

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



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Application of San Diego Gas & Electric Company  
(U 902 E) for Authority to Acquire the CalPeak El  
Cajon Energy Facility.

Application 11-01-004  
(Filed January 5, 2011)

**OPENING BRIEF OF THE INDEPENDENT ENERGY  
PRODUCERS ASSOCIATION**

**INDEPENDENT ENERGY PRODUCERS  
ASSOCIATION**

Steven Kelly  
Policy Director  
1215 K Street, Suite 900  
Sacramento, CA 95814  
Telephone: (916) 448-9499  
Facsimile: (916) 448-0182  
Email: steven@iepa.com

**GOODIN, MACBRIDE, SQUERI,  
DAY & LAMPREY, LLP**

Brian T. Cragg  
505 Sansome Street, Suite 900  
San Francisco, CA 94111  
Telephone: (415) 392-7900  
Facsimile: (415) 398-4321  
Email: bcragg@goodinmacbride.com

Attorneys for the Independent Energy Producers  
Association

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In Decision (D.) 07-12-052, the Commission affirmed its commitment to use competitive mechanisms for the procurement of resources by the investor-owned utilities (IOUs):

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.<sup>1</sup>

Whenever utility-owned generation (UOG) is a candidate for procurement, the Commission was more insistent that competitive mechanisms should be used: “Because the Commission has a strong preference for competitive solicitations, in all cases, if an IOU proposes a UOG outside of a competitive RFO [request for offers], the IOU must make a showing that holding a competitive RFO is infeasible.”<sup>2</sup>

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<sup>1</sup> D.07-12-052, p. 209 (emphasis in original).

<sup>2</sup> D.07-12-052, p. 210.

This application tests whether the Commission’s existing policy remains in effect or not and whether the Commission meant what it said in D.07-12-052 (and applied in D.08-11-004), or, alternatively, whether D.07-12-052 was merely a springboard to launch exception after exception to the stated policy favoring competitive mechanisms.

In this proceeding, San Diego Gas & Electric Company (SDG&E) seeks the Commission’s permission to exercise an option to purchase the El Cajon Energy Facility (ECEP), which after the purchase will become a UOG facility. SDG&E obtained this option as part of a lease that it provided to CalPeak Power LLC (CalPeak) in 2001 for construction of the ECEP in conjunction with a contract between CalPeak and the California Department of Water Resources (DWR).<sup>3</sup> SDG&E administers the contract between DWR and CalPeak, and SDG&E receives the output of the facility.

The facts of this proceeding demonstrate that SDG&E has not complied or even attempted to comply with the Commission’s policy and the requirements announced in D.07-12-052. It now asks the Commission to excuse this failure and to approve the ECEP acquisition anyway. For the reasons set forth in this brief, the Independent Energy Producers Association (IEP) respectfully urges the Commission to make it clear to SDG&E and the other IOUs that it meant what it said in D.07-12-052. SDG&E should be required to comply with the Commission’s policy in all aspects of its requested acquisition of the ECEP.

**I. SDG&E DID NOT COMPLY WITH THE POLICIES STATED IN D.07-12-052**

As noted above, the Commission’s policy as articulated in D.07-12-052 states that all long-term procurement of UOG should take place through competitive procurement

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<sup>3</sup> In 2007, the Commission concluded that RFOs that require bidders to give the IOU an option to purchase the facility at the end of the term of the power purchase agreement “distort the market,” and the Commission prohibited this practice. D.07-12-052, p. 212.

mechanisms, except in a few defined extraordinary circumstances. SDG&E acknowledges that the ECEF option was not bid into a competitive solicitation. Under the Commission's procurement policies, when a utility proposes to acquire a UOG asset outside of a competitive solicitation, the utility must either make a showing that a competitive RFO is infeasible or must qualify the acquisition as a "truly extraordinary circumstance."<sup>4</sup>

SDG&E has failed to meet either of these requirements for exercising the ECEF purchase option. While SDG&E offers two arguments to back its claim that it in fact complied with the Commission's policies, neither argument is persuasive. First, SDG&E contends that the ECEF option was a unique opportunity that created an exception to the Commission's rules. Second, SDG&E asserts that the results of the 2009 RFO provide a sort of market test for the ECEF.

