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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

RESOLUTION E-4077

April 12, 2007

RESOLUTION

Resolution E-4077: Pacific Gas and Electric (PG&E) requests approval of a tolling agreement between itself and Mirant Delta LLC (Mirant) for electricity and capacity from the Pittsburg and Contra Costa Facilities (Facilities). PG&E's Request is approved.

By Advice Letter 2874-E filed August 4, 2006

SUMMARY

AL 2874-E and the tolling agreement with Mirant is approved.

In Advice Letter (AL) 2874-E PG&E requests the Commission to find the proposed tolling agreement with Mirant for the Facilities for energy and capacity are in full compliance with all procurement authorities for all purposes including PG&E's rate recovery of payments made pursuant to this agreement, for the full duration of the agreement, subject to review in ERRRA. This agreement commences in January 2008 with agreement lengths and prices that vary depending on particular units. The agreement is for a total capacity of 1985 MW of gas fired capacity that decreases through the end of the agreement term in 2011. This tolling agreement fits within the confines of PG&E's approved Long Term Procurement Plan (LTPP), and is consistent with the requirements of Commission decisions and with the Energy Action Plan (EAP) Loading Order.

BACKGROUND

PG&E submitted AL 2874-E on August 4, 2006 seeking approval for an agreement between Mirant and PG&E for the Facilities. AL 2874-E requests the Commission to find this agreement in compliance with all procurement authorities.

PG&E claims that although they have sufficient procurement authority to enter into this agreement pursuant to D.04-12-048, they request Commission approval of this agreement due to the following factors:

- Procurement of Multiple Year RA from the Facilities complies with current requirements.
- Pittsburg 7 and Contra Costa 6 remain in service pursuant to existing procurement authorities.

D.02-10-062 lists a set of products and transaction types that PG&E may use to fill residual net open position, and D.04-12-048 approved the LTPP containing both Loading Order targets and net short positions. These decisions place a restriction on the sort of agreements into which PG&E can enter.

The Commission issued D.02-10-062 authorizing the IOUs to re-enter the process of procurement

In D.02-10-062 we ordered the IOUs to recommence procurement and to facilitate more long term planning. The decision set January 1, 2003 for the commencement of IOU driven procurement, and for implementation of AB 57. This decision approved short term procurement plans, but maintained the flexibility for the Commission to create more structure later. It also authorized the IOUs to enter into agreements of less than five years in duration, and authorized a list of procurement products and transactions into which the IOUs can enter. Preparation and approval of LTPPs were left until a later decision.

D.04-12-048 found reasonable and approved Long Term Procurement Plans (LTPPs) for the 3 IOUs.

D.04-12-048 extended the procurement authority of IOUs to ten years, and maintained the requirement to consult with the Procurement Review Group (PRG). Specifically the decision found reasonable PG&E's Net Short Position and resource scenarios and found its bottom up approach with respect to the Loading Order to be in compliance. This decision updated and reiterated the findings of D.02-10-062. In closing its net open position, PG&E is restricted to a set of authorized products and types of transactions authorized in its LTPP.

PG&E issued RFO9 and chose Mirant's offer for the Facilities and subsequently Mirant issued a Request for Bids for the Facilities and selected PG&E's Offer.

On December 8, PG&E issued Request for Offer Number 9 (RFO9) to address needs for intermediate term shapeable energy. Eight companies, including Mirant, submitted offers totaling 8000 MW of capacity. On December 19, 2005 Mirant issued a RFP for the Facilities and PG&E developed an indicative offer. On January 12th, PG&E presented their intended offer to their PRG group highlighting Mirant's high value compared to other offers, and on January 13th, they submitted their indicative offer to Mirant. Thereafter PG&E received notification that they had been placed on Mirant's shortlist and continued to negotiate an agreement.

On June 15th PG&E notified the PRG that it intended to move forward with this agreement and asked the PRG for final questions or feedback. PRG members responded with endorsement of this offer's valuation compared to other offers, and PG&E concluded this agreement before submitting the agreement to the CPUC for approval on August 4th.

