

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



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Application of Pacific Gas and Electric Company for  
Approval of the Manzana Wind Project and Issuance of  
a Certificate of Public Convenience and Necessity.  
(U 39 E)

Application 09-12-002  
(Filed December 3, 2009)

**RESPONSE OF THE INDEPENDENT ENERGY PRODUCERS  
ASSOCIATION**

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ASSOCIATION**

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**RESPONSE OF THE INDEPENDENT ENERGY PRODUCERS  
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Pursuant to Rule 2.6 of the Commission's Rules of Practice and Procedure, the Independent Energy Producers Association (IEP) submits its response to the application of Pacific Gas and Electric Company (PG&E) for approval of its proposed acquisition of the Manzanita Wind Project.

IEP does not oppose the Manzanita project. In fact, representations in the application suggest that the project should have, and apparently did, perform well in PG&E's 2005 renewables Request for Offers (RFO) in which the project was initially bid. However, the fact pattern underlying PG&E's proposed acquisition of a project originally bid into a utility RFO and now presented to the Commission as a proposed utility-owned generation (UOG) project raises questions about the functioning of the hybrid market that the Commission must answer before approving this particular transaction.

**I. INTRODUCTION**

IEP has repeatedly raised its concerns about the functioning of the Commission's adopted "hybrid market structure" for the investor-owned utilities' procurement of the resources

needed to meet their customers' demand. Under the hybrid market structure, the utility functions both as the primary *purchaser* of electricity and as a potential *supplier* in competition with independent power producers (IPPs). The utility's dual role has several implications.

First, the hybrid market structure creates an incentive for the utility to manage the procurement process in a way that may favor the development of UOG to the disadvantage of competing IPPs. The utility in its role as a load-serving entity and the primary procurer of electric resources is uniquely situated to receive bids and detailed information about proposed new projects from developers, to review and assess the proposed projects' qualities, and to consider the projects' development potential. In addition, the utility controls the timing of the RFO, the pace of evaluation and selection, the duration of final contract negotiation, and the timing for presentation of the proposal for the Commission's approval. The utility also effectively controls critical elements of planning for necessary interconnections for new generation, which may also impact the pace and timing of planned generation development by IPPs. Thus, the utility's control over the timing of critical elements of the procurement process has the potential to stall an IPP's project until a sale of the project to the utility becomes an attractive, and perhaps the only, option for the developer.

Second, in addition to the direct impacts of the utility's dual role in the hybrid market structure, the potential for favoritism (whether actually present or not) that is inherent in the hybrid market structure can chill investment in IPP projects. A rational lender may be reluctant to maintain its commitment to a project if extraneous factors related to the procurement process, rather than the merits of the project, result in undue or unexpected delay. As lenders pull out, the project becomes even more susceptible to acquisition by a utility.

Third, until a rational alternative to the hybrid market is established to mitigate the conflicts of interest noted above, a carefully thought-out methodology is needed to fairly compare UOG and IPP projects. The methodology must recognize that ratepayers underwrite the risks of UOG projects and thus assess the allocation of costs and risks between ratepayers, shareholders, and IPPs to determine the full costs and benefits of UOG and IPP proposals. Although the Commission has recognized the need for a fair and effective comparison methodology, it has not yet undertaken the development of such a methodology.<sup>1</sup>

PG&E's application indicates that the Manzana project is a good project that should be completed. That fact, however, raises some significant questions that must be addressed for the Commission to make a fully informed decision on the Manzana acquisition:

1. In light of the stated benefits of the project, why was PG&E's application for approval of a Power Purchase Agreement (PPA) with the Manzana project delayed from 2005, when the project was bid into PG&E's renewables RFO and short-listed, until PG&E requested a Certificate of Public Convenience and Necessity in 2009, when utility ownership was presented as the only option for completing the project? Despite numerous barriers to development, other renewable projects were completed during this period. What caused the delays that affected the Manzana project?

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<sup>1</sup> The order instituting R.08-02-007, the 2008 long-term procurement proceeding, included a preliminary scoping memo that identified as an issue for Phase 2 "Evaluation of whether and how refinements can be made to the bid evaluation process to ensure fair competition between power purchase agreements and utility-owned generation bids, and alternatives to the competitive market approach where competition cannot be used to reach equitable and efficient outcomes." (Order, p. 11.) Phase 2 has not yet started and has not yet been the subject of a scoping memo. On December 3, 2009, the Assigned Commissioner in R.08-02-007 issued a ruling suspending the procedural schedule and stating his intent to recommend the closing of R.08-02-007 and the initiation of two successor rulemakings.

