STATE OF CALIFORNIA EDMUND G. BROWN JR., *Governor*

PUBLIC UTILITIES COMMISSION

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TO PARTIES OF RECORD IN APPLICATION 11-07-010

This is the proposed decision of Administrative Law Judge (ALJ) Gamson. It will not appear on the Commission's agenda sooner than 30 days from the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in Article 14 of the Commission's Rules of Practice and Procedure (Rules), accessible on the Commission's website at www.cpuc.ca.gov. Pursuant to Rule 14.3, opening comments shall not exceed 15 pages.

Comments must be filed pursuant to Rule 1.13 either electronically or in hard copy. Comments should be served on parties to this proceeding in accordance with Rules 1.9 and 1.10. Electronic and hard copies of comments should be sent to ALJ Gamson at dmg@cpuc.ca.gov and the assigned Commissioner. The current service list for this proceeding is available on the Commission's website at www.cpuc.ca.gov.

/s/ KAREN V. CLOPTON
Karen V. Clopton, Chief
Administrative Law Judge

KVC:jt2

Attachment

Decision **PROPOSED DECISION OF ALJ GAMSON** **(Mailed 1/17/2012)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Approval of the GWF Transaction and Associated Cost Recovery (U39E).	Application 11-07-010 (Filed July 21, 2011)

DECISION APPROVING PACIFIC GAS AND ELECTRIC COMPANY/GWF TRANSACTION

1. Summary

This decision approves the request of Pacific Gas and Electric Company for approval of three contracts with GWF and associated cost recovery. The overall transaction will result in the early shutdown of five heavily-polluting petroleum coke power plants in Contra Costa County, and new purchased power agreements with two peaker plants in the Fresno area.

2. Background

Pacific Gas and Electric Company (PG&E) filed its application on July 21, 2011. No comments or protests were received.

PG&E seeks approval of three contracts in connection with a transaction with GWF. The GWF transaction involves seven power plants – the Hanford power plant located in Hanford, California; the Henrietta power plant located in Lemoore, California; and five petroleum coke power plants located in the San Francisco Bay Area Delta region (Contra Costa County) in California.

All seven power plants are currently under contract with PG&E. The Power Purchase Agreements (PPAs) for two power plants, Hanford and

Henrietta, are scheduled to terminate on December 31, 2012. The Qualifying Facility (QF) PPAs for the petroleum coke power plants are scheduled to terminate in 2020 and 2021. The GWF Transaction involves three separate agreements: an Omnibus Agreement which governs the shutdown of the five GWF petroleum coke power plants and the termination of their associated existing QF PPAs; and two new 10-year PPAs with the Hanford and Henrietta facilities (the Peaker PPAs).

The GWF Hanford and GWF Henrietta facilities are both relatively new, efficient peaking combustion turbine (CT) generation facilities. Both facilities employ natural gas simple cycle gas turbines, typically referred to as CTs. Combined, the facilities provide approximately 175 megawatts (MWs) of capacity on a peak summer day. These units are currently under contract to PG&E as a result of the novation of California Department of Water Resources agreements, which was approved by the Commission in Decision (D.) 10-07-042.

The five GWF petroleum coke facilities are non-dispatchable, baseload facilities. Each facility is approximately 19 MW and sells energy and capacity to PG&E under an existing QF PPA. As baseload facilities, these units operate year-round with capacity factors of roughly 90%. PG&E has no ability to dispatch these units in order to follow its customers' electricity demand, or to reduce output to minimize greenhouse gas (GHG) emissions. The facilities burn petroleum coke, a waste product of the oil refining process, as their source of fuel and, as such, are extremely carbon intensive. On a pounds per MW/hour basis, these units emit more than twice the GHG emissions as the Hanford and Henrietta facilities. In total, the petroleum coke facilities emit approximately 1,000,000 metric tons of GHG emissions per year, representing a sizable portion of California in-state electricity sector GHG emissions.