**A. The ECEF Option Is Not a Truly Extraordinary Circumstance or a Unique Opportunity**

Instead of exposing the ECEF option to a competitive RFO as the Commission's procurement policies require or making a showing that an RFO is infeasible, SDG&E asserts that its acquisition of ECEF is exempt from the competitive procurement requirement under the "unique opportunity" exception. However, SDG&E offers little support for its claim. In D.07-12-052, a "unique opportunity" was described as "an attractively priced resource resulting from a settlement or bankruptcy proceeding." Neither a settlement nor a bankruptcy (or similar circumstance) is present here.

SDG&E's assertion that the ECEF option is a unique opportunity rests on a circular argument. SDG&E's argument is that the ECEF option is a unique because it is lower-priced than other options. But the obvious way to prove that the ECEF is lower-priced than other

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<sup>4</sup> D.07-12-052, pp. 209-213.

options is to bid it into an RFO. SDG&E has in effect presumed the results of a competitive solicitation, and based on that presumption now argues that ECEF option should be exempted from the competitive solicitation requirement. If SDG&E's proposed standard were applied, then there would in effect be no standard and the policies of D.07-12-052 would be meaningless.

SDG&E's recent version of this argument is an extension of its earlier unsupported assertions about the state of the energy market and its claims that "it would be virtually impossible for any seller to offer a fully constructed, operational facility with equivalent benefits at a lower cost," and "conducting an RFO to solicit similar projects would serve little purpose."<sup>5</sup> It is hardly as certain as SDG&E portrays that no other seller could offer comparable capacity at a lower cost or that no similar projects would bid in a competitive solicitation, given the opportunity. The more important point, however, is that the Commission **requires** a competitive solicitation for UOG as a matter of policy so that it is not put in the position of having to rely on a utility's unsupported assertions about competitive conditions and its claims about the virtues of a prospective utility asset. Instead, the Commission requires a prospective UOG to be exposed to a competitive RFO, which will identify any more beneficial or lower-cost alternatives to the proposed UOG facility. It will be "virtually impossible" for comparable facilities to offer a similar project at a lower price **only if** SDG&E is permitted to exercise its option without first conducting a competitive solicitation, as the Commission's policy requires.

**B. The 2009 RFO Is Not a Suitable Market Test for the Exercise of the ECEF Option in 2011**

SDG&E also claims that the ECEF was subjected to an after-the-fact market test because the cost of exercising the option was compared to the bids submitted for Product 5 of the

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<sup>5</sup> Application, pp. 6-7.

2009 RFO. But there are several key differences between the requirements SDG&E imposed on Product 5 bidders and its treatment of the ECEF option:

- Product 5 requested offers for 10-year power purchase agreements, while the ECEF option would result in a commitment (*i.e.*, utility ownership) of at least 15 years. Bidders in the Product 5 solicitation were not given an opportunity to bid for a longer commitment, but the ECEF “price” was calculated by levelizing revenue requirements over a 15-year period.<sup>6</sup> In effect, bidders for Product 5 were forced to attempt to recover fixed costs over 10 years, while SDG&E gave itself 15 years to recover comparable costs. Moreover, SDG&E’s attempts to correct for this discrepancy in the duration of the commitment are based on unrealistic scenarios that have no relation to the price a bidder might actually bid for a 15-year commitment. Specifically, SDG&E adjusts for the 5-year discrepancy by (1) assuming a second 5-year power purchase agreement (PPA) at the same price as the 10-year PPA; (2) assuming a second 5-year PPA at a price equal to just the operation and maintenance (O&M) costs of the facility; or (3) assuming that SDG&E buys a new facility at the end of the 10-year PPA, which it sells after five years at its book value adjusted for inflation.<sup>7</sup> These after-the-fact efforts to transform a bid for a 10-year PPA into a bid for a 15-year commitment are no substitute

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<sup>6</sup> SDG&E’s Direct Testimony, p. 21. In other passages, SDG&E claims that savings from ECEF will increase “as the revenue requirement decreases over the 15-year remaining book life of the plant” (p. 24)—a statement that seems to contradict the levelization approach.

