Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Cost Recovery Mechanisms for Generation Procurement and Renewable Resource Development.	Rulemaking 01-10-024 (Filed October 25, 2001)

OPINION APPROVING REVISED POWER PURCHASE AGREEMENT FOR OTAY MESA GENERATING PLANT AND MODIFYING DECISION 06-02-031

Summary

This decision approves the Revised power purchase agreement (PPA) between San Diego Gas & Electric Company (SDG&E) and Otay Mesa Energy Center, LLC (OMEC), a wholly owned indirect subsidiary of Calpine Corporation (Calpine), relating to the 583 megawatt (MW) natural gas-fired combined-cycle power plant under construction in southern San Diego County (Otay Mesa plant). Previously, in Decision (D.) 04-06-011, the Commission approved a ten-year PPA between SDG&E and Calpine for the Otay Mesa plant as part of a motion by SDG&E for approval of a number of electric resources that were chosen following a request for proposal (RFP). The Otay Mesa plant was the subject of an application for rehearing that the Commission granted. Following the rehearing, the Commission again approved the ten-year PPA between SDG&E and Calpine in D.06-02-031.

SDG&E, The Utility Reform Network (TURN), Utility Consumers Action Network (UCAN), and the Division of Ratepayer Advocates (DRA) filed a Joint

Petition for Modification (Joint Petition) of the two previous Commission decisions approving the Otay Mesa PPA to reflect the fact that the PPA, while generally containing the same terms and conditions as the original PPA, has been modified. Most significantly, the PPA now includes Put and Call Options. With the inclusion of the Put and Call Options, SDG&E will have the opportunity to own and operate the plant, with a 30-year useful life, following the expiration of the ten-year PPA. In addition, the new PPA changes the commencement date for the plant's operation from January 2008 to May 1, 2009, and also includes other moderate modifications.

We grant the request to modify D.06-02-031. We approve the Revised PPA for Otay Mesa because we find that it gives SDG&E a cost-effective, local area reliable resource, with a lower long-term cost to the utility's ratepayers than the original PPA and with the option that the utility can own the plant at the expiration of the PPA. The plant will be a state-of-the-art, dispatchable, low heat-rate, clean facility in SDG&E's service territory with the potential for 30 plus years of benefits. Because the Commission granted the application for rehearing of D.04-06-011, there is no need to modify that decision.

Background

In D.04-06-011, the Commission approved a motion filed by SDG&E to enter into new electric resource contracts, including one for the Otay Mesa plant. These contracts were the result of a RFP issued by SDG&E to solicit bids to procure energy to meet its short- and long-term grid reliability needs. TURN and UCAN filed a joint application for rehearing challenging SDG&E's choice of the Otay Mesa plant as a winning bidder in the RFP. TURN and UCAN alleged that Otay Mesa was not selected as a least cost/best fit (LCBF) resource from the RFP to meet the utility's grid reliability, but instead was selected to meet

SDG&E's needs outside the scope of the RFP. In D.05-06-062, the Commission granted limited rehearing of Otay Mesa to determine if the generating plant could be approved on different grounds than as a winning bidder in the RFP.

In D.06-02-031, the Commission approved de novo, on rehearing, SDG&E's request for authorization to enter into a ten-year PPA with Calpine for Otay Mesa. The rehearing focused on whether the Otay Mesa PPA, when viewed as a bilateral contract and not as a winning bidder in the RFP, is reasonable and provides benefits to SDG&E's ratepayers. The decision found that Otay Mesa is reasonable and provides ratepayer benefits, and SDG&E was authorized to execute the PPA with OMEC.