Under the existing QF PPAs, PG&E pays for energy and capacity subject to terms of the agreements. Currently, the QF PPA energy payments are based on the Short-Run Avoided Cost (SRAC) price and the capacity payments specified are based on prices specified in the contracts. Under the Qualifying Facility and Combined Heat and Power Settlement approved by the Commission in D.10-12-035, PG&E will pay GWF for GHG emissions through 2014. After that point in time, GHG emissions costs will be paid solely through the SRAC price for energy. Under the QF PPAs, GWF would be required to pay minimum damages to PG&E for early termination of the agreements, reflecting the fact that customers paid front-end loaded payments in the earlier years of the contracts.

The Omnibus Agreement addresses the shutdown of the five GWF petroleum coke facilities and the termination of the existing QF PPAs. The Omnibus Agreement provides for termination of the QF PPAs when certain conditions precedent are satisfied, addresses payment obligations and requirements under the QF PPAs before a Commission decision on this Application becomes final and non-appealable, and requires certain actions by GWF once a Commission decision on this application becomes final and non-appealable. A summary of the Omnibus Agreement is included as Confidential Exhibit A to PG&E's application, and a copy of the Omnibus Agreement is attached as Confidential Exhibit B to PG&E's application.

Under the Peaker PPAs, PG&E will have the ability to dispatch two reliable and operationally flexible CTs. GWF will continue to own and operate the facilities, and energy from these facilities will be purchased by PG&E over a 10-year period beginning January 1, 2013. PG&E will have full dispatch rights over the facilities during that period, and says it will utilize the units to help ensure system reliability and to help integrate a growing amount of intermittent renewable resources. The Peaker PPAs are fuel conversion agreements under which PG&E will pay for the fuel and arrange to make it available at the project. GWF will then be paid to convert that fuel into energy. Copies of the Peaker PPAs are attached as Confidential Exhibits C and D and are summarized in Confidential Exhibit A to PG&E's application.

On September 21, 2011, Administrative Law Judge (ALJ) Gamson issued a ruling seeking more detail on a number of contentions in the application. PG&E filed its response on September 23, 2011. On November 1, 2011, ALJ Gamson issued a second ruling seeking further information. PG&E filed its response on November 10, 2011. On December 16, 2011 a Scoping Memo was issued. The Scoping Memo provided that Division of Ratepayer Advocates (DRA) and Robert Sarvey would be parties to the proceeding, in response to late-filed requests. The Scoping Memo scheduled an evidentiary hearing, which was held on January 6, 2012. PG&E, DRA and Robert Sarvey filed briefs on January 13, 2012.

3. PG&E's Arguments

PG&E contends the GWF transaction will provide significant environmental and operational benefits for California. PG&E contends the GWF transaction is reasonable and beneficial for PG&E's customers for the following reasons:

1. As a result of the closure of GWF's five petroleum coke facilities, the GWF transaction will result in a net reduction of GHG emissions of over 600,000 metric tons per year from PG&E's portfolio;
2. PG&E estimates that the GWF transaction will result in a net savings to customers of approximately $15 million as a result of the termination of the existing, higher priced QF PPAs;

3. The Peaker PPAs provide unit-specific dispatch throughout the year. The Henrietta and Hanford facilities are combustion turbine units that can provide the operational flexibility to manage changing grid conditions. As the amount of renewable generating capacity grows in response to California's Renewables Portfolio Standard, resources such as the Henrietta and Hanford facilities that are able to respond to changing grid conditions will become even more important. The units will also offer PG&E a range of ancillary services and other capabilities, including spinning reserves, quick start capability, and a large number of starts and operating hours;

4. The Hanford and Henrietta facilities provide local Resource Adequacy (RA) in the Fresno transmission constrained area and will help meet PG&E's local RA requirements during the 10-year contract terms; and

5. The shutdown of the petroleum coke facilities will benefit local communities with specific local and regional environmental improvements. These include the following reductions:

   a. more than 725 tons of criteria pollutants per year;

   b. more than 250 tons of ozone and particulate matter precursor emissions per year;

   c. more than 1800 acre feet of water use per year; and

   d. elimination of approximately 14,000 diesel truck trips hauling petroleum coke fuel and limestone from refineries through Contra Costa neighborhoods to the existing GWF petroleum coke facilities.