<sup>7</sup> SDG&E’s Direct Testimony, p. 22. Although SDG&E has claimed that the cost of the ECEF option is “substantially less” than comparable resources bid into the 2009, at least one shortlisted bid was lower than the ECEF purchase when the terms were equalized using the O&M cost replacement method. DRA’s Testimony, p. 4.

for the bids SDG&E would have received if a 15-year PPA had been a possible product in the 2009 RFO or for the actual bids SDG&E would receive in a solicitation conducted in 2011.<sup>8</sup>

- Existing units subject to once-through cooling regulations issued by the State Water Resource Control Board were not offered even the 10-year contract option for Product 5; instead, they were limited to bids for a two-year contract with eight one-year extension options.<sup>9</sup> For these units, SDG&E is in effect comparing the price of a 15-year contract with the price of a two-year contract.

Furthermore, it is worth noting that the “market test” mentioned in D.07-12-052 was in fact a competitive solicitation, and not some substitute for a competitive solicitation, as SDG&E has portrayed it. The Commission noted that one way to demonstrate that a UOG resource was “attractively priced”—one of the elements of the “unique opportunity” exception—is to subject the resource “to a ‘market test’ by conducting a competitive solicitation.”<sup>10</sup>

Moreover, the putative value of a comparison with the bids submitted in the 2009 RFO is undermined by SDG&E’s vigorous opposition to DRA’s modest suggestion that the ECEF should be subject to a cost cap based on the purchase price and forecast of O&M costs.<sup>11</sup> If SDG&E has so little confidence in the costs on which its “market test” is based that it cannot accept a cost cap based on those estimates, IEP can only wonder what the **real** costs of the ECEF are and whether the savings SDG&E claims for the ECEF have any basis in fact.

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<sup>8</sup> Testimony of Steven Kelly, pp. 4-5.

<sup>9</sup> Testimony, p. 14.

<sup>10</sup> D.07-12-052, p. 212, n.241.

<sup>11</sup> SDG&E’s Rebuttal Testimony, pp. 8-11.

C. **SDG&E Has Conducted RFOs in Similar Circumstances: The El Dorado Experience**

SDG&E's position in this proceeding contradicts the approach it took in similar circumstances when it obtained the Commission's approval to acquire another UOG facility. In A.07-08-006, SDG&E sought the Commission's authority to exercise an option to purchase the 480 MW El Dorado power plant. This application preceded the issuance of D.07-12-052 and the Commission's policy statement on how proposals for UOG should be handled. The option for purchase of El Dorado resulted from a settlement, and thus may have qualified for an exception to the competitive solicitation requirement, as a "unique opportunity," had D.07-12-052 been in effect at the time. Even without the guidance of D.07-12-052, however, SDG&E elected to expose its option to a competitive solicitation of comparable resources. Even though SDG&E might have assumed that it would be "virtually impossible" to match the price of the partially depreciated El Dorado plant,<sup>12</sup> the RFO attracted at least one other competitive offer. As it turned out, the Commission determined that the El Dorado option was more beneficial to ratepayers than the competing offer, and in D.07-11-046, it authorized SDG&E to exercise the option. In issuing its authorization, however, the Commission was able to rely on facts, not unsupported assumptions, and on a comparison between the specifics of two projects, not on untested assertions about the superiority of the El Dorado facility over all other alternatives.

The contrast between SDG&E's handling of the El Dorado acquisition and the ECEF option is striking. For its proposed acquisition of the El Dorado plant, SDG&E chose to conduct a competitive verification that the El Dorado acquisition was the best available option, even though the Commission had not yet stated the requirement that proposed UOG was to be

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<sup>12</sup> The El Dorado plant began commercial operation in May 2000, and pursuant to the option SDG&E will take ownership in October 2011.

subjected to a competitive solicitation. For the ECEF option, SDG&E has avoided competitive challenges, despite the fact that the Commission has articulated its policies requiring UOG proposals to be tested in a competitive RFO.

