

Decision **PROPOSED DECISION OF ALJ BROWN** (Mailed 11/17/2008)

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

Application of San Diego Gas & Electric  
Company (U902E) for Expedited Approval of the  
Miramar Energy Facility II Project.

Application 08-06-017  
(Filed June 16, 2008)

**DECISION APPROVING APPLICATION BY SAN DIEGO GAS & ELECTRIC  
COMPANY FOR THE MIRAMAR ENERGY FACILITY II PROJECT**

**1. Summary**

This decision approves the application by San Diego Gas & Electric Company (SDG&E) for a project with Miramar Energy Facility II (MEF II) for an Engineering, Procurement and Construction contract with Wellhead Services, Inc., and a contract with General Electric for the supply of a simple cycle gas-fired combustion turbine with a capacity of approximately 46.5 megawatts to provide peaking energy and capacity. The MEF II project will interconnect to the SDG&E system via the existing Miramar substation that also serves the Miramar Energy Facility I Project unit that is on the same site and was brought on-line in summer 2005. SDG&E owns the Miramar site, as well as the turbine/generator, and offered the MEF II project to the market for a competitive bid on a turnkey basis in its 2008 Peaker Request for Offers. Upon completion, the project will be owned and operated by SDG&E. SDG&E is authorized to recover in rates the cost of constructing and operating the MEF II project, consistent with the

construction-related risk and reward incentive mechanism described in this decision.

## **2. Background**

On June 16, 2008, SDG&E filed its application for approval of the MEF II project and supported the application with testimony and exhibits, including the Commission-approved Request for Offer (RFO) Solicitation Contract Approval Request (RFO Template).<sup>1</sup> The June 16, 2008 application also sought expedited approval of the project by September 4, 2008 so the unit could be on-line and available to serve SDG&E's summer 2009 peak load.

The Utility Consumers Action Network (UCAN), Western Power Trading Forum (WPTF) and MMC Energy, Inc. (MMC) filed protests and the Independent Energy Producers Association (IEP) filed a response to the application. UCAN and MMC objected to SDG&E's request for expedited approval of the project. UCAN, MMC, WPTF and IEP all questioned whether SDG&E's choice of the Engineering, Procurement and Construction (EPC) contract with Wellhead was the result of a fair competitive process, or if not, whether it met the exceptions for resources chosen outside of solicitations set forth in Decision (D.) 07-12-052.

A prehearing conference (PHC) was held on August 13, 2008 and MMC and WPTF requested evidentiary hearings (EH) on the issue of whether or not SDG&E had justified its request for expedited processing of the application, as well as EHs on the topic of whether or not the choice of the MEF II project met the Commission's specifications for procurement as established in D.07-12-052.

A telephonic PHC to calendar the EHs was scheduled for September 9, 2008. In advance of that conference, parties determined that no EHs were required for resolution of the application and a briefing schedule was set.

On September 10, 2008, an Administrative Law Judge (ALJ) ruling confirmed that no EHs were necessary, established the briefing scheduling, marked submitted testimony as exhibits and admitted the exhibits into the record.

Opening briefs were received on September 30, 2008 from MMC, IEP, WPTF and SDG&E. Reply briefs were received on October 15, 2008 from IEP and SDG&E.

### **3. Application**

SDG&E supports its application for the MEF II project on (1) Commission authorized need for new generation, (2) the competitive nature of SDG&E's 2008 Peaker RFO, and (3) and the unique qualities of the MEF II project. The testimony served in support of the application includes the RFO Template that details these factors.

#### **3.1. Need for New Resources**

To begin, SDG&E states that D.07-12-052, the most recent long-term procurement plan (LTPP) decision, approved a resource need for SDG&E's bundled customers' local and system resource adequacy (RA) requirements of 133 megawatts (MW) for already approved peakers, plus up to 400 MW of additional power depending on the approval and timing on the Sunrise

---

<sup>1</sup> SDG&E's use of the RFO Template facilitated the Commission's review of the MEF II project.