4. Positions of Parties

In its brief, DRA recommends that the Commission grant PG&E the approval requested. DRA believes that the evidence provided by PG&E indicates that the GWF Transaction is likely to provide both significant ratepayer savings and environmental benefits. DRA point out that if the GWF Transaction is approved in early 2012, PG&E would no longer be obligated to make payments under the existing QF PPAs, resulting in a net savings to customers. In addition, DRA agrees with PG&E that the replacement power under the Peaker PPAs will reduce annual GHG emissions by roughly one-half as compared to emissions from the existing petroleum coke facilities. Because the benefits from the GWF Transaction are greater the sooner the GWF Transaction is approved, DRA recommends that the Commission approve the GWF Transaction without modification.

In his brief, Robert Sarvey contends that the GWF transaction does not provide any ratepayer benefit due to the Henrietta and Hanford PPA's above market costs and the consideration of minimum damage payments. Mr. Sarvey contends that GHG emissions will actually increase globally if the GWF Petroleum Coke Facilities are closed. Mr. Sarvey claims that PG&E has not provided a proper economic assessment of the viability of the QF's under their current contract as required by prior Commission decisions. Despite these drawbacks, Mr. Sarvey concludes that the environmental benefits to the local environmental justice community provide justification for approval of the GWF transaction (despite PG&E's failure to quantify them). However, Mr. Sarvey expresses his concern that these environmental benefits may only be temporary unless the Commission assures that the Petroleum Coke QF's do not repower.

5. Discussion

After review of the application, PG&E's testimony, PG&E's responses to two ALJ rulings, and evidentiary hearings, we can make a number of findings which taken as a whole support granting the application.

We find that the transactions proposed by PG&E will lead to a significant net reduction of GHG emissions at the levels claimed by PG&E. While benefits from reduction of payments to GWF associated with GHG emissions are included in PG&E's analysis, we also find, as PG&E witness Mr. Monardi testified, that there is an economic benefit to the net reduction of GHG emissions from the overall GWF transaction which has not been quantified in the application. We find that the shutdown of the five petroleum coke facilities will benefit local communities in Contra Costa County with a variety of specific, but unquantified, local and regional environmental improvements, as claimed by PG&E.[1]

We also find that the Henrietta and Hanford facilities will also offer PG&E a range of ancillary services and other capabilities, including spinning reserves, quick start capability, and a large number of starts and operating hours. While PG&E does not assign a dollar value to these services and capabilities, we find there is a positive value associated with them. Finally, we find that the Peaker PPAs may help meet PG&E's local RA requirements during the 10-year contract terms in the Fresno transmission constrained area, but only if there will be any additional local RA capacity need in that area. However, the RA value of these PPAs in the Fresno area may be zero. Therefore, we do not find a positive value for local RA capacity.

We note that there is no evidence of any unquantified costs.

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[1] Robert Sarvey claims that the closure of the petroleum coke plants will actually increase pollution, because of the combination of: a) alternative uses for the petroleum coke which would have been used to power these plants, and b) the GHG emissions from the Hanford and Henrietta plants. We do not find evidence to support Mr. Sarvey's claim that the petroleum coke from the closure of these plants will be used elsewhere, or if so, that such use would cause the totality of the GHG transaction to result in net additional GHG emissions.

After review of the record (including confidential material in testimony, responses to ALJ Rulings and evidentiary hearings), we find some uncertainty about the accuracy of PG&E's claim that the cost of the new contracts with the Hanford and Henrietta peaker plants would be $15 million less than the cost of the five petroleum coke baseload plants. PG&E witness Mr. Monardi provided credible testimony[2] in closed session that PG&E's cost/benefit analysis may have underestimated certain benefits by approximately $7 million through the use of conservative assumptions with regard to a timing issue.

On the other hand, PG&E's confidential response to question number 1 to the September 2011 ALJ ruling showed that PG&E may have overestimated benefits in two areas. First, PG&E may have overestimated benefits in its capacity benefits model with regard to the value of the capacity for the two peaker plants by using too high market values for capacity in the later years of its analysis. This overestimation may be as much as $30 million. Second, PG&E may have overestimated the benefits stemming from the end of capacity payments to GWF for the petroleum coke plants; PG&E's contracts with GWF for these facilities provides that PG&E ends capacity payments in 2015 and 2016 (depending on plant), while the contracts last until 2020 or 2021 (depending on plants). This overestimation may be as much as $14 million.