**D. SDG&E Failed to Make a Showing that a Competitive RFO Is Infeasible**

In D.07-12-052, the Commission clearly stated the procedural predicates for procurement of UOG: “Because the Commission has a strong preference for competitive solicitations, in all cases, if an IOU proposes a UOG outside of a competitive RFO, the IOU must make a showing that holding a competitive RFO is infeasible.”<sup>13</sup> In this proceeding, SDG&E is requesting approval of its acquisition of a generating facility outside of a competitive RFO, yet it has made **no** attempt to show that a competitive RFO is infeasible. Thus, there can be no dispute that SDG&E has failed to make the showing required by the Commission’s procurement policies.

SDG&E should not now be heard to suggest that there was insufficient time to conduct a competitive RFO to expose the ECEF option to a market test. SDG&E acquired its option to purchase the ECEF in 2001, but it waited until January 2011 to initiate the process of seeking the Commission’s authority to exercise an option that will be triggered by the expiration of the CalPeak-DWR contract on January 1, 2012. Having chosen to wait so long to file its application, SDG&E cannot credibly contend that it lacked sufficient time to conduct an RFO to replace the expiring contract.

Moreover, SDG&E has a demonstrated ability to plan ahead when it chooses to. When SDG&E obtained an option to purchase the El Dorado power plant, discussed above, it filed its application for authority to exercise that option **over four years** before the triggering

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<sup>13</sup> D.07-12-052, pp. 210-211.

event, which allowed plenty of time for an RFO **and** the Commission's consideration of the desirability of exercising the option. The RFO was issued on March 7, 2007, and even though the RFO involved a variety of other products, SDG&E was able to receive bids, evaluate the bids, consult with the Procurement Review Group, retain an Independent Evaluator (IE) to analyze the conduct of the RFO, receive the IE's report, and file an application five months later, on August 8, 2007.

Even within the tight time constraints SDG&E attempts to place on the Commission, an RFO for the narrow purpose of replacing the expiring CalPeak-DWR contract could be conducted and completed on a compressed schedule, and complying with the Commission's requirements need not unduly delay a decision on the ECEF option. IEP notes that when Southern California Edison Company (SCE) was confronted with a potential capacity shortage after the July 2006 heat storm, it responded to the Commission's direction and quickly added a Summer 2007 track to an RFO that was launched on August 14, 2006. Bids were due on September 19, contracts were negotiated and signed by November 9, and an application seeking the Commission's approval (A.06-11-007) was filed on November 15, 2006, exactly three months after SCE was directed to conduct an RFO for additional resources.

Thus, SDG&E's failure to conduct a competitive RFO to test the ECEF option should not be excused because SDG&E elected to wait until the last year of the CalPeak-DWR contract to seek authority to exercise the option.

Of course, there would be no need to consider the question of how long it would take to conduct an RFO if SDG&E had complied with the Commission's policies and bid the ECEF option into its 2009 RFO. As discussed in the following section, SDG&E had an obvious opportunity to expose the ECEF option to a competitive test and to avoid putting the

Commission in the position of having to rely on SDG&E's assumptions and assurances to evaluate the option.

**II. SDG&E EVADES A KEY QUESTION: WHY DIDN'T SDG&E BID THE ECEF PURCHASE OPTION INTO ITS 2009 RFO?**

SDG&E devotes a great deal of its direct and rebuttal testimony to its argument that the 2009 all-source RFO provided an acceptable market test for its proposed acquisition of the ECEF. SDG&E notes how Product 5 of the RFO sought resources that SDG&E now claims were equivalent to the ECEF. What SDG&E fails to explain is why it did not simply bid the ECEF option in the 2009 RFO so that a direct comparison could be made with other options offered at the same time, so that no adjustments would be necessary for length of the term of the commitment, changing economic conditions, changing credit environments, and other significant differences between 2009 and 2011.

The relevant facts are these:

- SDG&E acquired the purchase option in 2001, at which time it knew that it had to exercise the option by no later than mid-2011.
- D.07-12-052 was issued in December 2007, at which time SDG&E was made aware of the Commission's "competitive market first" policy and its clear expectation that UOG would be subject to a competitive solicitation.<sup>14</sup>
- SDG&E launched its all-source RFO on June 9, 2009.<sup>15</sup> Product 5 of the RFO sought bids from existing units in SDG&E's service area for 10-year tolling agreements starting on January 1, 2012, the same date the CalPeak/DWR contract expires.