Powerlink transmission project (Sunrise). The decision opined that if Sunrise was approved and came on-line as anticipated, SDG&E would not need any additional power in addition to the 133 MW of approved peakers. SDG&E filed a Petition for Modification (PFM) of D.07-12-052 requesting additional procurement authority, even if Sunrise is approved, to meet its customers needs until power is actually available from the Sunrise project. On November 6, 2008, the Commission issued D.08-11-008 which granted SDG&E's PFM for the additional 400 MW. Therefore, SDG&E's request for the 46.5 MW associated with MEF II is within the utility's approved resource need numbers.

SDG&E also has unique local resource needs whereby the utility requires new, local generation in its service territory with or without the Sunrise Powerlink. When these resource needs are considered in light of the development and on-line date uncertainties associated with other yet-to-be built/completed projects in SDG&E's portfolio, the utility wants MEF II as a resource that can be on-line by summer 2009, as a hedge against the development risks of their other projects.

### **3.2. 2008 Peaker Request for Offers**

As SDG&E details in its RFO Template, following the summer 2006 heat storm, the utility requested, and was granted, authority to procure resources that it needed, for the time frame it anticipated.<sup>2</sup> On October 17, 2006 SDG&E issued the 2008 Peaker RFO seeking "new generating capacity resources [that] will be either turnkey projects owned by SDG&E or 25-year tolling agreements with

---

<sup>2</sup> Rulemaking 06-02-013 Scoping Memo, dated September 25, 2006 at pp. 26-27.

Respondent for the life of the resource.”<sup>3</sup> To make the projects more attractive to the bidders, the utility offered specific sites under the utility’s control, Miramar, Pala and Margarita, and also offered an already purchased turbine/generator as part of the bid package to developers. Offers at the Miramar site were limited to turnkey projects, since SDG&E already had a facility, MEF I, on the same property. SDG&E’s witness testifies that market interest in the RFO was high, and once all bids were in, the utility began the process of analyzing and comparing the merits of each entry, preparing a quantitative ranking of the bids and selecting a “short list”<sup>4</sup> of developers.

In the RFO Template, SDG&E provides details of the entire RFO process, but in summary, an offer was received for Pala, but no offers were received for projects at Miramar or Margarita. SDG&E states that it then re-offered these two sites to all other developers on its short list, other than the developer for Pala. The short-list developers were offered the opportunity to reconsider to do an EPC contract and deliver a turnkey project to SDG&E at the Miramar site. Wellhead was the only developer to express an interest in Miramar.

SDG&E then entered into a contract whereby Wellhead would utilize the turbine/generator already contracted for by the utility. As SDG&E contends, based on its conduct in the 2008 Peaker RFO, “MEF II was offered to the market via a competitive solicitation.”<sup>5</sup> In addition, all parties that participated in the RFO had the option to consider utilizing the already purchased turbines.

---

<sup>3</sup> SDG&E’s Opening Brief, September 30, 2008, p. 5, citing the RFO Template at Section II.A (p. 14).

<sup>4</sup> RFO Template, Exhibit 1, pp. 22-23.

<sup>5</sup> SDG&E Opening Brief, p. 8.

As part of the RFO process, SDG&E utilized an Independent Evaluator (IE) and consulted with its Procurement Review Group (PRG). SDG&E's RFO Template discusses the involvement of both the PRG and IE in the RFO process, and the IE submitted a Report of the Independent Evaluator (IE Report) which is attached to the RFO Template. The IE Report by PA Consulting Group was initially prepared on May 1, 2007 for the Pala and Margarita projects, and revised on June 4, 2008 to include the MEF II project at Miramar. In general, the IE Report addresses the following questions: Role of the IE; Was the IOU's Methodology for Bid Evaluation and Selection Designed Fairly?; Was the Least Cost, Best Fit (LCBF) Evaluation Process Fairly Administered?; How Did the IOU Conduct Outreach to Bidders, and Was the Solicitation Robust?; Project-Specific Negotiations; Affiliate Bids and Utility-Owned Generation (UOG) Ownership Proposals; and Code of Conduct.

