

Decision 10-07-042 July 29, 2010

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Approval of Agreements Related to the Novation of the California Department of Water Resources Agreement with GWF Energy LLC, Power Purchase Agreement with GWF Energy II LLC, and Associated Cost Recovery (U39E).

Application 09-10-022
(Filed October 16, 2009)

And Related Matter.

Application 09-10-034
(Filed October 30, 2009)

**DECISION APPROVING ONE POWER PURCHASE AGREEMENT
AND CONDITIONALLY APPROVING TWO OTHER POWER
PURCHASE AGREEMENTS**

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**DECISION APPROVING ONE POWER PURCHASE AGREEMENT
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PURCHASE AGREEMENTS**

1. Summary

In Application (A.) 09-10-022 and A.09-10-034, Pacific Gas and Electric Company (PG&E) requests approval of three transactions. The purpose of the transactions is to novate existing power purchase agreements (PPAs) from the California Department of Water Resources to PG&E, and then replace the novated agreements with new long-term PPAs. The new PPAs would procure 1,090 megawatts (MW) of fossil-fuel capacity, including 254 MW of new capacity.

Today's decision approves the Peakers Transaction under which PG&E will procure 502 MW of capacity, energy, and ancillary services from existing facilities through 2017, and 325 MW through 2021.

Today's decision grants conditional authority for PG&E to proceed with the Tracy Transaction and the Los Esteros Critical Energy Facility (LECEF) Transaction, which together provide 588 MW of capacity, including 254 MW of new capacity. Specifically, today's decision requires PG&E to proceed immediately with both of these transactions if PG&E's request for approval of the proposed Marsh Landing Project and/or Oakley Project is denied in A.09-09-021. If other events occur that create an unfilled need for the new capacity authorized by Decision 07-12-052 or subsequent decisions, PG&E may resubmit one or both of these transactions for Commission approval via a Tier 3 advice letter.

2. Background

2.1. Procedural Background

Pacific Gas and Electric Company (PG&E) filed Applications (A.) 09-10-022 and A.09-10-034 on October 16 and October 30, 2009, respectively. In these applications, PG&E requests Commission approval of three transactions involving ten contracts. If approved, each transaction would novate a power purchase agreement (PPA) from the California Department of Water Resources (DWR) to PG&E,¹ and replace the novated agreement with a new long-term PPA. Together, the three transactions would procure 1,090 megawatts (MW) of fossil-fuel capacity under new long-term PPAs, including 254 MW of new capacity.

The ten contracts contain confidential information regarding prices, terms, and conditions of electric procurement. Therefore, as allowed by Decision (D.) 06-06-066, PG&E filed the contracts under seal. Although PG&E has disclosed summary information about the contracts, the prices for capacity and other significant terms and conditions are confidential.

A prehearing conference (PHC) for both applications was held on December 16, 2009. The two applications were consolidated in a ruling issued on December 21, 2009. An Assigned Commissioner's Ruling and Scoping Memo (Scoping Memo) was issued on January 5, 2010.

PG&E served written testimony concurrently with each application, and supplemental testimony on January 11, 2010. The intervenors served testimony on January 15, 2010, and parties served rebuttal testimony on January 22, 2010. The Scoping Memo provided that an evidentiary hearing would be held if

¹ Novation is the substitution of a new contract for an existing one. Novation completely extinguishes the earlier contract. (Decision (D.) 08-11-056 at 9.)

requested by the parties. There were no requests for an evidentiary hearing and none was held. The written testimony was admitted into the record pursuant to Rule 13.8 of the Commission's Rules of Practice and Procedure (Rule). Opening and reply briefs were filed on January 29 and February 5, 2010, respectively.

The following intervenors participated actively in this proceeding: the Alliance for Retail Energy Markets jointly with the California Large Energy Consumers Association (together, AReM/CLECA); Californians for Renewable Energy (CARE); California Unions for Reliable Energy (CURE); Calpine Corporation (Calpine); the Division of Ratepayer Advocates (DRA); GWF Energy LLC (GWF); the Independent Energy Producers Association (IEP); Pacific Environment; and The Utility Reform Network (TURN).

2.2. Regulatory Background

In order to understand and evaluate PG&E's applications, it is necessary to first review the Commission's policies regarding (1) the novation of DWR contracts, and (2) long-term PPAs.

2.2.1. Novation of DWR Contracts

During the energy crisis of 2000 - 2001, PG&E and other investor-owned utilities (IOUs) could not buy electricity for their customers.² In response, the Legislature authorized DWR to purchase electricity under long-term PPAs and to resell the power to the retail customers of the IOUs. DWR eventually executed 59 long-term PPAs, including three that are the subject of today's decision. In

² The IOUs are PG&E, Southern California Edison Company, and San Diego Gas & Electric Company.

D.02-09-053, the Commission allocated the cost responsibility for the DWR contracts among the IOUs.

Most of the DWR contracts have a novation clause that gives DWR the right to transfer the contract “as is” to a financially solvent IOU. In D.08-11-056, the Commission determined that it is in the public interest to phase out DWR’s role in supplying electric power to utility customers and identified several benefits from doing so.³ To achieve this goal, D.08-11-056 directed the IOUs to seek ways to replace DWR as the buyer in their allocated contracts, either through the novation of the DWR contracts or the replacement of the DWR contracts with new bilateral agreements between the IOUs and power suppliers.⁴

D.08-11-056 delegated oversight of the novation/replacement process to the assigned Commissioner and the assigned Administrative Law Judge. They issued a joint ruling on February 4, 2009, that provided guidance regarding the process for negotiating novation and replacement agreements and the standard of review for such agreements (hereafter, “the Implementation Ruling”).⁵

2.2.2. Long-Term Procurement Contracts

The Commission is required by Pub. Util. Code § 454.5 to adopt a long-term procurement plan (LTPP) for each IOU.⁶ The Commission adopted PG&E’s current LTPP in D.07-12-052. Under its adopted LTPP, PG&E has a need

³ D.08-11-056 at 3, 9 - 10, and 29 - 34.

⁴ D.08-11-056 at 3 and Ordering Paragraph 1.

⁵ Assigned Commissioner and Administrative Law Judge’s Ruling Regarding Implementation Measures For Phase II(A)(2), issued February 4, 2009, in Rulemaking 07-05-025, at 8 - 11 and Ruling Paragraphs 4 and 8.

⁶ All statutory references are to the Public Utilities Code unless otherwise indicated.

to procure 800 MW to 1,200 MW⁷ of new capacity by 2015 and is authorized to execute long-term PPAs for this new capacity, subject to the Commission's review and approval.

3. PG&E's Applications

3.1. Summary of A.09-10-022 and the Tracy Transaction

In response to the energy crisis of 2000 – 2001, DWR executed a contract with GWF Energy II LLC (GWF) to provide 340 MW of capacity from three facilities (the "DWR-GWF Contract"). Each facility has two gas turbines. The Hanford Facility (88 MW) and the Henrietta Facility (88 MW) are located in the cities of Hanford and Lemoore, respectively, in Kings County. The Tracy Facility (164 MW) is located near the city of Tracy in San Joaquin County. The Hanford, Henrietta, and Tracy Facilities came online in 2001, 2002, and 2003, respectively.

The DWR-GWF Contract provides DWR with capacity and energy from the Hanford and Henrietta Facilities through December 2011, and from the Tracy Facility through October 2012. The cost responsibility for the contract was allocated to PG&E by D.02-09-053.

The DWR-GWF Contract is a fuel-conversion agreement, meaning that DWR buys the fuel and arranges to transport it to the facilities. GWF is then paid to convert the fuel into energy.⁸ The contract places limits on the maximum number of starts per month, the annual run hours, and ramp rates.

⁷ MW values are expressed in July peak operating conditions.

⁸ All the PPAs that are the subject of today's decision are fuel-conversion agreements.

In A.09-10-022, PG&E requests approval of five contracts that PG&E has signed with affiliates of GWF (referred to individually and together as “GWF”). These contracts are referred to collectively as “the Tracy Transaction.” The purpose of the Tracy Transaction is to (1) novate the existing DWR-GWF Contract to PG&E, and (2) enter a new 10-year PPA under which GWF will provide 299 MW of capacity, energy, and ancillary services to PG&E from an expanded Tracy Facility. PG&E represents that the five contracts are a package deal, and that all five contracts must be approved together or rejected together.

The five contracts that comprise the Tracy Transaction are as follows:

1. **The Tracy Novation Agreement** is a contract among DWR, GWF, and PG&E to novate the DWR-GWF Contract so that PG&E becomes the buyer under the DWR-GWF Contract and DWR is released of all its obligations.

2. **The Tracy Replacement Agreement** supersedes the novated DWR-GWF Contract. The Replacement Agreement is essentially identical to the novated DWR-GWF Contract, except that: (1) Contract provisions that are unique to a California state agency are removed; (2) obsolete provisions about the initial operating dates are deleted; and (3) PG&E receives increased operating flexibility in the form of ancillary services and reduced minimum run times for the Hanford and Henrietta facilities. The increased operating flexibility provides added customer benefits relative to the existing DWR-GWF Contract.

3. **The Tracy Market Redesign and Technology Update (MRTU) Agreement** modifies the Tracy Replacement Agreement to reflect the parties’ obligations under the MRTU program of the California Independent System Operator (CAISO), such as the way participants schedule energy and the processes by which transactions are settled.