2. Does the Manzana project share a fact pattern with other IPP-sponsored projects that emerge from the development doldrums only after being taken over by a utility?
3. Should a utility's rate of return on its investment in a turnkey project be adjusted to reflect that the risks of cost overruns and construction delays are transferred to the IPP developer?<sup>2</sup>
4. What is the forum for comparing the capital cost of the Manzana project and determining the overall benefits for ratepayers against competitive alternatives?

## **II. RESPONSE TO THE APPLICATION**

In its application, PG&E states that the Manzana project is “cost-competitive” compared to other alternatives and “represents a good value for PG&E customers.”<sup>3</sup> The project is also “highly viable due to its permitting status, technology, developer experience, project location, and transmission status.”<sup>4</sup> The project was bid into PG&E's 2005 renewables RFO as a PPA and was short-listed.<sup>5</sup>

At that point, the chronology presented in the application becomes fuzzy. The parties began negotiating the terms of a PPA for this short-listed project, but those negotiations apparently did not result in an agreement. The application vaguely mentions delays resulting from transmission issues (that should have been apparent when the project was short-listed) and the financing issues that renewable projects faced during the economic downturn (although

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<sup>2</sup> Testimony, p. 1-2.

<sup>3</sup> Application, p. 6. The estimated capital cost for this 246 MW project is \$911 million, or about \$3700 per kW.

<sup>4</sup> Application, p. 7.

negotiations for a PPA began three years before the economic downturn and the application does not state that this particular project faced financing issues).<sup>6</sup> In any event, the Manzana project did not come before the Commission until it became a UOG project four years after having been bid into the RFO.

**A. Parties' Ability to Examine UOG Applications Is Limited by the Commission's Confidentiality Rules.**

A thorough review and consideration of PG&E's Manzana application requires answers to several questions. Answering these questions, however, may require access to information claimed as confidential that is not publicly available due to the restrictions of the Commission's confidentiality rules. For example:

1. What would lead an experienced developer to cede its project to the utility?  
Delays in negotiating a PPA during a time of rapidly rising costs? Delays in obtaining interconnection and transmission capacity during a time when financial credit became progressively less available?
2. Did any action or inaction by PG&E or any other investor-owned utility contribute to the delays the Manzana project encountered?
3. Does the Commission's encouragement of renewable UOG create an incentive for a utility to "starve" or delay good projects during negotiations until the developer is driven to sell the project to the utility?

To be clear, IEP is not accusing PG&E or any other utility of taking inappropriate action in connection with the Manzana project. The information required to answer these questions is not available to IEP or many other members of the public, due to the Commission's

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<sup>5</sup> Application, p. 4.

<sup>6</sup> Application, p. 4.

confidentiality rules. IEP is accordingly in a position only to ask these questions, not to answer them. But a failure to answer these questions publicly will undermine the perceived integrity of the hybrid market structure and may inhibit investment in other IPP-sponsored projects, creating additional opportunities for utility takeovers of cost-competitive and viable IPP projects.

**B. Patterns of Procurement Suggest that Delays Favor UOG Development to the Detriment of IPPs.**

IEP has repeatedly raised the concern that a number of promising projects, including apparently the Manzana Project, have difficulty completing the procurement process while they remain IPP projects. When the same project becomes a UOG project, however, rapid project development is urged so that ratepayers may receive the economic, technological, or reliability benefits of the project—as if a mere change in ownership created energy, capacity, or Renewables Portfolio Standard benefits that would not be realized if an IPP retained the project and sold the output to a utility under a PPA.

IEP is concerned about a pattern in which IPP projects identified, designed, and developed by experienced and well-capitalized companies with a long history of developing projects in California, in the West, throughout the nation, and often internationally are unable to be completed in California under the hybrid market structure. IEP notes that several other projects—including the Mountainview project now owned by Southern California Edison Company (SCE) and PG&E’s proposed Tesla project—were originally IPP projects that surfaced for Commission approval only after they were taken over by the utility. For several other projects, utility ownership began or will begin after the project has been constructed and tested by a nonutility firm—*e.g.*, PG&E’s Colusa plant, the Miramar II project of San Diego Gas & Electric Company (SDG&E), and PG&E’s proposed Oakley project (also referred to as the Contra Costa or Radback project). In addition, the delays that apparently plagued the Manzana

project have not prevented the steady progress of several UOG projects, including four of SCE's peakers, the UOG photovoltaic projects of SCE (with approval pending for similar programs of PG&E and SDG&E), PG&E's Contra Costa 8, Colusa, and Humboldt plants, SDG&E's Palomar project, and SCE's Mountainview project.