After the Commission conducted evidentiary hearings (EH) on the rehearing phase for Otay Mesa, but before the Commission issued its decision on rehearing, on December 20, 2005, Calpine and various affiliates and subsidiaries of Calpine (but not including OMEC) filed voluntary petitions to restructure under chapter 11 of the United States Bankruptcy Code, in the U.S. Bankruptcy Court for the Southern District of New York, Case #05-60199. Therefore, in order to address concerns about Calpine's changed financial circumstances, after the Otay Mesa PPA was again approved by the Commission in February 2006, Calpine and SDG&E entered into discussions regarding modifications to the PPA. Most significantly, the parties discussed ownership and operating options, other than the ten-year PPA, for the Otay Mesa plant. The discussion continued from February through June 2006, and on June 14, 2006, Calpine and SDG&E reached an agreement whereby SDG&E would have an ownership option following the expiration of the ten-year PPA, and the plant's commencement date for operation was changed from January 2008 to May 1, 2009.

After reaching an agreement with Calpine, SDG&E continued to negotiate with the other stakeholders, TURN, UCAN, and DRA and on July 3, 2006, SDG&E, with the support of TURN, UCAN, and DRA, filed this petition for modification of D.04-06-011 and D.06-02-031.[1] As discussed further below, the Revised PPA accomplishes the primary objectives of SDG&E which is to preserve and improve upon the terms of the original PPA and get a state-of-the-art generation facility built in its service territory. The Revised PPA also creates the opportunity for SDG&E to obtain the plant at a fair and reasonable price after the expiration of the ten-year PPA. In addition, the revisions to the PPA address the concerns and objections TURN and UCAN had to the original PPA, rendering their Joint application for rehearing of D.06-02-031 moot.

EHs were held on SDG&E's original motion for approval of the electric resource contracts following the RFP, including the Otay Mesa PPA, and EHs were held de novo on the rehearing of the Otay Mesa PPA. The Commission has a complete evidentiary record on the PPA. In this Joint Petition, the parties are asking the Commission to again approve the Otay Mesa PPA, with its revisions that address the concerns TURN and UCAN had with the original PPA. Since this is an uncontested matter, there is no issue of material fact that would benefit from EHs.

Joint Petition for Modification

The Joint Petition seeks Commission approval of a revised ten-year PPA between OMEC and SDG&E, with a new on-line commencement date of May 1,

[1] Following the issuance of D.06-02-031 on February 17, 2006, TURN and UCAN filed an application for rehearing.

2009, and Put and Call options that could result in SDG&E owning the plant in 2019. The Put Option, exercisable at OMEC's sole discretion at the end of the ten-year PPA, would require SDG&E to purchase the Otay Mesa plant at a set price. The Call Option, exercisable at SDG&E's sole discretion at the end of the ten-year PPA, would require OMEC to sell the Otay Mesa plant at a set price. Pursuant to the terms of the Put Option, there would be no additional Commission review or approval required before OMEC's potential exercise of the option. At the price cost that would be significantly below that of the Net Book Value of the Palomar Energy Center[2] (Palomar) in 2019.

Under the terms of the Call Option, SDG&E would seek further Commission review and approval prior to exercising that option. The agreed upon price for Otay Mesa under the Call Option is slightly higher than the Net Book Value for Palomar in 2019, but SDG&E believes the price will be significantly less than market alternatives available at that time. However, if SDG&E's predictions are wrong and it is not economic to own Otay Mesa in 2019 at the Call Option price, then the utility does not have to exercise that option.

SDG&E argues that the addition of these Options to the PPA gives the utility the opportunity to evaluate the value of Otay Mesa at the end of 10 years in light of other possible generation projects or aging plant retirements and not be left without generation necessary to serve its grid reliability needs. This way,

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[2] Palomar is a 500 MW (base load)/555 MW (peaking load) combined cycle natural gas-fired generation plant, approved by the Commission in D.04-06-011 as part of SDG&E's request to enter into a number of electric resource contracts, including the Otay Mesa plant. Palomar is in SDG&E's service territory, is similar in size and type to Otay Mesa, and is a SDG&E owned asset. Therefore, Palomar is a comparable asset against which to evaluate Otay Mesa.

if Otay Mesa is needed and its price is competitive with other market options, SDG&E can exercise the Call Option, and if the market does not support the Call Option, SDG&E gets Otay Mesa under the Put Option at a below market price.