4. **The Tracy Upgrade PPA** expands the Tracy Facility from 154 MW to 299 MW (an increase of 145 MW) by converting the facility into a combined-cycle gas turbine (CCGT) facility. The expanded facility (hereafter, “the Tracy Upgrade”) is scheduled to begin operations on June 1, 2013, but GWF may accelerate the online date to June 1, 2012. PG&E will buy capacity, energy, and ancillary services from the Tracy Upgrade for a 10-year period.

The air-cooled Tracy Upgrade is designed for flexible operations and ancillary services, including spinning reserves and regulating reserves. PG&E will have full dispatch rights, which will help PG&E to (1) meet its local reliability and resource adequacy obligations, and (2) integrate a growing amount of intermittent renewable generation.

PG&E selected the Tracy Upgrade from the many bids it received in response to its 2008 long-term request for offers (LTRFO). To demonstrate the Tracy Upgrade PPA is a good deal, PG&E provided a comparison of the levelized net market value of the Tracy Upgrade PPA to other short-listed bids. The comparison is confidential and was filed under seal.

5. **The Tracy Transition Agreement** will enable GWF to accelerate the online date of the Tracy Upgrade by modifying the Tracy Replacement Agreement. Under the Tracy Replacement Agreement, deliveries from the Hanford and Henrietta Facilities end on December 31, 2011, and deliveries from the Tracy Facility end on October 31, 2012. Under the Transition Agreement, deliveries from the Tracy Facility will be reduced one year to October 31, 2011. To replace the lost capacity, deliveries from the Hanford and Henrietta Facilities will be extended one year to December 31, 2012. Ending deliveries from the Tracy Facility one year early will allow GWF to construct the Tracy Upgrade sooner so that its online date can be accelerated from June 1, 2013 to June 1, 2012.

Substituting the Tracy Facility with the Hanford and Henrietta Facilities for a one-year period will lower costs for PG&E's customers because the Hanford and Henrietta Facilities are more flexible and efficient. PG&E will also pay less in 2012 for capacity from the Hanford and Henrietta Facilities than PG&E would pay for the same capacity in 2011 under the DWR-GWF Contract.⁹

PG&E calculates the Tracy Replacement Agreement, as modified by the Transition Agreement, has a levelized net market value that is superior to the DWR contract it replaces. The details and results of PG&E's calculation are confidential and were filed under seal.

3.2. Summary of A.09-10-034

In A.09-10-034, PG&E requests Commission approval of five contracts and two transactions with affiliates of Calpine Corporation (referred to individually and collectively as "Calpine"). The transactions are summarized below.

3.2.1. The LECEF Transaction

During the energy crisis of 2000 – 2001, DWR executed a contract with Calpine to provide 180 MW of capacity from four gas turbines at the Los Esteros Critical Energy Facility (LECEF Facility) in Santa Clara County (hereafter, "the DWR-LECEF Contract"). The LECEF Facility came online in 2003. The DWR-LECEF Contract expires on December 31, 2012. The cost responsibility for the contract was allocated to PG&E by D.02-09-053.

In A.09-10-034, PG&E requests approval of three contracts with Calpine regarding the LECEF Facility. These contracts are referred to collectively as "the LECEF Transaction." The purpose of the LECEF Transaction is to (1) novate the

⁹ PG&E Opening Brief at 3.

existing DWR-LECEF Contract to PG&E, and (2) enter a new 10-year PPA under which Calpine will provide 289 MW of capacity, energy, and ancillary services to PG&E from an expanded LECEF Facility. PG&E represents that the three contracts are a package deal, and that all three contracts must be approved together or rejected together.

The three contracts that comprise the LECEF Transaction are as follows:

1. **The LECEF Novation Agreement** is a contract among DWR, Calpine, and PG&E to novate the DWR-LECEF Contract so that PG&E becomes the buyer under the DWR-LECEF Contract and DWR is released of all its obligations.

2. **The LECEF Replacement Agreement** supersedes the LECEF Novation Agreement. The Replacement Agreement is essentially identical to the novated DWR-LECEF Contract, except that 180 MW of local capacity will be provided from other Calpine facilities during 2012 instead of from the LECEF Facility. This provision will facilitate the construction of the LECEF Upgrade described below. The replacement capacity will be provided by Calpine's Gilroy Energy Center (100 MW to 110 MW) and other Bay Area resource adequacy facilities (70 MW to 80 MW). The replacement facilities will be more flexible and fuel efficient than the LECEF Facility, which will lower costs for PG&E's customers.

PG&E calculates that the LECEF Replacement Agreement has a levelized net market value that is superior to the DWR contract it replaces. The details and results of PG&E's calculation are confidential and were filed under seal.

3. **The LECEF Upgrade PPA** expands the LECEF Facility from 180 MW to 289 MW (an increase of 109 MW) by converting the existing facility into a CCGT facility. The expanded facility (hereafter, "the LECEF Upgrade") is expected to be on line by July 1, 2013. PG&E will buy capacity, energy, and ancillary services from the LECEF Upgrade for a 10-year period.

The air-cooled LECEF Upgrade is designed for flexible operations and ancillary services, including spinning reserves, regulating reserves, and two starts per day. PG&E will have full dispatch rights, which will help PG&E to (1) meet its local reliability and resource adequacy obligations, and (2) integrate a growing amount of intermittent renewable generation.

PG&E selected the LECEF Upgrade from the many bids it received in response to its 2008 LTRFO. To demonstrate that the LECEF Upgrade PPA is a good deal, PG&E provided a comparison of the levelized net market value of the LECEF Upgrade PPA to other short-listed bids. The comparison is confidential and was filed under seal.

3.2.2. The Peakers Transaction

During the energy crisis of 2000 - 2001, DWR executed a contract with Calpine to provide peaking capacity from 11 gas turbines located at ten facilities (the “DWR-Peakers Contract”). The ten facilities have a combined capacity of 502.6 MW. The contract capacity is 495 MW. The facilities are listed below:

Peaker Facility	Capacity (MWs)
Gilroy 1 & 2	91.5
Gilroy 3	45.8
King City	43.3
Yuba City	45.8
Feather River	45.8
Riverview	45.8
Creed Energy Center	47.2
Wolfskill	45.8
Lambie Energy Center	45.8
Goose Haven	45.8
Total Capacity	502.6
Contract Capacity	495.0

DWR's dispatch rights are limited to 2,000 hours per year, and only during peak hours in the months of May-October and December-January. DWR does not have unit-specific dispatch rights, so DWR can call on an amount of capacity but not from specific units. Because of this limitation, certain Peaker units have been designated by CAISO as Reliability-Must-Run (RMR) units that receive extra payments under CAISO's interim capacity procurement mechanism.

The cost responsibility for the DWR-Peakers Contract was allocated to PG&E by D.02-09-053. The contract expires on July 31, 2011.

In A.09-10-034, PG&E requests Commission approval of two contracts with Calpine regarding the Peakers Facilities. These contracts are referred to collectively as the "Peakers Transaction." The purpose of the Peakers Transaction is to (1) novate the existing DWR-Peakers Contract to PG&E, and (2) execute a new long-term PPA for the same 11 Peaker units. PG&E represents that the two contracts are a package deal, and that both contracts must be approved together or rejected together.

The two contracts that comprise the Peakers Transaction are as follows:

1. **The Peakers Novation Agreement** is a contract among DWR, Calpine, and PG&E to novate the DWR-Peakers Contract so that PG&E becomes the buyer under the DWR-Peakers Contract and DWR is released of all its obligations.

2. **The Peakers PPA** replaces the Peakers Novation Agreement. Under the Peakers PPA, Calpine will provide 502 MW of capacity, energy, and ancillary services to PG&E through December 31, 2017, and 325 MW through

December 31, 2021.¹⁰ There will be no physical changes to the Peaker Facilities as a result of the Peakers Transaction.

The Peakers PPA will provide PG&E with expanded operational flexibility, including (1) unit-specific dispatch at any time, (2) an increase in the annual hours that each unit can be dispatched, and (3) expanded dispatch range for each unit. The increased operational flexibility will help PG&E to ensure local reliability, satisfy resource adequacy obligations, and integrate intermittent renewable generation. PG&E will be able to claim the local capacity attributes of individual Peaker units for resource adequacy purposes, which should eliminate the need for CAISO to designate certain Peaker units as RMR resources.¹¹

The Peakers PPA was not procured through a competitive process such as the 2008 LTRFO. To demonstrate the Peakers PPA is a good deal, PG&E provided a calculation that shows the Peakers PPA has a positive levelized net market value. The details and results of PG&E's calculation are confidential and were filed under seal.

3.3. Compliance with Commission Policies

PG&E submits that the proposed Transactions comply with the following Commission policies and requirements.

¹⁰ The Peakers PPA provides PG&E with unit-specific dispatch rights and local capacity in the Bay Area (Gilroy, Riverview, Creed, Lambie, and Goose Haven) through December 31, 2021. The contract also provides PG&E with unit-specific dispatch rights and local capacity outside the Bay Area (Feather River and Yuba City) and system capacity (King City and Wolfskill) through December 31, 2017.

¹¹ PG&E estimates that in 2009, RMR designations for certain Peaker units will result in payments to Calpine of approximately \$5 million.

3.3.1. Novation of DWR Contracts

In D.08-11-056, the Commission directed the IOUs to endeavor to novate or replace the DWR contracts stemming from the 2000 – 2001 energy crisis. Each of the proposed transactions accomplishes this objective by novating and replacing an existing DWR contract.

