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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Expedited Approval of the Tesla Generating Station and Issuance of a Certificate of Public Convenience and Necessity and Request for Interim Order Authorizing Early Project Commitment to Stabilize Costs. (U39E)	Application 08-07-018 (Filed July 18, 2008)

RESPONSE OF THE CALIFORNIA ENERGY COMMISSION TO THE APPLICATION OF PACIFIC GAS AND ELECTRIC COMPANY FOR EXPEDITED APPROVAL OF THE TESLA GENERATING STATION AND ISSUANCE OF A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AND REQUEST FOR INTERIM ORDER AUTHORIZING EARLY PROJECT COMMITMENT TO STABILIZE COSTS

August 20, 2008

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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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Pursuant to Commission Rule 2.6(c), the California Energy Commission submits the following letter in response to the application of Pacific Gas and Electric Company for expedited approval of the Tesla Generating Station and Issuance of a Certificate of Public Convenience and Necessity and Request for Interim Order Authorizing Early Project Commitment to Stabilize Costs.

August 20, 2008

Respectfully submitted,

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STATE OF CALIFORNIA – THE RESOURCES AGENCY

ARNOLD SCHWARZENEGGER, *Governor*

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August 20, 2008

Michael R. Peevey
President
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Dear President Peevey:

On July 18, 2008, you received an application from Pacific Gas and Electric Company (PG&E) for expedited approval of the Tesla Generation Station and issuance of a Certificate of Public Convenience and Necessity (CPCN). The Tesla Generating Station, a new, 560 megawatt (MW) natural gas-fired combined-cycle generating facility, would be located in eastern Alameda County. The Energy Commission originally granted a license to Midway Energy LLC[1] for the Tesla Power Project on June 16, 2004, as an 1,120 MW combined-cycle generating facility. On July 16, 2008, PG&E entered into an agreement to acquire all of the interests and development rights associated with the Tesla Power Project site and now seeks a CPCN to construct the first power train. Under the acquisition agreement, PG&E retains an option to proceed with the future development of the second power train.

In its application, PG&E characterizes the Tesla project as a "unique opportunity" to develop a cost-effective, environmentally-sensitive new generation resource that is needed to replace, in part, 913 MW of projects from its 2004 Long Term Request for Offers that have been terminated or delayed. PG&E asserts that this generation is needed by the summer of 2012 in order to maintain long-term reliability and that it is the only available feasible alternative. With the application, PG&E asserts that it meets the California Public Utility Commission's (CPUC) requirements for utility ownership of a generating resource acquired outside of the competitive Request for Offer (RFO) process.

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[1] Midway Energy LLC is a wholly-owned subsidiary of ESI Energy LLC, which is a wholly-owned subsidiary of FPL Energy, LLC.

The Energy Commission has serious concerns that PG&E's CPCN application for the Tesla Power Project is the most recent example of generating resources acquisitions being characterized by CPUC-jurisdictional utilities as "unique circumstances" in order to justify acquisition outside of the competitive RFO process. Each of the utilities over the years has acquired power plants outside of the formal solicitation process:

- Southern California Edison (SCE) signed a power purchase agreement with an affiliate company for the 1,054 MW Mountain View Project in a one-on-one negotiated agreement approved by the CPUC.
- San Diego Gas &Electric (SDG&E) acquired two turn-key projects, the 550-MW Palomar Project and the 45-MW Ramco Project.
- PG&E acquired the rights to construct the partially-completed 530 MW Contra Costa 8 Project as part of the Mirant settlement of claims from the 2000-2001 energy crisis.
- PG&E received approval for a Purchase and Sale Agreement for the Colusa Project that was to be developed by a power plant developer and purchased and operated by PG&E.

As the Energy Commission stated in the 2005 *Integrated Energy Policy Report (IEPR)*, "...requiring the state's utilities to engage in long-term procurement now is the highest priority for California to ensure an affordable, reliable, safe, and environmentally sound electricity system."[2] In order to maintain an efficient and viable competitive process necessary to support long-term procurement, it is critical that market participants have faith in that process, and that it not be circumvented unnecessarily. A white paper commissioned by the National Association of Regulatory Utility Commissioners stressed that the fairness and integrity of a procurement process is affected not only by the actions of the utility, but also by regulatory oversight of the procurement process: "...regulators should align their own procedures and actions to support the development of a competitive response. Regulators' own actions can positively – and in some cases negatively - affect the integrity and outcomes of a procurement process. Positive signals can arise, for example, by... enforcing elements of the procurement design that enhance the overall fairness and objectivity of the process and the integrity of the procurement results."[3]

[2] 2005 *IEPR*, p. 53

[3] *Competitive Procurement of Retail Electricity Supply: Recent Trends in State Policies and Utility Practices*, July, 2008, p. 8.