Most of the IE Report was drafted to address the Pala and Margarita projects. In regards to Miramar and MEF II, PA Consulting reviewed SDG&E's financial analysis and the Miramar selection process. From the IE's review of the Miramar documents, "the selection . . . did not disadvantage any bidder at any point in the RFO. No bidders offered to build on that site, so none were eliminated in order to contract with Miramar. Furthermore the site and turbine were offered to Wellhead Power only after the shortlist was determined and all other shortlisted bidders were made the same offer. . . . Therefore, there is no unfairness in SDG&E's selecting this UOG proposal."<sup>6</sup>

---

<sup>6</sup> RFO Template, June 16, 2008, Attachment 9, SDG&E Miramar 2, IE Template, p. 7-2.

### **3.3. MEF II**

From SDG&E's perspective, MEF II is the least cost, best fit, opportunity for its ratepayers. The 46.5 MW simple cycle gas-fired combustion turbine facility will connect at the 69 kilovolt voltage level to the SDG&E system with an intertie to the MEF I facility and will provide peaking energy and capacity for meeting the utility's local and system RA as well as ancillary service needs, such as black start and non-spinning or quick-start reserves.<sup>7</sup> As an RA supply addition, the unit will be dispatchable by the California Independent System Operator (CAISO) under the RA tariff provisions.

Pursuant to the EPC contract, Wellhead will undertake the permitting, construction and testing of the project and be responsible for all pre-commercial operations permitting. During the construction period, SDG&E will provide the Miramar facility site and the turbine. Upon completion and successful passing of performance criteria, Wellhead will be relieved of its obligation under the EPC contract and once the facility is in commercial operation, SDG&E becomes the responsible owner and operator.

The total project cost for MEF II as currently projected is \$56.5 million and SDG&E's testimony indicates that is a competitive price.<sup>8</sup> SDG&E's application describes the interconnection costs to physically connect MEF II to the existing Miramar substation and the transmission system upgrades required to make the full capacity of MEF II deliverable. SDG&E proposes a construction risk/reward mechanism in which: (1) shareholders take no construction risk (and have no reward opportunities) for construction costs within 5% of the \$56.5 million

---

<sup>7</sup> RFO Template, Exhibit I, p. 29.

project cost estimate, (2) shareholders take 10% of the construction risk/reward for the band that is 5% over (or under) to 15% over (or under) the estimated project cost, and (3) cost overruns in excess of 15% of the estimated project cost are subject to recovery through a regulatory review process (and shareholders have no reward opportunities for savings resulting from actual costs being greater than 15% below the estimated project cost).

MEF II also meets the Commission's greenhouse gas (GHG) emission performance standards (EPS) for long-term contracts entered into by the investor-owned utilities (IOUs) as established in D.07-01-039. Under the EPS, a load-serving entity may enter into a long-term commitment to take power from a peaking power project (e.g., a facility with an estimated annual capacity factor less than 60%) without meeting the more stringent emissions requirements adopted in D.07-01-039. MEF II is a peaking project that will have an annual capacity factor less than 60%, and is therefore compliant with the EPS.

In addition, since MEF I is located on the site and has been on-line since summer 2005, MEF II will be built on a brownfield site consistent with Commission established procurement priorities. By utilizing an existing site, other greenfield sites will be preserved. In addition, there are certain economics that can be realized for both MEF I and MEF II since they can share common facilities.

### **3.4. Rate Treatment**

SDG&E projects that the total cost for MEF II will be \$56.5 million. The components of the revenue requirement include ratebase; return; depreciation;

---

<sup>8</sup> *Id.*, pp. 25-28, and SDG&E Opening Brief, p. 10.

taxes; and operating and maintenance expenses (O&M). SDG&E will record and recover MEF II costs as follows: non-fuel O&M and capital-related revenue requirements will be recorded in the Non-Fuel Generation Balancing Account (NFBA) for recovery from customers and fuel costs will be charged to the Energy Resource Recovery Account (ERRA). NFBA and ERRA costs are recovered through electric commodity rates applied to bundled service customers. SDG&E will seek recovery of the MEF II revenue requirement in SDG&E's next general rate case. When construction of MEF II is complete, SDG&E will file an advice letter with the Commission that provides an update of the final construction costs and associated revenue requirements.