3.3.2. Emissions Performance Standard

In D.07-01-039, the Commission adopted the emissions performance standard (EPS) for long-term PPAs. The EPS applies to:

1. Contracts that have a term of five years or longer, and
2. Generating facilities that are designed and intended to provide electricity at an annualized capacity factor of 60% or greater.

If both (1) and (2) apply, the facility's carbon dioxide (CO₂) emissions must be less than 1,100 pounds per MW hour (lbs/MWh).¹² PG&E represents that the proposed transactions comply with the EPS for the reasons set forth below.

The Tracy Replacement Agreement, as amended by the Tracy Transition Agreement, has a term of less than five years. Accordingly, the EPS does not apply to the Agreement.

The Tracy Upgrade PPA procures 299 MW of capacity for a period of 10 years. PG&E estimates the Tracy Upgrade will emit CO₂ at a rate of 916 lbs/MWh without duct firing, and 980 lbs/MWh with duct firing. Because these values fall below the cap of 1,100 lbs/MWh set by D.07-01-039, the Tracy Upgrade PPA complies with the EPS.

The LECEF Replacement Agreement has a term of less than five years. Accordingly, the EPS does not apply.

¹² D.07-01-039 at 8.

The LECEF Upgrade PPA procures 289 MW of capacity for a period of 10 years. PG&E estimates the LECEF Upgrade will emit CO₂ at a rate of 933 lbs/MWh without duct firing, and 951 lbs/MWh with duct firing. Because these values fall below the cap of 1,100 lbs/MWh set by D.07-01-039, the LECEF Upgrade PPA complies with the EPS.

The Peakers PPA has a term of 12 years. PG&E represents that all Peaker units will have an annualized capacity factor of substantially less than 60%. Therefore, the EPS does not apply.

3.3.3. Fit with PG&E's GHG Reduction Strategy

D.07-12-052 requires IOUs to demonstrate how each application for new fossil generation fits into the IOU's greenhouse gas (GHG) reduction strategy.¹³ PG&E states the Tracy Upgrade and LECEF Upgrade will be more efficient than the existing Tracy and LECEF Facilities, resulting in lower GHG emissions per MWh. In addition, because the two Upgrades will be operationally flexible, they will support PG&E's effort to integrate intermittent renewable generation and thereby enable an overall reduction in GHG emissions from PG&E's portfolio.

3.3.4. Use of Brownfield Sites

In D.04-12-048 and D.07-12-052, the Commission directed the IOUs to use brownfield sites whenever possible.¹⁴ PG&E states that the development of 254 MW of new capacity under the Tracy and LECEF Upgrade PPAs advances the Commission policy of using brownfield sites for new generation, since both

¹³ D.07-12-052 at 291, Conclusion of Law 6.

¹⁴ D.04-12-048 at 159 and D.07-12-052 at 89.

projects will use existing power plant sites, electric transmission lines, natural gas interconnections, water supply lines, paved access roads, etc.

3.3.5. Project Viability

D.07-12-052 directed the IOUs to undertake “far greater scrutiny” of project viability following the failure of several projects.¹⁵ PG&E submits that the two Upgrade projects are highly viable because (1) both projects are modifications of currently operating facilities; (2) the CAISO transmission studies for each project are complete; (3) regulatory and permitting risks are minimal; and (4) GWF and Calpine are experienced developers.

3.4. Significant Benefits

PG&E submits that the Commission should approve the proposed Transactions because of the following benefits the Transactions will provide.

3.4.1. Hedge Against Project Delay and Failure

The central purpose of PG&E’s contracting for 254 MW of new capacity from the Tracy Upgrade and the LECEF Upgrade is to hedge the risk that other projects for new capacity might fail or be delayed significantly. PG&E declares that if the Commission does not agree that the hedge is needed, the Commission should deny A.09-10-022 and A.09-10-034.

PG&E believes that recent experience demonstrates there is a substantial risk that projects will fail or be delayed significantly. Specifically, in D.06-11-048 the Commission authorized PG&E to procure 2,250 MW of new fossil capacity from seven projects. Since then, two of these projects have failed, two are under construction, and only two are in operation. The seventh project – the 600 MW

¹⁵ D.07-12-052 at 158-159.

Russell City Energy Center (RCEC) – recently received the last of its permits but has not yet started construction.

In D.07-12-052, the Commission authorized PG&E to procure 800 MW to 1,200 MW of new capacity, plus additional capacity to replace failed projects. Since D.07-12-052 was issued, two projects authorized by D.06-11-048 have failed. The failed projects had a combined capacity of 312 MW. Thus, the total new capacity authorized by D.07-12-052 is now 1,112 MW to 1,512 MW.

To obtain the new capacity authorized by D.07-12-052, PG&E has signed three contracts for 1,489 MW. One contract for 184 MW was approved in D.09-10-017. The other two contracts with a combined capacity of 1,305 MW were submitted for Commission approval in A.09-09-021.

In sum, PG&E now has four projects for 2,089 MW of new capacity that have not yet started construction. PG&E asserts that if any of these projects are delayed or fail, PG&E's ability to serve its customers could be jeopardized. PG&E believes the procurement of 254 MW of new capacity from the Tracy and LECEF Upgrade projects is a reasonable way to mitigate the risk of a supply shortage.

3.4.2. Integration of Renewable Resources

In D.07-12-052, the Commission determined that the 800 MW to 1,200 MW (now 1,112 MW to 1,512 MW) of new capacity authorized by the decision must be “dispatchable ramping resources that can be adjusted for the morning and evening ramps created by the intermittent types of renewable resources.”¹⁶ PG&E avers that the two Upgrades will provide the quick start, fast ramping,

¹⁶ D.07-12-052, Finding of Fact 43.

and voltage-regulation capabilities that are needed to integrate high levels of renewables. The Peakers PPA will likewise provide dispatchable generation with quick-start capability from 11 Peaker units.

PG&E asserts the need for flexible generation has grown significantly since D.07-12-052 was issued. At that time, the renewables portfolio standard was 20%. Since then, the Governor has issued Executive Order S-21-09 which set a policy goal of 33% by 2020. The increase from 20% to 33% will require more load-following generation than contemplated by D.07-12-052.

PG&E states that the need for the Tracy and LECEF Upgrades was affirmed in a letter submitted to the Commission on February 1, 2010, from CAISO. According to the CAISO letter, the Tracy Upgrade and the LECEF Upgrade will provide the types of services needed by CAISO to respond to changing grid conditions caused by intermittent renewable resources.

Finally, PG&E reports that the Tracy Upgrade might someday use solar thermal energy to generate electricity from an adjacent 200-acre parcel. Initial studies indicate the 200-acre parcel could produce 35-40 MW when integrated with the Tracy Upgrade. PG&E and GWF have agreed that if GWF decides to use solar thermal power, the parties will discuss modifications to the Tracy Upgrade PPA to accommodate this use.

3.4.3. Increased Fuel Efficiency and Lower Emissions

In the near-term (i.e., from November 2011 through December 2012), the Tracy Transition Agreement substitutes the existing Tracy Facility with the more efficient Hanford and Henrietta Facilities. The replacement units have a 13% better heat rate, resulting in lower fuel consumption and fewer greenhouse gas emissions per MWh of electricity produced. Similarly, during 2012 the

LECEF Replacement Agreement substitutes the LECEF Facility with the more efficient Gilroy Facility during the period the LECEF Upgrade is being built.

Longer term, the Tracy Upgrade and LECEF Upgrade will be approximately 50% and 34% more efficient, respectively, at converting natural gas into electricity (without duct firing) compared to existing facilities. The improved fuel efficiency will produce a corresponding reduction in emissions.

3.4.4. Resource Adequacy and Operating Flexibility

The Tracy Upgrade PPA and LECEF Upgrade PPA will add new capacity that increases resource adequacy (RA). Although the Peakers PPA will not add capacity, it will provide superior RA compared to the exiting DWR-Peakers Contract. Under the Peakers PPA, PG&E will have call rights on the capacity from each Peaker unit. This will enable PG&E to claim the local RA attributes of individual Peaker units, which should eliminate the need for CAISO to designate certain Peaker units as RMR resources.

All three Transactions will provide PG&E with increased operational flexibility. This will enhance PG&E's ability to respond to changing grid conditions, which will be increasingly important as the amount of intermittent renewable generation grows.

3.4.5. Economic Stimulus

The construction of the Tracy and LECEF Upgrades will provide local economic benefits. For example, PG&E estimates that construction of the Tracy Upgrade will provide 650,000 person-hours of construction jobs and 560,000 person-hours of secondary jobs. The local economic benefit will be approximately \$18.34 million in wages and spending, which will provide a much needed boost for hard-hit San Joaquin County.

3.4.6. Independent Evaluator's Report

The IOUs are required by D.07-12-052 to have their RFOs for long-term procurement reviewed by an Independent Evaluator (IE) to ensure that the IOUs use a fair process to solicit, evaluate, and select projects. PG&E states this requirement applies to the Tracy Upgrade PPA and the LECEF Upgrade PPA because the two projects are being procured through PG&E's 2008 LTRFO, but not to the Peakers PPA for which there was no RFO.

PG&E hired Sedway Consulting, Inc., to serve as the IE for the 2008 LTRFO. The IE recommends that the Commission approve the Tracy Upgrade PPA and the LECEF Upgrade PPA because, in the IE's opinion, the projects are viable, the PPAs support the Commission's policy of repowering peaking facilities, the economics are reasonable, and the incremental capacity is a reasonable hedge against the risk that other projects will fail.¹⁷

3.4.7. Just and Reasonable

PG&E avers that the proposed Transactions are just and reasonable for all of the reasons described previously. To summarize, the Transactions (1) achieve the Commission's objective of novating DWR contracts; (2) hedge the risk that other projects might fail or be delayed; (3) provide environmental benefits via brownfield development, lower emissions, avoidance of once-through cooling, and support for renewable generation; (4) are cost effective; and (5) provide economic stimulus. PG&E states these benefits are uniquely certain due to the strong viability of the Tracy Upgrade and LECEF Upgrade projects.