Other revisions to the PPA in addition to the change in the in-service start date and the Put and Call Options include the following: two forms of incentive mechanisms, output and heat-rate; increase in equity to offset additional debt; FIN 46(R)[3] filing requirements and recovery of additional costs associated from the impacts of this filing; and a request for cost allocation of the local area reliability costs of the Revised PPA to all customers in SDG&E's service territory.

No party filed opposition to the Joint Petition, and the filings by TURN/UCAN and Calpine supported the Joint Petition.

Rule 47

Pursuant to Rule 47(d) of the Commission's Rules of Practice and Procedure, a petition for modification must be filed within one year of the effective date of the decision, or the petition must explain why it could not have been presented within one year. The Joint Petition includes a Declaration setting forth the timeline of the Commission's two decisions concerning the Otay Mesa plant, as well as the intervening bankruptcy filing by Calpine. The original Commission decision on Otay Mesa issued in June 2004, the decision on rehearing issued in February 2006, and the Calpine bankruptcy filing was in December 2005. The filing of the Joint Petition in July 2006 is certainly within

[3] The Financial Standards Accounting Board (FASB) issued FASB Interpretation No. 46(R) FIN 46(R), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, in 2003 (FIN 46(R)).

one year of the decision on rehearing, and within one year of the Calpine bankruptcy filing—the triggering event that prompted the revision to the PPA.

We find that the filing of the Joint Petition in July 2006 is timely, because we are modifying D.06-02-031, issued earlier this year.

Discussion

DRA, TURN, and UCAN joined in the Joint Petition because they believe that SDG&E customers are likely to realize substantial benefits from the revised PPA for Otay Mesa. UCAN represents residential and small commercial customers in SDG&E's service territory and TURN represents ratepayer interests throughout the state, as does DRA. Although these intervenors presented arguments against the approval of the Otay Mesa PPA in both the original proceeding considering the plant, as well as during the rehearing proceeding, they now join with SDG&E in urging the Commission to approved the revised Otay Mesa PPA. In summary, although the revised PPA includes generally the same terms and conditions as the original PPA the Commission previously approved, the revisions to the PPA enhance the benefits to SDG&E's customers making it an agreement the intervenors can now support.

In particular, TURN and UCAN find that the revised PPA resolves the uncertainty associated with the Calpine bankruptcy and certain conditions precedent SDG&E had proposed for the unrevised PPA. TURN and UCAN were concerned with the status of Calpine's financial condition and what effect that would have on the viability of the PPA. Now that SDG&E has renegotiated the PPA, from TURN and UCAN's perspective, the financial risks to SDG&E's customers have been removed.

The original PPA was for a ten-year term with an on-line date of January 2008. TURN/UCAN argued against the Commission's approval of the PPA

because (1) there was no protection against the potential future exercise of market power by Calpine once the ten-year term expired; (2) it is very likely that SDG&E will need the output from Otay Mesa post 2018; and (3) there were projected low capacity factors for the first half of the ten-year term, making the asset uneconomical for SDG&E customers.

Now, however, with a delayed on-line date that mitigates the low capacity factors for the first 17 months and the Put and Call Options that ensure that the benefits of the plant continue past the initial ten-year period, TURN/UCAN believe SDG&E customers will benefit from the resource and urge the Commission's approval.

Other Benefits of Put and Call Options

As mentioned above, when the original Otay Mesa ten-year PPA had a start date of January 2008, the consumer intervenors raised questions as to the economic efficacy of the asset since SDG&E did not show a "need" for the MW output from the plant until 2010. For a ten-year PPA, that basically meant that ratepayers were paying for a baseload asset for two years when there was no demonstrable need. Now, however, with the start date delayed by 17 months, that problem is mitigated.