#### **4. Discussion**

The gravamen of the opposition to MEF II was focused first on SDG&E's request for an expedited decision and then on the process by which SDG&E chose the MEF II project. To begin, numerous parties challenged SDG&E's request to expedite the application and seek a Commission decision by September 4, 2008 - less than three months after the application was filed on June 16, 2008. The Commission did not expedite the application, so that issue is moot.

WPTF and UCAN were concerned with the process that led SDG&E to choose MEF II, a utility-owned asset, and not necessarily with whether MEF II was the least-cost, best-fit resource for the utility. Following the electricity market crisis of 2000-2001, the paradigm for electricity procurement shifted from the competitive process envisioned under the 1996 electricity restructuring to a hybrid market whereby both the regulated utilities and the independent power producers compete. The Commission has signaled in numerous decisions its commitment to pursue policies and procedures that promote competition and

customer choice, while maintaining a viable and workable electricity generation sector that assures reliable service at just and reasonable rates for bundled utility customers. The Commission's preference for this end state was clearly established in D.07-12-052, the decision on the three IOUs' LTPPs for 2006-2015. D.07-12-052 recognized, however, that while the Commission is developing a functional competitive energy market, California is currently operating under a hybrid market.

D.07-12-052 stated "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>9</sup> (Emphasis in original.) The decision further explained that before a utility could bring a resource to the Commission that met the "truly extraordinary circumstances" exception, "the IOU must make a showing that holding a competitive RFO is infeasible."<sup>10</sup> The extraordinary circumstances were identified as Market Power Mitigation; Preferred Resources; Expansion of Existing Facilities; Unique Opportunity; and Reliability.

SDG&E alleges in its application that MEF II is the result of its 2008 Peaker RFO. However, because there were atypical circumstances surrounding the choice of MEF II "within the 2008 Peaker RFO," SDG&E also contends that should the Commission find that the resource was chosen outside of a

---

<sup>9</sup> D.07-12-052, p. 206.

<sup>10</sup> D.07-12-052, pp. 208-209.

competitive solicitation – MEF II meets every one of the five extraordinary circumstances listed above.

The Commission has carefully weighed SDG&E's application, supporting testimony, (including the IE's Report) and the utility's briefs in support of MEF II and we have some of the some concerns expressed by parties regarding the process through which the MEF II project was selected. It is clear that MEF II was not a winning bid from the 2008 Peaker RFO. In fact, the utility states that it invited bids for the Miramar site and did not receive a single bid to build a turnkey facility, using the turbines already owned by SDG&E. SDG&E then chronicles the steps it took utilizing other winners from the 2008 Peaker RFO, to execute the MEF II contract. While SDG&E can trace its choice of MEF II to bidders from the RFO, the relationship between the RFO and MEF II is very tenuous at best and does not give the Commission and the other parties any assurance that the resource and price were the result of a fair, open, and vigorous competitive solicitation process.

D.07-12-052 did anticipate that there could be exceptional circumstances that would justify a utility choosing a resource outside of a competitive solicitation. However, the intervenors argued that MEF II does not meet these enumerated exceptions. On November 6, 2008, the Commission issued D.08-11-008 modifying D.07-12-052. D.08-11-008 again addressed when a utility could chose a contract outside of a competitive solicitation and stated: "While extraordinary circumstances are by definition difficult to identify a priori, our

intention is to set a high bar for an “appropriate circumstance” for an IOU to circumvent the potential for private ownership by soliciting EPC bids.”<sup>11</sup>

D.07-12-052, as modified by D.08-11-008, intended to reiterate the Commission’s commitment to the competitive solicitation process, yet acknowledge that there will always be unusual, and sometimes even extraordinary, circumstances that confront the utilities and the Commission as the utilities strive to meet their procurement needs.