¹⁷ The IE did not submit an opinion on the Peakers Transaction.

3.5. Requested Relief

PG&E asks the Commission to issue an order that does the following:

- Approves the Tracy Transaction, the LECEF Transaction, and the Peakers Transaction, together with all the agreements that comprise the Transactions.
- Authorizes PG&E to (1) recover costs incurred pursuant to each approved Transaction through the Energy Resource Recovery Account, and (2) recover any stranded costs.
- Authorizes PG&E to recover stranded costs from departing load customers via a non-bypassable charge, consistent with D.04-12-048 and D.08-09-012.
- Finds that each Transaction complies with the EPS.
- Finds that procurement under the Tracy Replacement Agreement, the LECEF Replacement Agreement, and the Peakers PPA provides resource adequacy to the same extent as procurement under the existing DWR contracts.

4. Support for PG&E's Applications

The following parties support PG&E's applications: Calpine, CURE, GWF, and IEP (together, "the Supporting Parties"). Their arguments largely mirror PG&E's arguments that are summarized elsewhere in today's decision and will not be repeated here. What follows is a summary of the additional and supplementary arguments raised by the Supporting Parties.

4.1. New Capacity Is Authorized by D.08-11-056

The Supporting Parties assert the new capacity provided by the Tracy and LECEF Upgrades is authorized by D.08-11-056. There, the Commission held that it is in the public interest to "phase out of DWR's remaining involvement in supplying electric power to retail utility customers, and to return full

responsibility to the IOUs.”¹⁸ Consistent with D.08-11-056, the new capacity provided by the Tracy and LECEF Upgrades is part of transactions that remove DWR from supplying electric power to PG&E’s customers.

Calpine and GWF argue that the following passage in D.08-11-056 indicates D.07-12-052 does not apply to the novation process:

We conclude that the process of implementing novation does not conflict with the statutorily required procurement planning process as prescribed by Pub. Util. Code § 454.5. (D.08-11-056 at 51.)

Calpine and IEP emphasize that the Commission had full knowledge of D.07-12-052 when it issued D.08-11-056. The Commission in D.08-11-056 could have prohibited the novation process from resulting in the procurement of more new capacity than authorized by D.07-12-052, but the Commission did not. Instead, the Commission gave parties maximum negotiating flexibility.¹⁹

4.2. New Capacity Is a Reasonable Hedge

D.07-12-052 directed the IOUs to rely on extending contracts with aging generation facilities to address the risk of project delay and failure.²⁰ The Upgrade PPAs are consistent with this direction, according to CURE, because they provide a backstop for delayed or failed projects. However, instead of extending contracts with aging units, PG&E is contracting for new facilities. GWF adds that relying on aging facilities undermines other important policy objectives, such as GHG reductions and increased renewable generation.

¹⁸ D.08-11-056 at 3.

¹⁹ Implementation Ruling at 10.

²⁰ D.07-12-052 at 96-97.

CURE and GWF assert that the need to hedge the risk of project delay and failure is evident from the status of PG&E's four fossil generation projects that are in various stages of permitting and development (i.e., the Mariposa, Marsh Landing, Oakley, and RCEC projects). None has started construction, and all are behind schedule. The failure or further delay of these projects would create a large hole in PG&E's portfolio and jeopardize PG&E's ability to serve.

GWF acknowledges that D.07-12-052 rejected PG&E's request to procure extra capacity to hedge the risk that projects might fail,²¹ but GWF argues that D.07-12-052 is not controlling here because it considered only abstract concerns about the risk of project failure and equally abstract solutions. In contrast, the instant proceeding addresses the very real risk that specifically identified projects might fail (i.e., the Mariposa, Marsh Landing, Oakley, and RCEC projects), for which PG&E has proposed a concrete solution in the form of the Upgrade PPAs.

Finally, CURE and GWF state that the Upgrade PPAs will hedge the risk of costly price increases of other projects. This is because an essential element to moderating price risk is ensuring an adequate supply of capacity. The Upgrade projects will help ensure an adequate supply of capacity. CURE and GWF also state that the Upgrade PPAs have a low risk of price escalation because of their advanced stage in the permitting process, their use of brownfield sites, and the fact that they are managed by experienced project owners.

²¹ D.07-12-052 at 97.

4.3. Extra Procurement Is Allowed by D.06-06-035

Calpine argues that D.06-06-035 provides a precedent for procuring more new capacity than authorized by D.07-12-052. In D.06-06-035, the Commission authorized PG&E to build the Contra Costa 8 Facility (“CC 8 Facility”) with 530 MW of capacity. Importantly, the CC 8 Facility exceeded the new capacity that PG&E was authorized to procure at that time by D.04-12-048.²² Nonetheless, D.06-06-035 approved the CC 8 project because it was “a low-cost and low-risk project that meets PG&E’s long-term procurement needs and... [enhances] grid reliability.”²³ Calpine believes the same reasoning applies to the Upgrade PPAs.

4.4. The CAISO Letter

The Supporting Parties believe the CAISO’s letter submitted to the Commission on February 1, 2010, provides strong support for the proposed Upgrade projects. The letter states:

[CAISO] will need flexible gas-fired generation resources possessing quick start and significant ramping capability to integrate renewable resources and maintain grid reliability... PG&E's proposed contracts with GWF and Calpine for the output from [the Upgrade] projects... would meaningfully contribute to satisfying this growing need.

The Supporting Parties contend the CAISO letter confirms that the Tracy and LECEF Transactions will help satisfy the growing need for flexible gas-fired resources to support the growth of intermittent renewable generation.

²² D.06-11-048 at 2-3. See also D.04-12-048 at 237, Ordering Paragraph 4, and D.06-11-048 at 2.

²³ D.06-06-035 at 20, Conclusion of Law 10.

4.5. The LECEF Upgrade Supports Renewable Generation

Calpine asserts that the record does not sustain CARE's claim that the LECEF Upgrade lacks the flexibility needed to support the integration of intermittent renewable generation. Calpine believes the fallacy of CARE's claim is apparent from the above-cited CAISO letter.

4.6. The Transactions Are Indivisible

The Supporting Parties agree that if one part of a Transaction is rejected, the entire Transaction must be rejected. To do otherwise would undermine the balance of benefits and obligations that was negotiated by PG&E and the counterparties. For example, GWF states the Tracy Replacement Agreement provides PG&E with superior fuel efficiency relative to the DWR Contract it replaces. GWF did not receive extra compensation in the Tracy Replacement Agreement in exchange for providing PG&E with better value. The benefit to GWF is provided by the Tracy Upgrade PPA. If the Commission were to adopt the Tracy Replacement Agreement but reject the Tracy Upgrade PPA, GWF would be unfairly deprived of the benefits that it bargained for.

5. Opposition to PG&E's Applications

The following parties oppose part or all of the proposed Transactions: AReM/CLECA, CARE, DRA, Pacific Environment, and TURN (collectively, the "Opposing Parties"). Their positions and arguments are summarized below.

5.1. New Capacity Is Not Authorized by D.07-12-052

PG&E is authorized by D.07-12-052 to procure 1,112 MW to 1,512 MW of new capacity by 2015. The Opposing Parties note that PG&E has filed four applications to obtain a total of 1,743 MW of new capacity, including 254 MW in the instant proceeding, which is 231 MW more than authorized by D.07-12-052.

The Opposing Parties believe it is unreasonable for ratepayers to bear the cost of unneeded capacity. AReM/CLECA and DRA recommend that the Tracy and LECEF Upgrades be rejected because these two projects exceed the capacity authorized by D.07 12-052. CARE, Pacific Environment, and TURN believe the Commission should evaluate the Upgrade projects in conjunction with the three other projects that PG&E has brought before the Commission (i.e., the Mariposa, Marsh Landing, and Oakley projects) and select the combination of viable projects that best fits PG&E's authorized need of 1,112 MW to 1,512 MW.

The Opposing Parties argue that D.07-12-052 prohibits PG&E's strategy of procuring more new capacity than authorized by D.07-12-052 to hedge the risk that some projects might fail or be delayed. Specifically, D.07-12-052 rejected PG&E's request to procure up to 600 MW of new capacity to address the contingency of "contracted resource uncertainty," stating:

Regarding the... contingency that is the result of conventional generation contracts, we would expect the IOUs to handle this uncertainty... [by] delaying retirements (in this case, via contract extensions with aging facilities) until [the] uncertainties are addressed. (D.07-12-052 at 94.)

The Opposing Parties urge the Commission to affirm its determination in D.07-12-052 that the appropriate way to address the risk of project delay and failure is to extend contracts with aging units.

DRA, Pacific Environment, and TURN believe there is ample capacity available from aging facilities to replace failed projects. They state that D.07-12-052 assumed PG&E would retire 4,200 MW of aging facilities by 2015,²⁴ which is more than enough to backfill any failed projects.

²⁴ D.07-12-052 at 116, Table PGE-1.