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<sup>14</sup> D.07-12-052, p. 209.

<sup>15</sup> SDG&E's Direct Testimony, p. 18.

- SDG&E discussed exercising the ECEF option with SDG&E's Procurement Review Group (PRG) as early as October 23, 2009.<sup>16</sup>
- No Commission decision or policy prevented SDG&E from bidding the ECEF option into the 2009 RFO. The decision not to participate in the RFO, despite the Commission's policy statements requiring UOG resources to be bid into competitive solicitations, rested with SDG&E, and only SDG&E.

These facts show that SDG&E, in full knowledge of the Commission's policies, failed to take advantage of an obvious and convenient vehicle for complying with the Commission's policies. Product 5 of the RFO sought bids from existing units in SDG&E's service area for 10-year tolling agreements starting on January 1, 2012, the same date the CalPeak/DWR contract expires. SDG&E could have bid the ECEF option directly or through an affiliated entity in the Product 5 category. But it didn't—according to SDG&E's testimony, no UOG or affiliate bids were placed for Product 5.<sup>17</sup> If SDG&E **had** bid the ECEF option in the 2009 RFO, it would have complied with the Commission's requirements, and the Commission would have had the benefit of a direct comparison of the ECEF option with competing projects. SDG&E's decision not to compete when it had an obvious opportunity available should not now excuse its failure to follow the Commission's policy directions. SDG&E has provided no justification for this disregard of the Commission's decisions.

### **III. CONCLUSION**

SDG&E's proposed treatment of the ECEF option is contrary to both the Commission's policies and express instructions in D.07-12-052 and the process SDG&E

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<sup>16</sup> SDG&E's Rebuttal Testimony, p. 6.

<sup>17</sup> SDG&E's Direct Testimony, p. 36.

followed to demonstrate the benefits of the El Dorado option. The Commission should adhere to and enforce its policy preference for competitive procurement and not authorize SDG&E to exercise its option to purchase the ECEF unless and until SDG&E conducts a competitive solicitation to determine the best resource to replace the expiring CalPeak-DWR contract.

In similar circumstances, the Commission acted quickly to dismiss a utility application for UOG. In D.08-11-004, the Commission dismissed the application of Pacific Gas and Electric Company (PG&E) to acquire the Tesla facility because:

PG&E's proposal fails to conform to Commission policies under which all long-term power should be obtained through "competitive procurements, rather than through preemptive actions by the Investor-owned Utilities, except in truly extraordinary circumstances."

More specifically, the Commission finds that facts that PG&E has alleged in its application do not adequately establish that conducting a request for offer is infeasible; a central requirement to proposing utility owned generation outside of a competitive process, as required by Decision 07-12-052.

(D.08-11-004, p. 2 (footnotes omitted).)

The precedent of the Tesla decision provides ample support for denying SDG&E's application. The Commission should deny this application and require SDG&E to commence an open, transparent, and competitive RFO for any capacity needed to replace the CalPeak-DWR contract. SDG&E should promptly proceed to conduct an RFO in which it can bid the ECEF option.

What the Commission should **not** do at this time is to accept SDG&E's claims that the ECEF option is so much better than any available options that it would be senseless to require the ECEF to be tested in a competitive solicitation. As this brief has demonstrated, there is considerable doubt about the validity of SDG&E's valuation of the ECEF option in comparison with the PPA bids submitted in the 2009 RFO. The surest way for the Commission

to satisfy itself and SDG&E's ratepayers that the ECEF is the least-cost option available to fit SDG&E's needs is to order SDG&E to subject the option to a competitive solicitation, as the Commission's policies require. There is no reason presented in this proceeding for the Commission to start backtracking on a policy that has provided a needed stability, fairness, and transparency to a market that is often uncertain and opaque.

Respectfully submitted this 3rd day of June, 2011 at San Francisco, California.

GOODIN, MACBRIDE, SQUERI,  
DAY & LAMPREY, LLP  
Brian T. Cragg  
505 Sansome Street, Suite 900  
San Francisco, California 94111  
Telephone: (415) 392-7900  
Facsimile: (415) 398-4321

By /s/ Brian T. Cragg

Brian T. Cragg

Attorneys for the Independent Energy  
Producers Association