Also, part of the attraction of the Otay Mesa plant was its location within SDG&E's load pocket. This attraction could become a market-power liability, however, if SDG&E really needed that power upon the expiration of the ten-year PPA, and Calpine was free to charge whatever price the market would bear. Now, with the option to purchase the plant with guaranteed pricing, SDG&E's ratepayers will not be subsidizing the construction of a new generation asset, with a 30-year projected life, but only receiving benefits for 10 years. In addition, to ensure that SDG&E will only acquire a plant that is functioning well and in

good condition at the end of the ten-year delivery term, the Put and Call Options prices are contingent upon the plant being designed, constructed, operated and maintained in accordance with manufacturers' specifications and prudent industry standards.

Other Revisions to the PPA

FIN 46(R)

With the addition of the Put and Call Options to the PPA, SDG&E opines that it now has additional filing and reporting requirements with the Securities and Exchange Commission (SEC). In December 2003, FASB issued FIN 46(R), to provide guidance on the identification of and financial reporting for, entities over which control is achieved through means other than voting rights. Such entities are called variable-interest entities (VIE). SDG&E reads FIN 46(R), as applying to the Put and Call Options it has with OMEC. FIN 46(R) stipulates that a contract to purchase the entire output of a single plant entity at something other than a fixed price constitutes a "variable interest" in that entity. Furthermore, the "primary beneficiary" of a VIE's activities must consolidate the financial statements of the VIE when issuing the primary beneficiary's financial statements.

Based on a litany of factors, SDG&E reads FIN 46(R) as characterizing OMEC as a VIE. According to that interpretation, SDG&E believes that since it may likely be the owner of the power plant after the term of the Revised PPA, it will be the Primary Beneficiary of OMEC, and it will be required to consolidate the financial statements of OMEC. After consolidation, SDG&E's capital structure will have much higher leverage. Therefore, SDG&E believes it will have to increase the amount of equity in its capital structure to keep it in line

with what the Commission authorized in SDG&E's Cost of Capital decision, D.05-12-053. SDG&E is requesting rate recovery to cover this cost.

DRA, TURN, and UCAN do not take a position on SDG&E's analysis of FIN 46(R) because there has not been enough time to see how the SEC applies this new regulation. In order to not have this issue impede all the parties from supporting the Joint Petition, the parties have agreed to maximum amounts eligible for recovery pursuant to SDG&E's proposed FIN 46(R) treatment, as set forth in the Joint Petition. If future evidence suggests that SDG&E does not have to increase its equity to comply with FIN 46(R), DRA, TURN, and UCAN reserve the right to petition the Commission to adjust SDG&E's capital structure accordingly.

TURN, UCAN, and DRA caution that their position on the FIN 46(R) issue should not be regarded as a precedent for any future similar transaction. The agreed-upon caps (in nominal dollars) are as follows:

> 2009 - $16.0 million // 2010 - $15.5 million // 2011 - $15.0 million // 2012 - $14.4 million // 2013 - $13.9 million // 2014 - $13.4 million // 2015 - $12.8 million // 2016 - $12.3 million // 2017 - $11.8 million // 2018 - $11.2 million.

Incentive Mechanisms

The first incentive mechanism covers the incremental output capacity of the plant and the second covers the heat-rate. In order to ensure that OMEC designs, builds and then operates the plant under good industry standards throughout the ten-year delivery term, SDG&E designed a performance incentive that would compensate OMEC if and only if the plant maintains a

designated output capacity.[4] The incentive mechanism is spread over the ten-year delivery term to ensure that OMEC maintained this peak performance throughout the ten-year delivery term.

With respect to the heat-rate, the Otay Mesa plant is designed to utilize dry cooling instead of the wet cooling system used at Palomar. SDG&E's customers will therefore save in operation and maintenance (O&M) charges since the plant will not require the high levels of make-up water used for wet cooling. However, dry cooling technology typically uses more ancillary loading at the plant site, which reduces the net effective heat-rate of the plant. SDG&E therefore designed a performance incentive mechanism that will provide an incentive for OMEC to design, build and operate the project at the lowest possible heat-rate. The incentive is crafted to compensate OMEC for the savings that will be realized by utilizing dry cooling technology that could match the heat-rate performance of a power plant that employs wet cooling. This heat-rate incentive is also spread out over the ten-year term.