Pacific Environment and TURN also note that the Commission determined in D.07-12-052 that PG&E would not need any new capacity until at least 2014.²⁵ Despite this distant need, PG&E has already requested approval of 1,489 MW of new capacity. TURN maintains that it makes no sense to procure an additional 254 MW of new capacity at this time for a need in 2014 that will be met by the 1,489 MW that PG&E has already contracted for.

5.2. New Capacity Is Not Authorized by D.08-11-056

AReM/CLECA, DRA, and TURN assert that D.08-11-056 does not allow PG&E to procure more capacity than authorized by D.07-11-052. They note that D.08-11-056 linked the replacement of DWR contracts with D.07-12-052:

[A]ny replacement agreement that would extend the term of a contract should also be reviewed by the Commission for consistency with long-term procurement planning criteria, pursuant to Section 454.5. (D.08-11-056 at 81.)

The Commission adopted long-term procurement criteria pursuant to § 454.5 in D.07-12-052, including a limit on the procurement of new fossil capacity. AReM, DRA, and TURN state that because the Upgrade PPAs exceed the new capacity authorized by D.07-12-052, these contracts are not authorized by D.08-11-056.

5.3. PG&E's Authorized Capacity Has a Built-In Hedge

DRA and Pacific Environment contend that the 1,112 MW - 1,512 MW of new capacity authorized by D.07-12-052 includes a cushion to hedge the risk that some generation projects will fail. Pacific Environment states that the amount of

²⁵ D.07-12-052 at 116, Table PGE-1.

the cushion is 600 MW.²⁶ DRA and Pacific Environment argue that it is unreasonable for PG&E to procure even more new capacity to serve as a hedge, as doing so would force ratepayers to pay for the same hedge twice.

5.4. There Is No Need for a Hedge

The Opposing Parties state there have been several developments since D.07-12-052 was issued which indicate that PG&E's need for new capacity has declined significantly and eliminate any need to procure the Upgrade PPAs. First, the determination in D.07-12-052 that PG&E needs 800 MW to 1,200 MW of new capacity by 2015 (now 1,112 MW to 1,512 MW) was based, in part, on the assumption that 3,000 MW of power would be exported from PG&E's planning area during periods of peak demand. However, in October 2008 the staff of the California Energy Commission (CEC) issued a report which forecasts that exports will be 100 MW to 1,100 MW in 2015,²⁷ far less than the 3,000 MW assumed by D.07-12-052. If D.07-12-052 were revised to reflect the CEC staff's lower forecast of exports, PG&E would have no need for new capacity in 2015.

Second, D.07-12-052 was based, in part, on the CEC's 2007 forecast of peak demand for electricity in PG&E's planning area. The CEC's more recent 2009 forecast shows that peak demand in 2015 will be 597 MW (4.48%) lower than the 2007 forecast.²⁸

²⁶ D.07-12-052 at 104 and 116, footnote 6.

²⁷ *Revisiting Path 26 Power Flow Assumptions* at <http://www.energy.ca.gov/2008publications/CEC-200-2008-006/CEC-200-2008-006.PDF>.

²⁸ *California Energy Demand 2010-2020 Staff Revised Forecast* at 35 (<http://www.energy.ca.gov/2009publications/CEC-200-2009-012/CEC-200-2009-012-SF.PDF>.)

Finally, Pacific Environment argues that the decline in PG&E' need for new capacity is confirmed by PG&E's 2008 California Gas Report. The Report shows that PG&E expects the use of natural gas to generate electricity will decline through 2015, which casts doubt on PG&E's need for any new gas-fired capacity at this time.²⁹

5.5. The New Capacity Is Too Expensive

CARE, DRA, and TURN each presented an analysis of the cost of the Upgrade PPAs. The details of their analyses and conclusions are confidential. In general, they state that the 254 MW of incremental capacity provided the Upgrade PPAs has a substantial negative market value (as calculated by the IE) in both absolute terms and relative to other projects. DRA describes the two Upgrade PPAs as "a terrible deal for ratepayers." TURN concurs.

5.6. The New Capacity Violates the Mariposa Settlement

In D.09-10-017, the Commission adopted a settlement agreement that authorized PG&E to procure 184 MW of new capacity from the Mariposa project. CARE represents that PG&E agreed in the settlement to limit its procurement of new capacity to 1,512 MW, inclusive of the Mariposa project.

CARE notes that PG&E has requested 1,743 MW of new capacity, including 254 MW from the Upgrade PPAs. CARE alleges that the amount of new capacity requested by PG&E violates the Mariposa settlement agreement, which limited PG&E to 1,512 MW of new capacity.

²⁹ 2008 California Gas Report at 32, 49 - 55.
(http://www.socalgas.com/regulatory/documents/cgr/2008_CGR.pdf.)

5.7. Lack of Competitive Procurement

AReM/CLECA allege that the Upgrade PPAs violate the Commission's policy of competitive procurement. They state that because the Upgrade PPAs were unsuccessful participants in PG&E's 2008 LTRFO, there is no colorable argument that the projects were selected via a competitive process.

5.8. The CAISO Letter

On February 1, 2010, CAISO submitted a letter that states:

[The Tracy Upgrade and LECEF Upgrade] would support the development of generation resources with operational characteristics that will compliment [CAISO's] efforts to integrate the increased number of renewable resources in the [CAISO] balancing authority area... [CAISO] will shortly be releasing its preliminary Phase I study to determine the amount, type, and location of the required additional generation resources necessary to support the goal of 33% renewable generation. This study... identifies an increased need for regulation and load following resources like the Tracy and Calpine Upgrade projects. PG&E's proposed contracts with GWF and Calpine for the output from these projects... would meaningfully contribute to satisfying this growing need. (CAISO letter at 1.)

All of the Opposing Parties note that CAISO is not a party to this proceeding and state that its letter does not have any evidentiary value.

AReM/CLECA, DRA, Pacific Environment, and TURN see nothing in the CAISO letter that indicates PG&E needs more new capacity than authorized by D.07-12-052 to integrate renewable generation. Pacific Environment adds that the CAISO letter is contradicted by the CEC's 2009 Integrated Energy Policy

Report (IEPR), which found that there is no need for more capacity in the Bay Area to integrate renewable energy.³⁰

AReM/CLECA, CARE, and DRA state that because CAISO has not completed its preliminary Phase I study, it is improper for CAISO to suggest that the study supports the procurement of the Tracy and LECEF Upgrades. TURN also questions the CAISO's characterization of the Phase I study. TURN represents that it is familiar with the CAISO study, and TURN does not believe that "[the CAISO] will shortly be releasing" the study. Nor does TURN believe the study is sufficiently advanced to support the CAISO's statement that the study "identifies an increased need for regulation and load following resources like the Tracy and Calpine Upgrade projects" and that "PG&E's proposed contracts with GWF and Calpine for the output from these projects...would meaningfully contribute to satisfy this growing need." In addition, the CAISO's study is focused on renewable integration needs in the year 2020. Thus, its relevance to the Tracy and LECEF Upgrades, which are scheduled for completion in 2012 – 2013, is doubtful.

5.9. The LECEF Upgrade Is Not a Flexible Resource

CARE states the LECEF Upgrade will have start times of up to four hours, which means the LECEF Upgrade will not provide dispatchable, load-following power that is needed to integrate a growing amount of intermittent renewable generation. In contrast, the current LECEF Facility has a start time of five to ten minutes, and can ramp up and down to meet variable demand, making it well suited to support the integration of intermittent renewable power. CARE

³⁰ CEC 2009 IEPR at 190 (http://www.energy.ca.gov/2009_energypolicy/).

believes that ratepayers would be better off with the lower price and superior flexibility of the existing LECEF configuration.

5.10. Deferred Action on the Upgrade PPAs

TURN states that if the 600 MW RCEC project fails, the Commission might have to approve the Upgrade PPAs, in spite of their high costs, in order to ensure reliable service. Therefore, TURN recommends that the Commission defer its decision on the Upgrade PPAs until after September 10, 2010, which is the deadline for Calpine to start construction or its CEC permit will expire. If the RCEC project cannot begin construction within the next several months, then TURN recommends that the Commission approve the Upgrade PPAs to meet PG&E's system reliability requirements in 2015. Conversely, if the RCEC project is able to proceed, then the Upgrade PPAs should be rejected as unneeded.

TURN emphasizes that in no event should the Tracy Transition Agreement be approved. The purpose of this Agreement is to accelerate the online date of the Tracy Upgrade from 2013 to 2012. TURN argues that PG&E does not have a need for new capacity in 2012 under any reasonable scenario.

5.11. The Transactions Can Be Disaggregated

Of the ten contracts that comprise the Tracy Transaction, the LECEF Transaction, and the Peakers Transaction, the Opposing Parties believe the Commission has complete flexibility to approve some agreements and reject others. The one exception is the Tracy Transition Agreement. TURN believes this contract can be approved only if the Tracy Upgrade PPA is approved.

5.12. The Cost of the Peakers PPA Is Not Justified

DRA recommends that the Commission reject the Peakers PPA because PG&E did not provide enough information for DRA to determine if the agreement is cost effective. DRA believes that ratepayers would be better served

if the Peakers capacity were acquired through a competitive process such as the next intermediate-term RFO.

TURN opposes the Peakers PPA for different reasons. Although PG&E has calculated a positive net market value for the Peakers PPA, TURN has little confidence in the calculation. TURN notes that PG&E's calculation includes a forecast of rising RA prices several years into the future. If lower price increases are assumed, which TURN believes is likely, the Peakers PPA would not be cost effective.