Indeed, the CPUC itself recognized the importance of preserving faith in the competitive procurement process when it stated in D. 07-12-052 that: "We firmly believe that all long-term procurement should occur via competitive procurements, except in truly extraordinary circumstances. While we do not explicitly disallow utility ownership options in the generation market, we continue to look unfavorably on this procurement option but realize that in extraordinary times this may be the optimal method for meeting the needs of California's ratepayers."[4] The CPUC specified five categories of unique circumstances warranting some form of utility ownership[5]:

- market power mitigation
- preferred resources
- expansion of existing facilities
- unique opportunity
- reliability

The Energy Commission agrees wholeheartedly that truly extraordinary and unique circumstances must exist before any long-term procurement is allowed to occur outside of the competitive process. If this standard becomes eroded over time such that utility ownership of facilities outside the competitive process becomes a common exception to the rule, the robustness of the procurement process will surely suffer. In fact, PG&E's acquisition agreement contains an option allowing it to proceed with the future development of the second power train. With this option, PG&E already seems to be planning for another opportunity to add to its own stock of generation resources, implying that yet another "extraordinary circumstance" may be just around the corner.

The 2005 *IEPR* found that while the CPUC did not prohibit IOUs from entering into long-term contracts, utilities had shown little interest in doing so.[6] It noted that utilities released some RFOs for long-term contracts, but they accounted for less than 20 percent of solicitations, totaling 2,000 MW of the approximately 12,500 MW under recent solicitations.[7] As in 2005, it

[4] D. 07-12-052, pp. 212-213

[5] D. 07-12-052, pp. 211-212

[6] 2005 *IEPR*, p. 61.

[7] 2005 *IEPR*, p. 62.

remains critical in 2008 that there are enough long-term commitments for California to meet future need due to increasing electricity demand growth and to modernize its generation fleet. The CPUC must assure that the framework it has enacted for competitive long-term procurement continues in the most efficient manner possible, unabated by the impression that the process may be easily enough circumvented at the request of an investor-owned utilities (IOUs). It can do this by signaling to IOUs and other market participants that it regards the competitive RFO process to be the proper avenue for long-term procurement and that any exceptions will be allowed only under truly extraordinary circumstances. Therefore, we strongly encourage the CPUC to critically examine PG&E's Tesla Application in this light and ensure that the spirit as well as the letter of D. 07-12-052 is met.

Sincerely,

JPfannenstiel

JACKALYNE PFANNENSTIEL
Chairman

Cc: Dian M. Grueneich, Commissioner
John Bohn, Commissioner
Rachelle Chong, Commissioner
Timothy Alan Simon, Commissioner

California Public Utilities Commission

CPUC Home

CALIFORNIA PUBLIC UTILITIES COMMISSION
Service Lists

PROCEEDING: A0807018 - PG&E - TELSA GENERAT
FILER: PACIFIC GAS AND ELECTRIC COMPANY
LIST NAME: LIST
LAST CHANGED: AUGUST 19, 2008

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CERTIFICATION OF SERVICE

I, **SCOTT MCDONALD**, certify that I have caused copies of the **RESPONSE OF THE CALIFORNIA ENERGY COMMISSION TO THE APPLICATION OF PACIFIC GAS AND ELECTRIC COMPANY FOR EXPEDITED APPROVAL OF THE TESLA GENERATING STATION AND ISSUANCE OF A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AND REQUEST FOR INTERIM ORDER AUTHORIZING EARLY PROJECT COMMITMENT TO STABILIZE COSTS,** to be served by electronic mail, on or before **AUGUST 20, 2008,** on all parties who provided e-mail addresses for the identified service list **A.08-07-018** provided by the California Public Utilities Commission for this proceeding. I have also served by overnight mail two copies to ALJ Timothy J. Sullivan and two copies to Commissioner Michael R. Peevey of the California Public Utilities Commission on August 20, 2008.

August 20, 2008

DECLARANT
(Service Lists attached to the original only.)