. No party requested hearings and we determine that a hearing is not necessary.

8. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on November 16, 2011 by SDG&E and IEP. Reply comments were filed on November 21, 2011 by SDG&E. This decision has been revised in response to comments, as necessary.

9. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Amy C. Yip-Kikugawa is the assigned ALJ in this proceeding.

Findings of Fact

1. The ECEF is an existing peaker power plant located on SDG&E's property.
2. SDG&E leased the property to CalPeak to construct the ECEF.
3. The land lease agreement terminates on December 31, 2011.
4. Under the terms of the lease agreement, SDG&E would have the right to purchase the plant upon termination of the lease agreement. If SDG&E fails to exercise this right, the facility would be dismantled and the property would be restored as much as possible to the condition that had existed prior to the lease.
5. D.07-12-052 articulated the Commission's preference that long-term procurement should undergo a competitive solicitation.
6. D.07-12-052 recognized that there were circumstances under which utility owned generation outside of a competitive RFO would be the most attractive option for ratepayers.
7. SDG&E serves a locally constrained area.
8. SDG&E compared the cost of the ECEF purchase option with the results of existing generation resources for Product 5 from its 2009 Request for Offer.
9. The estimated total cost for the ECEF is $16.8 million, with an annual revenue requirement of $4.4 million in 2012.
10. SDG&E proposes to recover the revenue requirement for the ECEF by including the facility as part of its GRC base margin, and costs recovered in electric commodity rates charged to bundled customers.
11. The ECEF revenue requirement will be rolled into the base margin revenue requirement that is adopted in Application 10-12-005.

12. The ECEF will likely be placed into SDG&E's service before a final decision in A.10-12-005 is issued.

Conclusions of Law

1. The Commission's support of a competitive market for generation resources is to benefit ratepayers by selecting the least-cost best-fit options in procurement.

2. A "unique opportunity" should not be limited to only opportunities arising from a settlement or bankruptcy proceeding.

3. The ECEF purchase option should be considered a unique opportunity because the ECEF is a fully constructed, operational facility located on SDG&E's property that currently provides local and system resource adequacy for SDG&E's bundled customers.

4. The 2009 RFO Product 5 results provide an adequate market test with which to evaluate the competitiveness of the ECEF purchase option.

5. SDG&E should be authorized to acquire the ECEF.

6. SDG&E's authorization to acquire the ECEF should not be considered precedential and limited to the facts in this application.

7. The cost to acquire the ECEF should be capped at $16.8 million.

8. SDG&E's request to establish a memorandum account to record the ECEF revenue requirement from the time the facility is placed in service until the date a decision adopting SDG&E's revenue requirement is issued in A.10-12-005 should be granted.

9. The costs to be tracked in the memorandum account should be capped at $4.4 million, which represents SDG&E's estimated 2012 revenue requirement.

10. SDG&E should file a Tier 3 advice letter after the acquisition process has been completed to report final actual costs to the Commission.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company is authorized to purchase the CalPeak El Cajon Energy Facility from CalPeak Power-El Cajon LLC at a cost of $16.8 million.

2. San Diego Gas & Electric Company (SDG&E) is authorized to establish a memorandum account to record the CalPeak El Cajon Energy Facility (ECEF) revenue requirement from the date the ECEF is placed in service until the date a final decision adopting SDG&E's revenue requirement is issued in Application (A.) 10-12-005. The amount to be tracked in this memorandum account shall not exceed $4.4 million. Once a final decision is issued in A.10-12-005, SDG&E shall recover the revenue requirement for the ECEF in a manner consistent with other utility generation assets. SDG&E shall file a Tier 3 advice letter to transfer the amounts tracked in the memorandum account to the Non-Fuel Generation Balancing Account in November, 2012, for rates effective January 1, 2013.

3. San Diego Gas & Electric Company shall file a Tier 3 advice letter after it has completed acquisition of the CalPeak El Cajon Energy Facility. This filing shall compare actual expenditures to the $16.8 million cost estimated in this application.

4. No hearings are necessary.

5. Application 11-01-004 is closed.

This order is effective today.

Dated December 1, 2011, at San Francisco, California.

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK J. FERRON
Commissioners