To address concerns that the consumer intervenors had regarding the additional costs for these incentive payments, SDG&E agreed to caps for both the performance and the heat-rate incentive mechanisms. In addition, if OMEC does not meet the performance thresholds, no payments will be made. SDG&E believes that the savings achieved by the increased performance and lower heat-

[4] SDG&E filed the specifics of the incentives under a Protective Order (PO) adopted on January 14, 2004, as part of R.01-10-024, the docket under which SDG&E originally filed its motion for approval of its new electric resource contracts. SDG&E asserts the position that materials submitted in this docket that pertain to its Procurement Plans are covered by this PO.

rate will exceed the performance incentive payments, netting a benefit to ratepayers.

Local Area Reliability Costs

SDG&E, and the other Joint Parties, ask that the Commission allocate a portion of the local area reliability costs of the Revised PPA to all customers in SDG&E's service territory who benefit from the addition of the Otay Mesa plant, not just to the utility's bundled customers. Thus far, SDG&E has generally been able to accomplish such an equitable cost allocation through a reliability-must-run agreement (RMR) for Palomar, and proposes the same treatment for Otay Mesa.

Since the Joint Petition was filed on July 3, 2006, the Commission issued a decision on July 20, 2006, D.06-07-029, that established a cost sharing mechanism for utilities' to spread the benefits and costs of new generation throughout their service territory. The Joint Parties ask that the Commission provide the option for SDG&E to seek cost recovery for the Otay Mesa plant under this new cost sharing mechanism, rather than RMR. The Joint Parties do not view RMR as a long-term solution, nor a superior solution, but SDG&E believes otherwise.

However, we specifically declined to extend the new cost allocation mechanism to SDG&E's Otay Mesa facility in D 06-07-029.[5] The Otay Mesa resource was chosen by SDG&E in its 2003 Grid Reliability RFP, and based on the assets chosen from that RFP, SDG&E made no showing of need in its 2004 long-term procurement proceeding (LTPP) filing. In D.06-07-029, we limited the

[5] D.06-07-029, *mimeo.*, p. 46.

application of the new cost allocation mechanism to the need findings of the LTPP proceeding, D.04-12-048. No need was found for SDG&E.

Therefore, the new cost allocation mechanism is not available to SDG&E for Otay Mesa during the PPA period. Furthermore, pursuant to D.06-07-029, if Otay Mesa does become a utility-owned asset of SDG&E at the expiration of the ten-year PPA, it would not be eligible for the new cost allocation mechanism since utility-owned assets are excluded.

SDG&E always assumed that the Otay Mesa would receive RMR treatment. SDG&E has the option of utilizing RMR treatment, or the cost sharing mechanism established in D.04-12-048, whichever option is in the best interest of its ratepayers.

Conclusion

We again authorize SDG&E to enter into a ten-year PPA with OMEC for the output from the Otay Mesa generating plant. While we have previously issued this authorization to SDG&E, once in D.04-06-011, and again on rehearing in D.06-02-031, what is before us now is a Revised PPA—an agreement that brings all of the benefits we previously found for the ratepayers of SDG&E, but with enhancements that obviate the concerns the other stakeholders, in particular DRA, TURN, and UCAN, have with the original ten-year PPA.

In D.06-02-031, we approved the Otay Mesa PPA based on our findings that the ten-year agreement would provide the following benefits:

a. Provide substantial benefits both to the customers of SDG&E and to the state as a whole.
b. Allow [SDG&E] to reduce RMR costs.
c. Provide state-of-the-art, low heat-rate, economical, clean power to SDG&E's service territory.

d. Increase overall efficiency and reliability in SDG&E's service territory.

e. Provide a cost effective "insurance policy" in the event of another energy crisis.

f. Allow older units in SDG&E['s] service territory to eventually be retired [resulting] in electric generation within SDG&E's service territory [being] much cleaner and more efficient.[6]

All of these finding are still relevant to the Revised PPA, and in fact, as already discussed, with the revisions, the plant brings even more potential benefits to SDG&E's ratepayers. In particular, the plant represents new generation—something the Commission is very concerned with having for the state as a whole. In D.06-07-029, we found that there was "a need for the state to invest in new generation in both northern and southern California in order to assure continued reliable service at a reasonable cost."[7] The Revised Otay Mesa PPA presents SDG&E, and the state, with an opportunity for a 573 MW new natural gas-fired combined cycle power plant in SDG&E's service territory that will serve both local area reliability needs for the utility, as well as benefit the electric system as a whole.