A final issue involves the potential of damage payments from GWF to PG&E if the petroleum coke plants were to close before the end of the contractual periods in 2020 or 2021, depending on the plant. Based on the record, much of which involves confidential material on this point, we find that PG&E properly

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[2] A significant portion of Mr. Monardi's testimony contains confidential material and is under seal.

accounted for potential early termination damage payments in its cost-benefit analysis.

Therefore, the range of possible outcomes of a cost/benefit analysis of the overall GWF transaction varies from a positive value of $22 million to a negative value of $29 million. While it is not possible to assign probabilities to each of these outcomes, based on quantifiable factors we find it equally likely that ratepayer value may be either positive or negative. However, as discussed above, there are a number of real benefits that are not quantified in the application. In addition to those listed above, one further unquantified benefit is increased certainty: the pricing and terms of the PPAs provide more certainty to PG&E and ratepayers as a hedge against higher capacity costs than do the pricing and terms for the petroleum coke plants. These unquantified benefits make it more likely that the GWF transaction will provide overall ratepayer benefits. It is important to note that the ratepayer impact -- whether positive, negative or zero -- will be small compared to the total costs PG&E will incur over the span of the two PPAs. Therefore, we find that the most likely outcome of the GWF transaction will be slightly positive, but close to ratepayer indifference.

We now turn to a second analysis: whether the proposed GWF transaction is superior to other reasonable alternatives available to PG&E at this time. PG&E provided, in a confidential response to the November 2011 ALJ ruling, information about other recent transactions and offers for capacity. This material shows that potential offers in the market for capacity in the relevant area are both higher and lower than the capacity price in the proposed transaction with GWF for the Henrietta and Hanford plants. This material shows that PG&E has the opportunity to acquire similar capacity (both in terms of amount and purpose) for less than the price in the proposed transaction with GWF. We would not be likely to approve a proposed transaction which is significantly above market, absent a compelling rationale.

PG&E maintains that the proposed transaction is, in fact, about more than simply acquiring capacity at the Hanford and Henrietta plants; it is also about shutting down five heavily-polluting petroleum coke plants in Contra Costa County. In other words, it is a package deal.

Mr. Monardi testified that PG&E negotiated in good faith and obtained a reasonable negotiated outcome with GWF, an outcome which PG&E calculates provides overall ratepayer benefits. Nevertheless, analysis of recent contract prices shows that there may well have been opportunities to increase ratepayer benefits because the capacity prices for the peakers appear to be above market levels. In other words, PG&E may well have left money on the table.[3] We emphasize that the utility is obligated to seek the best possible outcome and not simply one which provides minimal ratepayer benefits. Participants in Procurement Review Group meetings should evaluate potential deals from this perspective, and utilities should expect additional scrutiny if ratepayer benefits are not maximized.

Based on the above discussion, we will approve PG&E's application, including the Peaker PPAs and the Omnibus Agreement that terminates the existing QF PPAs. The deal provides some ratepayer benefits, includes large GHG emission reductions and provides other unquantified environmental and

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[3] Alternatively, it is possible (but less likely) that PG&E could have negotiated a shutdown of the petroleum coke plants without also agreeing to the peaker PPAs, and then acquire similar capacity, energy and other benefits (with the likelihood of far lower GHG emissions compared to the petroleum coke plants) at a lower price than with the PPAs.

market benefits. We also approve PG&E's request for approval to recover costs incurred pursuant to each of the agreements through a debit to its Energy Resource Recovery Account and the recovery of stranded costs associated with the GWF transaction consistent with D.08-09-012.

6. Categorization and Need for Hearings

In Resolution ALJ 176-3278 dated July 28, 2011, the Commission preliminary categorized this application as Ratesetting and preliminarily determined that hearings were necessary. We confirm these preliminary determinations.

7. Motions

On July 21, September 23 and November, 2011 PG&E filed Motions for Leave to File Confidential Material Under Seal consistent with the confidentiality protections of D.06-06-066, Public Utilities Code Section 583 and General Order 66-C. The protected materials are described in tables attached to the Motions. The ALJ reviewed the Motions and the confidential material therein. The Motions were granted by ALJ Gamson at the January 6, 2012 hearing.