We concur with SDG&E’s assessment that its acute need for local capacity in its service territory by summer 2009 is an “exceptional circumstance” justifying its choice of a UOG. SDG&E is facing delays associated with a number of generation projects currently under development, and MEF II will provide peaking energy and capacity that will contribute to SDG&E meeting its local and system RA requirements.

Additionally, MEF II, as an RA supply addition to SDG&E’s portfolio, will be dispatchable by the CAISO, so the CAISO will be able to allow aging plants in SDG&E’s service territory to retire. As additional positive attributes, MEF II will be on a brownfield site (since it will be developed on a site already developed for industrial use for the Miramar I project) and meets the Commission’s GHG emissions performance standards.

The Commission finds that SDG&E needs MEF II for its bundled ratepayers and this need constitutes the “extraordinary circumstances” that D.07-12-052 and D.08-11-008 provided for as exceptions to the preferred competitive solicitation protocols. SDG&E did attempt to get MEF II built

---

<sup>11</sup> D.08-11-008, pp. 19-20.

through the 2008 Peaker RFO, and while parties can now, with hindsight, critique what the utility did or did not do concerning the site and the RFO process, the end result was no bidder bid on the MEF II project. Therefore, while we reiterate our commitment to an open, competitive process for the selection of procurement resources, we approve SDG&E's application to build and operate the MEF II project under the unique facts of this application.

Regarding the requested rate treatment for MEF II, as described earlier in the decision, SDG&E proposes a construction risk/reward mechanism in which: (1) shareholders take no construction risk (and have no reward opportunities) for construction costs within 5% of the \$56.5 million project cost estimate, (2) shareholders take 10% of the construction risk/reward for the band that is 5% over (or under) to 15% over (or under) the estimated project cost, and (3) cost overruns in excess of 15% of the estimated project cost are subject to recovery through a regulatory review process (and shareholders have no reward opportunities for savings resulting from actual costs being greater than 15% below the estimated project cost). In light of the modification to the 50/50 cost sharing requirement made in D.07-12-052, SDG&E's proposed approach is fairly consistent with the risk/reward mechanism approved by the Commission in the PG&E Gateway settlement, which we find to be a reasonable model for a mechanism of this sort, and no ratepayer advocacy group (or any party, for that matter) provided arguments against or recommended any modifications to the proposed mechanism. Consequently, we adopt the proposed mechanism, and determine that once the project is constructed and operating consistent with its design specifications, the construction costs (consistent with the adopted risk/reward mechanism) and operating costs of MEF II should be recoverable from bundled ratepayers through rates.

**5. Comments on the Proposed Decision**

Comments were filed on December 8, 2008 by SDG&E, WPTF and IEP. Reply comments were filed by SDG&E, WPTF and IEP on December 15, 2008.

SDG&E generally supports the Proposed Decision (PD), but asked the Commission to emphasize that MEF II is the “product of unique and extraordinary [ordinary] circumstances,”<sup>12</sup> and that the Commission should make more transparent its application of extraordinary circumstances to communicate clearly to the market that UOG, while held to a higher standard, is still a viable option available to a utility. Based on SDG&E’s comments, the PD was augmented to give as clear a signal as possible that we are approving MEF II because it is needed by SDG&E to ensure reliable electric service to its bundled customers and that constitutes the extraordinary circumstances exception to the preferred competitive solicitation protocol.

WPTF asks the Commission to reject MEF II on the same grounds that we granted motions to dismiss Pacific Gas and Electric Company’s (PG&E) application for Tesla in D.08-11-004. In Tesla, PG&E did not hold a competitive RFO, and we found that PG&E did 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.”<sup>13</sup> SDG&E’s situation is not exactly parallel to the PG&E/Tesla, so we decline to adopt WPTF’s suggestion to reject MEF II at this stage of the proceeding.