With the enhancements that make the PPA acceptable to DRA, TURN, and UCAN, we find it reasonable to approve the Revised PPA. Although we approved the original ten-year PPA in D.04-06-011, when we granted rehearing on the PPA in D.05-06-062, we considered the Otay Mesa PPA de novo. When we issued the decision on rehearing, D.06-02-031, we made findings of fact,

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[6] D.06-02-031, *mimeo.*, p. 17, citing D.04-06-011.

[7] Finding of Fact 3, D.06-07-029.

conclusions of law, and issued ordering paragraphs based on the record on rehearing. We did not rely on the previous record, nor did we incorporate it by reference into D.06-02-031. Therefore, we only modify our decision on rehearing, D.06-02-031 and the changes are contained in this decision.

Comments on Draft Decision

This is an uncontested matter in which the decision grants the relief requested. Pursuant to Pub. Util. Code § 311(g)(2), the 30-day comment period is waived.

Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Carol A. Brown is the assigned ALJ in this proceeding.

Findings of Fact

1. SDG&E, DRA, TURN, and UCAN filed a Joint Petition seeking approval of a Revised ten-year PPA between SDG&E and OMEC, for power from the 573 MW Otay Mesa gas-fired, combined-cycle power plant, with an in service date of May 1, 2009, Put and Call Options, and other minor modifications.

2. The Otay Mesa PPA was originally brought to the Commission for approval by SDG&E as part of a portfolio of winning bidders from a 2003 RFP for new electric resources.

3. In D.04-06-011, we authorized SDG&E to sign the ten-year PPA with Otay Mesa, with a start date of January 2008.

4. TURN and UCAN filed an Application for Rehearing of D.04-06-011, and in D.05-06-062, we granted limited rehearing to determine if Otay Mesa could be approved on different grounds than as a winning bidder in the RFP.

5. On December 20, 2005, Calpine filed a petition under Chapter 11 of the United States Bankruptcy Code.

6. Following de novo evidentiary hearings on rehearing, we issued D.06-02-031, approving the Otay Mesa PPA because it was reasonable and would provide ratepayer benefits.

7. SDG&E and Calpine entered into discussions to refine the Otay Mesa PPA, seeking ways to make the building and operation of the plant less risky for SDG&E ratepayers in light of Calpine's changed financial situation.

8. By June 2006, SDG&E and Calpine reached an agreement whereby SDG&E would have some ownership option following the expiration of the ten-year PPA, and the plant's commencement date was changed from January 2008 to May 2009.

9. On July 3, 2006, SDG&E, with TURN, UCAN, and DRA joining, filed a Petition for Modification of the Commission's two previous decisions approving the Otay Mesa PPA, D.04-06-011 and D.06-02-031, seeking Commission approval of a Revised PPA for Otay Mesa.

10. The Revised PPA is reasonable and provides ratepayer benefits in excess of those we previously found for the original Otay Mesa PPA because the revisions allow SDG&E to get a state-of-the-art generation facility built in its service territory and SDG&E now has an option to obtain the plant at a fair and reasonable price after the expiration of the PPA, obviating the risks associated with future resource procurement from the plant.

11. At the end of the ten-year term of the Revised PPA, SDG&E has the right to exercise the Call Option, to purchase the Otay Mesa plant at a price that compares favorably with Palomar adjusted to 2019 prices and avoids the market risk of skyrocketing prices for either the plant, or its output.