6. PG&E's Response to the Opposing Parties

6.1. The New Capacity Is Authorized by D.08-11-056

PG&E disputes the Opposing Parties' claim that the Upgrade PPAs exceed the new capacity authorized by D.07-12-052. PG&E states that D.08-11-056 encouraged the novation of DWR contracts to the IOUs. In doing so, the Commission provided the IOUs with broad latitude to negotiate new contracts. Using this authority, PG&E negotiated the Upgrade PPAs. PG&E contends that because these contracts were negotiated pursuant to D.08-11-056, the 254 MW of new capacity provided by the Upgrade PPAs does not count towards the 1,512 MW of new capacity authorized D.07-12-052.

6.2. The Hedge Is Needed and Consistent with D.07-12-052

PG&E disagrees with Pacific Environment and TURN's claim that PG&E will have surplus capacity until 2014, making the Upgrade PPAs unnecessary. While D.07-12-052 found that PG&E would have a surplus capacity, that was based on the assumption that both the 600 MW RCEC project and the 180 MW San Francisco Peakers project would be operational. However, the former has

not yet begun construction, and the latter will probably never be built.³¹ Given the status of these projects, PG&E may have a capacity deficit as soon as 2012.

PG&E says it cannot wait for projects to fail before it takes action given the long lead time to hold a competitive solicitation, obtain Commission approval of the RFO winners, and to permit and build a project. PG&E believes the Upgrade PPAs provide an important insurance policy. If no projects fail, the Commission can account for the additional resources in the next LTPP proceeding and adjust accordingly.

PG&E argues that the Opposing Parties mistakenly interpret D.07-12-052 as requiring PG&E to hedge the risk of project delay and failure by deferring the retirement of aging power plants. PG&E contends that D.07-12-052 did not intend to defer retirements indefinitely. Rather, the Commission held that retirements should be deferred “until these uncertainties are addressed.”³² PG&E has addressed the uncertainties with the Upgrade PPAs.

Furthermore, D.07-12-052 directed the IOUs to contract for new capacity to force the retirement of aging power plants.³³ PG&E avers that the Upgrade PPAs advance the Commission’s policy of transitioning away from aging power plants and towards modern, flexible facilities that support the integration of intermittent renewable resources.

³¹ D.07-12-052 at 116, Table PGE-1, Line 8 (showing 180 MW addition in 2009 which represents the San Francisco Peakers project).

³² D.07-12-052 at 97.

³³ D.07-12-052 at 88-89 and Table PGE-1, line 5, “Retirements (Laddered reduction of Aging Units).”

6.3. PG&E Used a Competitive Process

PG&E disputes AReM/CLECA's claim that the Upgrade PPAs were not procured through a competitive process. PG&E responds that these projects were selected through a very competitive process – PG&E's 2008 LTRFO. The Tracy Upgrade and LECEF Upgrade were two of the 48 offers received in the 2008 LTRFO and competed head-to-head with the other offers.

The winning offers were presented to the Commission for approval in A.09-04-001 (the Mariposa project) and A.09-09-021 (the Marsh Landing and Oakley projects). The Tracy and LECEF Upgrades were the next best offers, and are now being presented to the Commission for approval as a part of the novation of DWR contracts, consistent with D.08-11-056.

6.4. The Mariposa Settlement Does Not Bar the Transactions

PG&E disagrees with CARE's assertion that PG&E is estopped by the Mariposa settlement agreement from procuring more new capacity than authorized by D.07-12-052. PG&E responds that D.07-12-052 does not apply because the Upgrade PPAs are being procured as part of the novation process authorized by D.08-11-056.

6.5. The Upgrade PPAs Are Reasonably Priced

PG&E argues that CARE, DRA, and TURN improperly rely on the incremental capacity method alone to reach the erroneous conclusion that the Upgrade PPAs are over priced. PG&E explains there are two basic ways to value projects that expand the capacity of an existing facility. Under the total capacity method, the expanded facility is treated as single unit. Under the incremental capacity method, the expanded facility is divided between the existing capacity and incremental new capacity, and each is valued separately. PG&E recommends that both methods be used to assess the value of the Upgrade PPAs.

PG&E contends that it is improper to rely solely on the incremental capacity method as recommended by CARE, DRA, and TURN, since this method overstates the cost of the incremental capacity. This is because the incremental capacity method assigns all costs incurred to upgrade the entire facility to the incremental capacity only, even though the existing capacity benefits from these costs, too. For example, part of the cost of the Upgrade PPAs goes to improving the fuel efficiency of the entire facility, not just the incremental capacity.

PG&E maintains that even if the incremental capacity method is used as the sole method to value the Upgrade PPAs, which PG&E opposes, the Upgrade PPAs are reasonably priced. The IE used the incremental capacity method and found that the cost of the Upgrade PPAs is reasonable. PG&E also notes that the Upgrade PPAs were among the best offers from PG&E's 2008 LTRFO, which demonstrates that the price of the insurance provided by the Upgrades is reasonable.

6.6. The Peakers PPA Is Reasonably Priced

TURN claims the net market value of the Peakers PPA would be lower if PG&E had used a lower forecast of RA prices in its calculation of net market value. PG&E responds that its calculation reflects PG&E's best estimate of future RA prices. PG&E uses consistent RA prices for all contract valuations, including offers received in response to the 2008 LTRFO, intermediate-term RFOs, and renewable resource solicitations. PG&E's forecast of RA prices have been vetted by several IEs and provided to PG&E's Procurement Review Group. This shows that PG&E's forecast of RA prices is reasonable.

PG&E opposes DRA's recommendation to require the Peakers capacity to be procured through competitive process such as the next intermediate-term RFO. PG&E says there is no guarantee that prices in an intermediate-term RFO

would be any better than the Peakers PPA, particularly since many of the Peaker units are in local areas where capacity is often sold at a premium.

7. Discussion

7.1. Standard of Review

PG&E requests Commission approval of three transactions. The purpose of each transaction is to (1) novate an existing DWR contract to PG&E, and (2) replace the novated DWR contract with a new long-term PPA. The three transactions will together result in long-term PPAs for 1,090 MW of capacity, including 254 MW of new capacity.³⁴

We agree with PG&E, Calpine, and GWF that each transaction is indivisible, and that all the contracts that comprise a particular transaction must be approved together or rejected together. For each transaction, the costs and benefits of the novated contract are small relative to the long-term PPA. Thus, in deciding whether to approve a transaction, the novated contract is not a significant factor, and we may limit our analysis to the long-term PPA.

D.08-11-056 and the Implementation Ruling provide criteria for determining if the replacement of a DWR contract with a new long-term PPA should be approved. First, the new long-term PPA must be just and reasonable under § 451³⁵ based on “relevant conditions, including market conditions in effect at the time of negotiation and for the period that such replacement contract

³⁴ The amount of capacity drops to 913 MW beginning January 1, 2018.

³⁵ D.08-11-056 at 52, 83, 90 (Conclusions of Law No. 5-7) and 94 (Ordering Paragraph 11). The text at 52 refers to § 454, but the term “just and reasonable” appears in § 451. Later references in D.08-11-056 are to § 451.

would be in effect.”³⁶ Second, the long-term PPA must be “at least as beneficial for ratepayers as the existing [DWR] contract.”³⁷ Finally, the long-term PPA should “be reviewed by the Commission for consistency with the long-term procurement planning criteria, pursuant to [§ 454.5.]”³⁸ All of these criteria will be met if there is a need for the capacity, energy, and ancillary services provided by the PPA and the PPA is reasonably priced. PG&E has the burden of demonstrating that each transaction meets the above criteria.

For the reasons set forth below, we conclude that the Tracy Transaction and the LECEF Transaction are not needed at this time, but they could be needed in the future. Accordingly, we deny without prejudice PG&E’s request to approve these two Transactions. On the other hand, we find that the Peakers Transaction is just and reasonable, and we approve the Transaction.

7.2. The Tracy and LECEF Transactions

The Tracy Transaction and the LECEF Transaction will together procure 588 MW of long-term capacity, including 254 MW of new capacity. In order to approve the two Transactions, we must find they are consistent with PG&E’s long-term procurement plan.³⁹

In D.07-12-052, the Commission adopted PG&E’s current LTPP pursuant to § 454.5.⁴⁰ Under the adopted LTPP, PG&E is authorized to procure 1,112 MW

³⁶ D.08-11-056 at 67, 83, and 90, Conclusion of Law No. 7.

³⁷ D.08-11-056 at 75, and Implementation Ruling at 10.

³⁸ D.08-11-056 at 81, and Implementation Ruling at 11.

³⁹ D.08-11-056 at 81, and Implementation Ruling at 11.

⁴⁰ D.07-12-052 at 290 (Conclusion of Law 1) and 300 (Ordering Paragraphs (OPs) 1, 2, and 4).

to 1,512 MW of new capacity by 2015 to meet the needs of its customers.⁴¹ To procure the new capacity, PG&E issued a request for long-term offers in 2008. PG&E received 48 bids, and eventually selected three offers totaling 1,489 MW to fill the LTPP need of 1,112 MW – 1,512 MW. The three winning offers were the Mariposa project (184 MW), the Marsh Landing project (719 MW), and the Oakley project (586 MW). The Mariposa project was approved by the Commission in D.09-10-017. PG&E submitted the Marsh Landing and Oakley projects for Commission approval in A.09-09-021, which remains pending.

The Tracy Upgrade project and the LECEF Upgrade project were the next best offers received by PG&E in response to the 2008 LTRFO. The 254 MW of new capacity provided by these two projects, together with the 1,489 MW of new capacity provided by the three winning offers from the 2008 LTRFO, will provide PG&E with 1,743 MW of new capacity (assuming all five projects are built), which is 231 MW more than authorized by D.07-12-052.