Along with its brief, DRA filed a Motion for Leave to File Confidential Material Under Seal. The Motion is granted.

8. Assignment of Proceeding

Michel Peter Florio is the assigned Commissioner and David M. Gamson is the assigned ALJ in this proceeding.

9. Comments on Proposed Decision

The proposed decision of ALJ Gamson 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 _________, and reply comments were filed on ____________ by _______________.

Findings of Fact

1. No party protested PG&E's application.

2. The transactions proposed by PG&E would lead to a significant net reduction of GHG emissions.

3. While benefits from reduction of payments to GWF associated with GHG emissions are included in PG&E's analysis, there is an economic benefit to the net reduction of GHG emissions from the overall GWF transaction that is not quantified in the application.

4. The proposed shutdown of five petroleum coke facilities will benefit local communities with a variety of specific, but unquantified, local and regional environmental improvements.

5. The proposed Peaker PPAs will help meet PG&E's local RA requirements during the 10-year contract terms in the Fresno transmission constrained area. However, the value of this benefit is unknown and unspecified by PG&E and may be zero.

6. The proposed PPAs with the Henrietta and Hanford facilities offer PG&E a range of ancillary services and other capabilities, including spinning reserves, quick start capability, and a large number of starts and operating hours. While PG&E does not assign a dollar value to these services and capabilities, there are positive values associated with them

7. There are positive, but unquantified, benefits to the PPAs associated with market certainty.

8. PG&E's cost/benefit analysis may have underestimated certain benefits associated with timing in the proposed transaction by approximately $7 million.

9. PG&E may have overestimated benefits in its capacity benefits model with regard to the value of the capacity for the two peaker plants. This overestimation may be as much as $30 million.

10. PG&E may have overestimated the benefits stemming from the end of capacity payments to GWF for the petroleum coke plants. This overestimation may be as much as $14 million.

11. PG&E properly accounted for potential early termination damage payments from GWF for the petroleum coke plants in its cost-benefit analysis.

12. We do not find evidence to support Mr. Sarvey's claim that the petroleum coke from the closure of the Contra Costa County plants will be used elsewhere, or if so, that such use would cause the totality of the GHG transaction to result in net additional GHG emissions.

13. The range of possible outcomes of a cost/benefit analysis of the overall GWF transaction varies from a positive value of $22 million to a negative value of $29 million, based on quantifiable factors. Unquantified benefits make it more likely that the GWF transaction will provide overall ratepayer benefits.

14. The most likely outcome of the GWF transaction will be slightly positive ratepayer benefits, but close to ratepayer indifference.

15. PG&E may have been able to obtain the capacity benefits from the proposed Peaker PPAs at lower cost through the market.

16. The proposed GWF transaction is a package deal so that the elements of the transaction must be considered as a whole.

17. PG&E' proposed cost recovery through the Energy Rate Recovery Account is consistent with similar treatment in previous Commission decisions.

18. PG&E's proposal to recover stranded costs is consistent with the process set forth in D.08-09-012.

Conclusions of Law

1. The proposed GWF transaction, as a whole, is just and reasonable and should be approved.

2. The cost recovery mechanism and treatment of stranded costs proposed by PG&E are just and reasonable.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company's Application 11-07-010 is approved, including two Peaker Purchased Power Agreements with GWF (contained in Confidential Exhibits C and D to the application), and an Omnibus Agreement (contained in Confidential Exhibit B to the application) that terminates existing Qualifying Facilities Purchased Power Agreements with GWF.

2. Pacific Gas and Electric Company's requests for approval to recover costs incurred and associated with the application through a debit to its Energy Resource Recovery Account, and the recovery of stranded costs associated with the application and consistent with Decision 08-09-012, are approved.

3. The January 6, 2012 Ruling of Administrative Law Judge Gamson to grant Pacific Gas and Electric Company's July 21, September 23 and November, 2011 Motions for Leave to File Confidential Material Under Seal consistent with the confidentiality protections of D.06-06-066, Public Utilities Code Section 583 and General Order 66-C is affirmed.

4. The January 13, 2012 Division of Ratepayer Advocates Motion for Leave to File Confidential Material Under Seal is granted.

5. Application 11-07-010 is closed.

This order is effective today.

Dated ____________________________, at San Francisco, California.