IEP’s comments focused on the decision’s rationale for approving MEF II and suggest that the final decision identify the “extraordinary circumstance” that

---

<sup>12</sup> SDG&E Opening Comments, p. 3.

triggers the exceptional treatment afforded MEF II.<sup>14</sup> IEP acknowledges that D.07-12-052 established a framework for procurement through a competitive solicitation, unless exceptional circumstances justified utility-owned generation, and that D.08-11-008 further clarified those exceptions: “certain extraordinary circumstances that are unpredictable in advance may necessitate utility ownership of generation at a particular site.”<sup>15</sup>

D.08-11-008, in modifying D.07-12-052, gave the Commission flexibility to determine when a confluence of factors justified the Commission approving a UOG project chosen other than through a competitive solicitation. That is the situation that is facing SDG&E and the Commission: SDG&E did conduct an RFO that included soliciting bids for the Miramar site, and the process failed to produce an acceptable bid. Other projects that SDG&E had in its procurement pipeline began to develop on-line date delays. This combination of factors led to a concern on the part of SDG&E that it might not have sufficient local area capacity in place by summer 2009 to meet its bundled customers’ reliability needs. SDG&E then took the steps it outlined in its application to secure an EPC contract for its Miramar site that could be on-line by summer 2009.

We carefully reviewed and considered IEP and WPTF’s comments and although we are approving MEF II, we are also admonishing SDG&E to have adequate procedures in place to ensure that they do not again find themselves in a reliability crisis without sufficient time to follow the procurement protocols set forth in D.07-12-052. Specifically, SDG&E must institute internal mechanisms

---

<sup>13</sup> WPTF Opening Comments, p. 4, citing D. 08-11-004, p. 2.

<sup>14</sup> IEP Opening Comments, p. 4.

that are triggered when projects run into unanticipated delays or cancellations so that the utility can conduct a “fast track” RFO and procure needed reliability resources through the competitive solicitation process. This is a subject that may be explored further in the current 2008 LTPP, R.08-02-007, or in another appropriate proceeding. In the interim, all utilities should be monitoring their procurement portfolios so they can be proactive if projected projects run into delays or failures.

#### **6. Assignment of Proceeding**

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

#### **Findings of Fact**

1. SDG&E has a need for the 46.5 MW from the MEF II project to serve the needs of its bundled electric customers for summer 2009.
2. SDG&E’s contract with MEF II for an EPC contract with Wellhead and General Electric to supply 46.5 MW of peaking capacity and energy is a reasonable option to meet the need for SDG&E’s bundled customers.
3. SDG&E conducted a 2008 Peaking RFO and offered the Miramar site and already purchased equipment to bidders for a turnkey project, but no offers were received.
4. Since no offers were received for a turnkey project at the Miramar site, the procedures SDG&E took to secure an EPC contract for the site were reasonable under the unique circumstances of this application.
5. SDG&E’s proposed construction risk/reward mechanism is reasonable.

---

<sup>15</sup> *Id.*, p. 3, citing D.09-11-008, pp. 19-20.

6. SDG&E's request to recover the costs of the MEF II project through bundled ratepayer rates is reasonable.

**Conclusions of Law**

1. The EPC contract for 46.5 MW of peaking capacity and energy, deliverable by summer 2009, on the Miramar site is reasonable and should be approved.

2. The costs of the MEF II facility should be recovered from SDG&E's bundled ratepayers.

**O R D E R**

**IT IS ORDERED** that:

1. We authorize San Diego Gas & Electric Company (SDG&E) to enter into a project with Miramar Energy Facility II (MEF II) for an Engineering, Procurement and Construction contract with Wellhead Services, Inc. and General Electric for the supply of a simple cycle gas-fired combustion turbine with a capacity of approximately 46.5 megawatts to provide peaking energy and capacity.

2. We authorize SDG&E to collect the costs of the MEF II facility through rates from its bundled ratepayers.

3. Application 08-06-017 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.