Several of the Opposing Parties recommend that the Commission evaluate the Tracy Upgrade project and the LECEF Upgrade project in conjunction with the Mariposa, Marsh Landing, and Oakley projects and select the combination of projects that best meets PG&E's needs. We decline to adopt this recommendation for the reasons given by PG&E:

As PG&E demonstrated in its reply testimony, the winning bids in the 2008 LTRFO were superior offers, have better market value than other bids and are in the best interests of PG&E's customers. Replacing one of the winning bids with the Tracy and LECEF Upgrades would not benefit PG&E's customers, and would severely undermine the credibility of

⁴¹ D.09-10-017 at 3, Footnote 2.

competitive procurement solicitations in California – detrimentally impacting future utility solicitations and increasing customer costs. This is not an approach that the Commission should adopt. (PG&E Opening Brief at 29-30. Footnotes omitted.)

PG&E selected the Mariposa, Marsh Landing, and Oakley projects to fill the need for new capacity authorized by D.07-12-052 because they were the winners of the 2008 LTRFO. This makes the Mariposa, Marsh Landing, and Oakley projects a better value for ratepayers than the Tracy Upgrade and the LECEF Upgrade if the Commission determines PG&E should procure capacity to the high end of the allowed range.⁴² The purpose of the latter two projects is not to fill the need authorized by D.07-12-052, but to hedge the risk that other projects will fail or be delayed significantly.

7.2.1. The New Capacity Is Not Authorized by D.07-12-052

As described previously, the Upgrade PPAs exceed the new capacity authorized by D.07-12-052 by 231 MW. Today's decision does not revisit the amount of new capacity that PG&E is authorized to procure by D.07-12-052.⁴³

We conclude that it is unjust and unreasonable for PG&E's ratepayers to pay for more capacity than PG&E's authorized need, particularly given the substantial costs involved. PG&E's electric rates have risen faster than inflation in recent years.⁴⁴ It is unreasonable to exacerbate this trend by imposing

⁴² Today's decision in no way prejudices whether the proposed Marsh Landing and Oakley projects will be approved or rejected in A.09-09-021.

⁴³ Scoping Memo at 4, Item 3.

⁴⁴ PG&E's average bundled electric rates for residential service rose from 12.7 cents per kilowatt hour (KWh) in 2004 to 16.3 cents/KWh in 2009, an increase of 28.3% over five years. (<http://www.cpuc.ca.gov/NR/rdonlyres/6E9249FE-922C-46F4-B7EA->

Footnote continued on next page

unnneeded costs on ratepayers, especially at a time when California residents are struggling with high unemployment and stagnant incomes.

We are not persuaded by Calpine that because PG&E was authorized by D.06-06-035 to procure new capacity in excess of the LTPP, PG&E should be allowed to do so again. That decision adopted a settlement agreement which authorized PG&E to procure the CC 8 project outside the LTPP process. Under Rule 12.5, the adoption of a settlement agreement “does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding” unless the Commission expressly provides otherwise. There is nothing in D.06-06-035 that indicates the Commission intended to establish a precedent of any sort.

In addition, the factual circumstances at issue in D.06-06-035 were very different from the current proceeding. The Commission found in D.06-06-035 that the CC 8 project was a low-cost project that compared very favorably with other projects that had been recently approved by the Commission.⁴⁵ That is not the case with the Tracy Upgrade and LECEF projects. Although we cannot discuss the cost of these two projects in detail because this information was admitted under seal, we generally agree with DRA and TURN’s assessment that the two projects are a poor deal for ratepayers⁴⁶ if only because they were not winners in the RFO process.

[66F3C56D81A6/0/AnnualAverageBundledCustomerRates2000_2009_Corrected.PPT](#)). We take official notice of this information pursuant to Rule 13.9 and California Evidence Code § 452(h).

⁴⁵ D.06-06-035 at 20, Findings of Fact 10 and 11.

⁴⁶ DRA Exhibit 7-C at 9 – 21, and TURN Exhibit 5-C at 13 - 15.

Assuming for the sake of argument that the Commission intended D.06-06-035 to set a precedent (which is not the case), the precedent was overturned by D.07-12-052. There, the Commission rejected PG&E's request to over procure new capacity to mitigate the risk of project delay and failure.⁴⁷ We decline to reverse our holding in D.07-12-052, as doing so would force PG&E's customers to pay for costly and unneeded new capacity.

7.2.2. The Hedge Is Not Authorized by D.07-12-052

The primary reason PG&E seeks to procure more new capacity than authorized by D.07-12-052 is to hedge the risk of project delay and failure.⁴⁸ The Commission addressed this issue in D.07-12-052 and concluded that the IOUs should hedge this risk by deferring the retirement of existing power plants.⁴⁹

We see no reason to deviate from our prior holding. There is ample capacity available from aging facilities to address the risk of project delay and failure. As DRA and TURN observe, D.07-12-052 anticipated that PG&E would retire 4,200 MW of aging capacity by 2015.⁵⁰ DRA represents there have been no retirements as of early 2010.⁵¹ The 4,200 MW of anticipated retirements is more than double the capacity for all of PG&E's fossil generation projects that are currently in various stages of approval and development (i.e., the 600 MW RCEC project, the 184 MW Mariposa project, the 719 MW Marsh Landing project, and

⁴⁷ D.07-12-052 at 97 – 100.

⁴⁸ PG&E Exhibit 3 at 2-9.

⁴⁹ D.07-12-052 at 96 – 99.

⁵⁰ D.07-12-052 at 116, Table PG&E-1, Line 5. (Note: There are two pages numbered 116. Table PG&E-1 appears on the second page 116 that immediately follows page 120.)

⁵¹ DRA Opening Brief at 13.

the 586 MW Oakley project). In light of the large reservoir of capacity available from power plants slated for retirement, there is no need for PG&E to procure the 254 MW of new capacity from the Upgrade projects to hedge the risk that other projects will fail or be delayed significantly.

PG&E and the Supporting Parties assert that D.07-12-052 adopted a policy of transitioning away from aging power plants. The Commission stated:

We find merit in TURN's position that [aging] units represent a natural contingency for a number of uncertainties that the IOUs, and in particular PG&E, have raised in identifying their need for additional generation. However, we also recognize the benefits of transitioning from the use of these aging units... to new peaking and intermediate units with much greater flexibility that will better support the anticipated intermittent-heavy, GHG-constrained portfolios resulting from AB 32. (D.07-12-052 at 88-89.)

PG&E states the above passage from D.07-12-052 demonstrates that it is the Commission's policy to transition to new power plants to hedge the risk of project delay and failure. PG&E submits that the Upgrade projects are a good fit with the Commission's policy.

PG&E's characterization of D.07-12-052 is incomplete and inaccurate. It is true that D.07-12-052 adopted a policy to transition away from aging facilities. In fact, D.07-12-052 requires PG&E to retire 4,200 MW of aging capacity by 2015, and authorizes PG&E to procure sufficient new capacity to both replace the retired capacity and to meet projected increases in demand.⁵² At the same time,

⁵² D.07-12-052 at 87-89 and 116, Table PG&E-1, Line 5.

D.07-12-052 rejected PG&E's request to procure even more new capacity such as the Upgrade PPAs to hedge the risk of project delay and failure.⁵³

GWF contends that D.07-12-052 addressed only abstract concerns about the risk of project delay and failure. GWF submits that the risk is now very real, and that PG&E has offered a concrete solution in the form of the Upgrade PPAs. We are not persuaded by GWF's argument. We find that D.07-12-052 adopted a solution to address the risk of project delay and failure that is not only practical, but superior to PG&E's proposal to procure expensive and unneeded capacity.

Finally, PG&E notes that the IE endorses PG&E's strategy of contracting for more capacity than authorized by D.07-12-052 to hedge the risk of project delay and failure. We accord little weight to the IE's opinion on this matter, as it appears the IE relied on information provided by PG&E and did not consider the many issues raised by the Opposing Parties. We are also concerned that the IE expressed an opinion on this matter. D.07-12-052 states the "purpose of an IE...is to ensure a fair, competitive procurement process."⁵⁴ Thus, it is beyond the scope of the IE's responsibility to opine on whether PG&E should contract for more capacity than authorized by D.07-12-052.

In its comments on the proposed decision, PG&E argues that it was proper for the IE to opine on this matter because the "long-form template" for IE reports that was adopted by an ALJ ruling issued on May 8, 2008, in R.06-02-013, directs the IE to state whether a proposed IOU contract is reasonably priced, needed,

⁵³ D.07-12-052 at 97 and 99.

⁵⁴ D.07-12-052 at 140.

and merits Commission approval. We agree with PG&E that the directions in the long-form report template could be interpreted that way.

We hereby clarify that the IEs hired by PG&E shall refrain from expressing an opinion on whether it is reasonable for PG&E to procure more new capacity than explicitly authorized by a Commission decision. Further, we direct Energy Division to revise the template to ensure that the IEs focus on their core responsibility of evaluating whether an IOU conducted a well-designed, fair, and transparent RFO for the purpose of obtaining the lowest market price for ratepayers, taking into account many factors (e.g., project viability, transmission access, etc.).

To facilitate compliance with D.07-12-052 and provide greater clarity going forward, Energy Division will revise Items H and I on the long-form template for IE reports on proposed PG&E contracts.

The scope of the IE's responsibilities and the content of the IE long-form report may be further refined in R.10-05-006 where we intend to examine IE-related issues,⁵⁵ among other things.