The tolling agreement between PG&E and Mirant is for 1985 MW of electricity and capacity from Pittsburg units 5, 6, and 7, and Contra Costa units 6 and 7. PG&E and Mirant separated the agreement into two parts, one for the calendar year of 2007 which was filed in their quarterly transaction reports and the other part, contained in AL 2874-E, covered the period from January 1, 2008 through October 31, 2011. The agreement's obligation as to duration and price vary by unit. The total capacity decreases over the life of the contract. The pricing of the agreement is based on the combined term of the two parts.

NOTICE

Notice of PG&E AL 2874-E was made by publication in the Commission's Daily Calendar. PG&E mailed a redacted copy of the Advice Letter and distributed it in accordance with Section III-G of General Order 96-A.¹

¹ GO 96-B, effective July 1, 2007, will reorder the sections, but do not modify these requirements. They are in Section 4.3 of GO 96-B. GO 96-A governed when PG&E filed AL 2874-E

PROTEST

No protests were filed.

DISCUSSION

PG&E requested that the Commission decide via approved resolution that their actions in entering into this agreement are in compliance with existing procurement authorities and specifically the following:

1. PG&E's entrance into this agreement is in compliance with all existing procurement authorities for all purposes including recovery of rates via the ERRRA proceeding for the entire term of the agreement.
2. Procurement of Multiple Year RA from the Facilities complies with current requirements.
3. Pittsburg 7 and Contra Costa 6 remain in service pursuant to existing procurement authorities.

In D.04-12-048 we established a list of specific criteria from which to judge whether an agreement is in accordance with the policies and procurement requirements.² Specifically PG&E must demonstrate:

1. that there is a residual energy or capacity need to be met with this transaction;
2. this transaction fits within the EAP Loading Order only after cost effective higher order resources are procured first;
3. that this transaction occurs via approved transaction types, and PG&E is transacting in approved products for approved durations;
4. the RFO was open to all offers and transparent, within the constraints of the product offered;
5. that the product transacted gives the highest ratepayer value compared with alternatives using the Least Cost Best Fit Methodology; and
6. that the RFO, bid valuation, and selection were thoroughly reviewed with the PRG

² D.04-12-048, page 154, exempts contracts of five years or less from the requirement to add a GHG adder to all fossil bids.

PG&E requested findings

Rate Recovery via ERRA Proceeding

We have outlined the process for balancing the ERRA accounts and tracking administration of power procurement agreements, and reaffirm that this process is the correct one for determining rate recovery.³ PG&E's payments according to this agreement are procurement costs, and can be recorded directly into the ERRA balancing account consistent with existing Commission policy.

Multi-year RA

It is our intention to facilitate and encourage long term planning, and have determined to take up the issue of multi-year RA contracts in Phase 2 of Rulemaking 05-12-013. The terms and conditions of AL 2874-E do not dispute our authority to develop RA rules through the RA program, or whatever successor agency manages a future RA program. We believe there is sufficient certainty in this program over the four year term of the agreement to warrant forward contracting for RA capacity, and that AL 2874-E does not ask us to prejudge future policy decisions regarding counting conventions and resource requirements.

Retirement of Pittsburg 7 and Contra Costa 6

AL 2874-E seeks approval of an agreement with a package of five units located at the Pittsburg and Contra Costa Plants including two (Contra Costa 6 and Pittsburg 7) that had previously filed with the CAISO to retire if they did not reach an agreement that would allow them to remain in operation. This agreement provides revenue to Mirant to continue to operate these two plants, and these two plants have rescinded their offer to retire. PG&E's entrance into this agreement is consistent with PG&E's procurement authorities.

³ D.02-10-062 pages 62-64

Residual Energy and Capacity Need

PG&E demonstrates its residual need via a set of energy and capacity tables required by D.04-12-048 and updated in AL 2643-E and 2643-E-A. The Energy Division has reviewed these tables and determined a projected need for energy and capacity, especially hour ahead dispatchable and shapeable energy and Local RA capacity. This agreement provides PG&E with sufficient shapeable local resources to meet their projected need through the term of this agreement as current resource commitments begin to expire.