12. If market conditions in 2019 do not favor SDG&E's ownership of Otay Mesa, the utility does not have to exercise its Call Option. If OMEC exercises its

right under the Put Option, the price SDG&E will pay is significantly below the Net Book Value of Palomar in 2019 dollars.

13. The change in the in-service date for the Otay Mesa plant from January 2008 to May 1, 2009 is more beneficial and cost-effective for the ratepayers, especially when coupled with the option SDG&E has to own the plant at the end of the ten-year PPA.

14. We find the other revisions to the Original PPA, including the rate recovery to cover any filing and reporting requirements SDG&E might have with the SEC pursuant to FIN 46(R), with the agreed upon maximum amount eligible for recovery; the performance and heat incentive mechanisms with the agreed upon caps; and option for SDG&E to elect the superior cost-sharing mechanism for the allocation of the local area reliability costs to all be reasonable, in the interests of SDG&E ratepayers, and positive enhancements to the original PPA.

15. If future evidence suggests that FIN 46(R) does not require consolidation of the Otay Mesa plant with SDG&E's financials, then TURN and UCAN reserve the right to petition for an appropriate adjustment to SDG&E's capital structure. TURN, UCAN, and DRA caution that their position on the FIN 46(R) issue should not be regarded as a precedent for any future similar transaction. The agreed-upon caps (in nominal dollars) are as follows:

> 2009 - $16.0 million // 2010 - $15.5 million // 2011 - $15.0 million // 2012 - $14.4 million // 2013 - $13.9 million // 2014 - $13.4 million // 2015 - $12.8 million // 2016 - $12.3 million // 2017 - $11.8 million // 2018 - $11.2 million.

16. The Otay Mesa plant represents new generation in SDG&E's service territory, a goal that comports with our recent decision encouraging new generation for the state, D.06-07-029. SDG&E may allocate a portion of the local

area reliability costs of the Revised PPA either through RMR contracts or the cost allocation mechanism adopted in D.04-12-048, whichever option is best for ratepayers.

17. With the joinder of TURN and UCAN in the Joint Petition, TURN and UCAN's application for rehearing of D.06-02-031 is moot.

18. We find it is reasonable and in the interest of SDG&E's ratepayers to approve the revised PPA for Otay Mesa and to modify D.06-02-031 accordingly.

19. We find it is reasonable to approve the acquisition by SDG&E of the Otay Mesa plant at the end of the ten-year PPA if OMEC exercises the Put Option.

Conclusion of Law

The Revised Otay Mesa PPA is reasonable, is in the public interest, and should be approved. The Revised Otay Mesa PPA includes the Put and Call Options at the expiration of the ten-year period; the changed in-service date from January 2008 to May 1, 2009; performance and heat incentives, with caps; limited cost recovery for SDG&E if it has increased costs for filing and reporting obligation under FIN 46(R); and the option for the utility to choose the superior cost-sharing mechanism for the local area reliability costs.

O R D E R

IT IS ORDERED that:

1. The Joint Petition for Modification of Decision 06-02-031, filed on July 3, 2006, is granted as set forth herein.

2. San Diego Gas & Electric Company (SDG&E) shall execute the Revised Otay Mesa Power Purchase Agreement (PPA) with Otay Mesa Energy Center, LLC (OMEC), a wholly owned subsidiary of Calpine Corporation, which is the subject of this Joint Petition for Modification and includes the terms and conditions of the Letter Agreement filed with the Joint Petition.

3. SDG&E is authorized to record the costs of this Revised PPA in the Electric Resource Recovery Account and other appropriate accounts, depending on the cost allocation mechanism that is ultimately adopted for the Otay Mesa plant.

4. SDG&E is authorized to recover the costs, subject to the agreed upon caps and potential future adjustment to SDG&E's capital structure, associated with the equity re-balancing SDG&E deems necessary due to filing and reporting requirements of FIN 46(R) and the consolidation of the OMEC financial data with

SDG&E's quarterly and annual financial statements to the Securities and Exchange Commission.

5. Rulemaking 01-10-024 is closed.

This order is effective today.

Dated _____, at San Francisco, California.