Meanwhile, the development of a methodology for fairly comparing UOG and IPP projects—*i.e.*, to select the most cost-effective resources—has been put off repeatedly, as discussed above.

**C. The Manzana Application Raises Issues Regarding the Operation and Structure of the Hybrid Market.**

A complete answer to the questions raised in this Response will require a detailed factual investigation of the background of PG&E's acquisition of the Manzana project, an investigation that is hampered by the lack of publicly available information. A complete answer would also require the Commission to undertake its promised development of a comparison methodology, so that UOG proposals may be compared directly and fairly with IPP offers.<sup>7</sup>

Because of the serious concerns that this and other utility acquisitions of IPP projects raise, the Commission should take steps to evaluate objectively the integrity and viability of the hybrid market structure. First, the Commission should promptly develop a methodology for making fair comparisons between UOG and PPA, so that the cost-effectiveness of UOG projects may be tested against IPP offers. Second, it should make more transparent the utilities' procurement, interconnection, and decision-making processes that result in some

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<sup>7</sup> The Net Market Value Methodology described in Chapter 4 of the testimony accompanying the application does not provide the needed methodology for fairly comparing the full costs of a UOG project with the costs of a PPA. The extensive redactions in this chapter make it difficult to follow, but there is no indication that the full costs of the Manzana project, including the contributions that ratepayers will make and the risks that ratepayers will underwrite, are considered in the calculations presented in the testimony.

projects being awarded PPAs while other projects are delayed until they become targets for acquisition by the utility.

A simpler potential alternative to this effort would be for the Commission to require the investor-owned utilities to use an affiliate to own and operate generating plants. Transactions between utilities and affiliates are governed by the Affiliate Transaction Rules, which require arms' length negotiation between the affiliate and the utility, or, alternatively, the affiliate could participate in an RFO on the same basis as any other bidder. Putting the utility in the same position as other bidders would level the procurement playing field and neither favor nor disadvantage the utility affiliate or competing IPPs. The pay-for-performance price structure of most PPAs would allow for an easy comparison with IPPs' offers. The risk of cost overruns and poor performance would be placed on shareholders, rather than on ratepayers.

IEP notes that two of the three large investor-owned electric utilities regulated by the Commission have viable affiliates engaged in the development and operation of electric generation assets. To the extent the regulated utilities have generation development interests, IEP urges the Commission to adopt rules obligating the regulated utilities to undertake generation development and ownership through their affiliates, subject to the Commission's Affiliate Transaction Rules, except in extraordinary circumstances. This simple step will help ensure the reality of a competitive level playing field and allay existing concerns regarding the potential for favoritism.

### **III. CONCLUSION**

For the reasons stated in this Response, IEP respectfully urges the Commission to promptly develop a methodology for making fair comparisons between UOG and PPAs and to make more transparent the utilities' procurement, interconnection, and decision-making

processes. Alternatively, the Commission should require the regulated utilities to undertake generation development and ownership through their affiliates, subject to the Commission's Affiliate Transaction Rules, except in extraordinary circumstances. In addition, the Commission, through its staff, should conduct a thorough investigation of the circumstances that led an experienced and successful developer to sell its project to a utility. This Response is submitted solely to highlight the issues that this application raises about the operation and structure of the hybrid market.

Respectfully submitted this 6th day of January, 2010 at San Francisco, California.

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By           /s/ Brian T. Cragg            
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**CERTIFICATE OF SERVICE**

I, Lisa Vieland, certify that I have on this 6th day of January 2010 caused a copy of the foregoing

**RESPONSE OF THE INDEPENDENT ENERGY PRODUCERS ASSOCIATION**

to be served on all known parties to A.09-12-002 listed on the most recently updated service list available on the California Public Utilities Commission website, via email to those listed with email and via U.S. mail to those without email service. I also caused courtesy copies to be hand-delivered as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 6th day of January 2010 at San Francisco, California.

/s/ Lisa Vieland  
Lisa Vieland

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