Compliance with the EAP Loading Order

The EAP Loading Order, published May 8, 2003 and endorsed again in D.04-12-048, contains explicit direction regarding the state's preferences for meeting identified resource needs, and the IOUs are to prioritize their resource selections accordingly.⁴ Cost effective procurement of Demand Response (DR), Distributed Generation (DG), and Renewable Energy (RE) are to occur prior to any procurement of fossil resources.

In D.04-12-048 we chose to accept compliance with the EAP by finding that the LTPPs "are EAP-compliant to the extent they include EAP targets established in the RPS, DR and EE proceedings; included, at a minimum, the DG forecasts in the 2003 IEPR, and added transmission and clean central-station generation to meet remaining energy and capacity needs."⁵ Chapter 4 of PG&E's LTPP laid out the goals for the growth of DR, DG, and RE in a table alongside projections of need for fossil resources. Chapter 4 discussed the "bottom-up" methodology that PG&E would use to compute residual need for cost effective fossil generation after all the higher order resources are accounted for and subtracted. In order to protect resource mixes and other commercially sensitive information, we merely say here that this agreement does not constitute a departure from the EAP, since it is in line with PG&E's LTPP and fits within the residual net short after preferred higher order resource targets are carved out.

⁴ D.04-12-048, page 31

⁵ D.04-12-048, page 45

Types of Approved Transactions and Products

D. 02-10-062 lists a set of approved products and transactions, including the terms of this agreement. An RFO for energy and capacity is approved. PG&E also has authority to enter into a tolling agreement with duration of under five years.⁶

Open and Transparent RFO

D.04-12-048 requires that RFOs be open to all sources and be conducted transparently and without prejudice towards utility owned generation or counterparty. IOUs have the option however “to tailor their RFOs to reflect their specific resource needs.”⁷ This RFO for shapeable energy is a type of specific resource need; PG&E would need to show in issuing RFO9, through which Mirant bid the Facilities, that there was no restriction other than particular product specifications that encouraged or discouraged particular products from bidding. Of primary concern is bias towards utility owned generation, and bias against renewable or other non-central station fossil fuel.

Part of the determination is made by examination of the specific RFO language, and part is made via survey of the PRG materials presented regarding the RFO and from the general determination of PRG recipients.

The language from the RFO makes clear the exact and precise product being solicited by PG&E. The RFO solicits offers for flexible dispatchable resources with an hour ahead and real time call option and a minimum size of 25 MW. Resources with day ahead and less flexibility were not accepted. A 25 MW minimum offer is warranted due to the magnitude of the needed capacity sought in the RFO. We see it as reasonable that PG&E is trying to more efficiently procure resources, and we find the 25 MW minimum offer to be warranted.

PG&E has the authority to issue RFO9 for shapeable energy, and within the technical and operational limits of the product, we find that the RFO was open and transparent. Of importance is the nature and quality of the bids. Significantly, no renewable generator bid into this RFO, as well as no

⁶ D.02-10-062, page 37-38

⁷ D.04-12-048, page 218

one with dispatchability concerns. Also of note is that PG&E has no affiliates, and the only bids were from truly independent facilities.⁸

Highest Value to Ratepayers via Least Cost Best Fit

D.04-12-048 requires the use of Least Cost - Best Fit (LCBF) methodology⁹. Application of this methodology can be verified via PRG comments and presentations of valuation. PG&E demonstrated via the PRG presentations on January 12, 2006 that as a package, Mirant's combined offer for the Facilities held the most value when taking into account the value of Local RA, which this agreement provides. Mirant's offer also gives PG&E full dispatch rights to the unit including ancillary services.

We are convinced that the methodology has been used adequately here, and that this agreement provides positive and maximized value to ratepayers, relative to the other offers in RFO9.

Consultation with PRG

PG&E consulted with the PRG on various occasions through the development and execution of RFO9. PG&E presented needs analysis both with and without this contract to the PRG on January 12th, 2006 along with a valuation of the various offers received. On February 27th, PG&E presented the final arrangements for this offer to the PRG, and reiterated the valuations and need analysis for the PRG on June 15th, 2006 before giving PRG members the opportunity to submit comments before PG&E filed this offer. The responses from the PRG were in support of the economics of this deal, and were submitted to the Energy Division during evaluation of AL 2874-E.

PRG participants are also allowed and encouraged to submit support, opposition, or analysis to the Commission via comments during the Advice Letter protest period, but none did.

⁸ D.04-12-048, page 217, finding of Fact No. 84 lifts the ban on dealing with affiliates in RFOs, but requires an Independent Evaluator when affiliates are present in the bids.

⁹ D.04-12-048, page 127, orders IOUs to use "Qualitative and quantitative attributes include performance risk, credit risk, price diversity (10 vs. 20 yr. price terms), and operational flexibility etc." when evaluating bids in an all source RFO.

PG&E's entrance into this tolling agreement is in compliance with all procurement authorities

Due to the preceding discussion, we are convinced that PG&E's entrance into this tolling agreement is in compliance with all procurement authorities, for all purposes including rate recovery for the entire duration of the agreement. We are satisfied that the specific contracting requirements established in D.02-10-062 and D.04-12-048 are met, and that this agreement fits within the restrictions of PG&E's approved LTPP. This agreement represents positive ratepayer value through use of the Least Cost Best Fit methodology.

COMMENTS

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to PU Code 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

FINDINGS

This resolution finds:

1. On August 4, 2006, PG&E filed AL 2874-E requesting approval of a tolling agreement between Mirant and PG&E for 1985 MW of energy and capacity from the Facilities lasting from January 2008 through October 2011.
2. PG&E has demonstrated sufficient residual need for capacity and shapeable energy that this agreement will fulfill via AL 2643-E and 2643-E-A and PRG presentations.
3. We find that although the RA program is developing, there is sufficient structure to allow PG&E to pursue multi-year RA products, given that the agreement specifically realizes our oversight of the eventual counting rules, and our prerogative to change rules as the program evolves.
4. PG&E must use the ERRRA proceeding in order to recover in rates the procurement costs related to this agreement. AL 2874-E does not seek nor have we granted exception to that rule.

5. PG&E's entrance into this contract to continue operation of the Contra Costa 6 and Pittsburg 7 units is consistent with PG&E's procurement authorities.
6. D.04-12-048, by approving the LTPP, also determined that PG&E has satisfied the requirements of the EAP Loading Order. This tolling agreement does not prevent the cost effective procurement of higher order resources; this tolling agreement fits within the residual need after said resources are procured.
7. PG&E can enter into a tolling agreement lasting less than five years for energy and capacity through a public RFO, under authority granted by the Commission.
8. RFO9, for shapeable energy, fulfilled the requirement that the RFO was open to all sources, given the constraints of the product being solicited.
9. PG&E has demonstrated that the Mirant agreement is preferred in terms of economic value via application of the LCBF methodology.
10. PG&E has satisfied D.04-12-048 by consulting with the PRG prior to the issuance of the RFO and throughout the bidding and contracting process. The PRG has provided useful comment and oversight in the method of valuation and ranking of offers.
11. The entry of PG&E into this agreement is in compliance with all procurement authorities for all purposes of rate recovery during the duration of the agreement.

THEREFORE IT IS ORDERED THAT:

1. The request of PG&E for Commission approval of a tolling agreement between itself and Mirant for capacity and energy from the Facilities, to begin January 1, 2008 and continue to October 31, 2011, entitled Multi year tolling agreement for the Contra Costa Facility and Pittsburg Facility, dated July 28, 2006 is approved.
2. PG&E shall track expenses incurred from the operation of this tolling agreement in its ERRA account which shall be subject to Commission jurisdiction via the ERRA proceeding.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on April 12th, 2007.

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
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DIAN M. GRUENEICH
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Commissioners