7.2.3. There Is No Need for More New Capacity than Authorized by D.07-12-052

PG&E asserts that it needs the new capacity provided by the Upgrade PPAs to ensure it can serve its customers if a project fails or is delayed significantly. Based on our review of the record, we find there is no risk of a capacity shortage. As discussed previously, D.07-12-052 directed PG&E to address the risk of project delay and failure by deferring the retirement of aging plants. The plants slated for retirement have more than enough capacity to fully

⁵⁵ Order Instituting Rulemaking 10-05-006 at 17.

mitigate this risk. In addition, D.07-12-052 found that PG&E would have surplus capacity through 2013,⁵⁶ which provides further protection against the risk of project delay and failure.

The Opposing Parties cite two reports which reinforce our conclusion that there is no risk of a supply shortage. First, the CEC staff issued a report in October 2008 which states unequivocally that D.07-12-052 “over estimated the amount of capacity flowing North to South on Path 26 during PG&E peak demand periods by at least 1,900 MW.”⁵⁷ If the CEC staff report is correct, then PG&E has no need to procure 1,112 MW to 1,512 MW of new capacity authorized by D.07-12-052, and certainly no need to procure more capacity than authorized by D.07-12-052 in order to hedge the risk of project delay and failure.

Second, the Opposing Parties point to the CEC adopted report on December 2, 2009, titled *The California Energy Demand 2010-2020 Adopted Forecast* (hereafter, the “2009 Forecast”). The 2009 Forecast, when compared to the 2007 Forecast that was used by D.07-12-052, shows the CEC has reduced its forecast of peak demand in PG&E’s planning area in 2015 by 597 MW.⁵⁸ The CEC attributes the drop in forecasted demand to lower economic growth and increased energy efficiency. The reduction in forecasted peak demand is more than double the 254 MW of new capacity provided by the Tracy and LECEF Upgrades, which

⁵⁶ D.07-12-052 at 116, Table PG&E-1, Line 26.

⁵⁷ *Revisiting Path 26 Power Flow Assumptions* at 3. See also 1 and 7. (<http://www.energy.ca.gov/2008publications/CEC-200-2008-006/CEC-200-2008-006.PDF>).

⁵⁸ 2009 Forecast at 55, Table 10, Column 4, Row 21 (25,163 MW) minus Column 2, Row 21 (25,760 MW). The 2009 Forecast is incorporated into the CEC’s 2009 *Integrated Energy Policy Report* (IEPR) at 52-54. The CEC adopted the 2009 IEPR on December 16, 2009.

calls into question PG&E's claim that it needs these two projects to ensure reliability, particularly if the Commission approves both the Marsh Landing and Oakley Projects.

In their comments on the proposed decision, DRA and TURN assert that a report recently issued by CAISO confirms there is no need to procure the Upgrade PPAs to hedge the risk of project delay and failure. The CAISO's *2010 Summer Loads and Resources Operations Preparedness Assessment* dated May 10, 2010,⁵⁹ states at pages 1 - 4 that PG&E's service territory is forecast to have a planning reserve margin of 38.5% during the summer of 2010, primarily due to a slow recovery in electric demand from the economic recession and 1,760 MW of newly built capacity. We agree that the CAISO report shows there is no near-term need for the Upgrade PPAs.⁶⁰

PG&E and GWF state that PG&E's need for new capacity has risen since D.07-12-052 due to the indefinite delay of the 180 MW San Francisco Peakers project. We recognize this project has been dormant for several years and shows no signs of development. However, the risk of a capacity shortage from the failure of this project and others is fully mitigated by the 4,200 MW of reserve capacity available in aging power plants slated for retirement.

We emphasize that today's decision does not revisit the Commission's determination in D.07-12-052 that PG&E has a need for 800 MW to 1,200 MW (now 1,112 MW to 1,512 MW) of new capacity by 2015. Today's decision affirms that if a project for new capacity fails, PG&E may execute a contract with another

⁵⁹ The CAISO report is available at: <http://www.caiso.com/2793/2793ae4d395f2.pdf>. We take official notice of the CAISO report pursuant to Rule 13.9.

⁶⁰ DRA Reply Comments at 2, and TURN Reply Comments at 4.

project to obtain the 1,112 MW to 1,512 MW of new capacity authorized by D.07-12-052, subject to the Commission's review and approval. Today's decision addresses a different issue, namely, whether PG&E should contract for more capacity than authorized by D.07-12-052 to hedge the risk of project delay and failure. We conclude that PG&E should not.

In their comments on the proposed decision, GWF and PG&E claim that a decision issued by the State Water Resources Control Board (SWRCB) on May 4, 2010,⁶¹ makes it impossible for PG&E to rely on 4,200 MW of aging capacity to hedge the risk of project delay and failure. The SWRCB decision requires power-plant owners to substantially reduce the use of once-through cooling (OTC). GWF and PG&E insinuate that the SWRCB decision will force the rapid retirement of the 4,200 MW of aging capacity, making it "difficult to imagine how...OTC generation provides a legitimate means to mitigate the risk of project delay or failure."⁶²

GWF and PG&E misconstrue the effect of the SWRCB decision. As noted by TURN in its Reply Comments, the SWRCB decision does not accelerate the retirement of 4,200 MW of aging capacity. To the contrary, the SWRCB decision indicates that the phase out of OTC generation in PG&E's service territory will occur at a slower pace than forecast by D.07-12-052.⁶³

⁶¹ The SWRCB decision is available at: http://www.swrcb.ca.gov/water_issues/programs/npdes/cwa316.shtml#otc. We take official notice of the SWRCB decision pursuant to Rule 13.9 and California Evidence Code § 452(b).

⁶² GWF Opening Comments at 2.

⁶³ SWRCB Decision, Attachment 1, Section 3 E, Table 1. See also TURN's Reply Comments at 1 – 3.

Furthermore, the SWRCB decision contemplates that OTC generation will remain in service until retrofitted or replacement capacity comes on line in a well-planned manner.⁶⁴ To this end, the Commission recently instituted Rulemaking 10-05-006 where the Commission intends to adopt a new LTPP for PG&E that includes the elimination of OTC generation.⁶⁵ In sum, to the extent 4,200 MW of aging capacity consists of OTC generation, it will continue to be available in one form or another (i.e., its existing form, retrofitted form, or replaced-by-new-capacity form) to hedge the risk of project delay and failure.

We recognize that it is possible the Upgrade PPAs might be selected in the future to replace OTC generation.⁶⁶ However, that is an entirely separate matter from the issue before us in this proceeding, namely, whether the Upgrade PPAs should be procured immediately to hedge the risk of project delay and failure.

7.2.4. PG&E Has Not Demonstrated that the Upgrade PPAs Are Needed to Support Renewable Generation

PG&E submits that the Commission should approve the Upgrade PPAs because, in part, they will provide load-following capacity needed to integrate a growing amount of intermittent renewable generation. Based on our review of the record, though capable of assisting in renewable integration, we find that PG&E has not demonstrated that the Upgrade PPAs are needed to integrate renewable generation. The 1,112 MW to 1,512 MW of new capacity that PG&E is authorized to procure by D.07-12-052 must be able to integrate intermittent

⁶⁴ SWRCB decision, Attachment A, Items 1.I and 1.J.

⁶⁵ Order Instituting Rulemaking 10-05-006 at 9 and 12 - 15.

⁶⁶ Today's decision in no way prejudices when and how OTC generation will be retrofitted or replaced.

renewable generation.⁶⁷ To fill this need, PG&E has signed contracts for 1,489 MW of new capacity from the Mariposa, Marsh Landing, and Oakley projects. If approved, there is no evidence that these projects cannot provide all of the load-following capacity needed to integrate renewable generation through at least 2016, the last year of PG&E's LTPP adopted by D.07-12-052.

We recognize that after D.07-12-052 was issued, the Governor issued Executive Order S-21-09 that set a goal of increasing renewable power from 20% of PG&E's portfolio to 33% by 2020. Again, PG&E provided no evidence that the 1,489 MW of new capacity that it is procuring pursuant to D.07-12-052 cannot integrate the higher level of renewable generation. Nor did PG&E link needs in the year 2020 to the Upgrade projects that would come on-line in 2012 and 2013.

Turning to a related issue, CARE alleges that the LECEF Upgrade project will have start times of up to four hours, which makes it unsuitable for providing load-following power that is needed to integrate intermittent renewable power. We find that CARE's claim of start times of up to four hours is unfounded, as it is contradicted by the start times specified in the LECEF Upgrade PPA.⁶⁸

7.2.5. The Cost of the Upgrade PPAs Is Unreasonable

The appropriate standard for determining if the cost of the Upgrade PPAs is reasonable is the market price for the capacity, energy, and ancillary services provided by the Upgrade PPAs. If the cost of the Upgrade PPAs is less than or equal to the market price, then the cost is presumptively reasonable. Conversely,

⁶⁷ D.07-12-052 at 277, Finding of Fact 43.

⁶⁸ The LECEF Upgrade PPA is confidential and was filed under seal.

if the cost of the Upgrade PPAs is higher than the market price, then the cost is inherently unreasonable. To ensure that ratepayers pay no more than the market price, the Commission encourages utilities to procure power using a competitive process that is fair and transparent.

PG&E used a competitive process to procure the new capacity authorized by D.07-12-052. As described previously, PG&E received dozens of offers in response to its 2008 LTRFO. The winning bids were the Mariposa, Marsh Landing, and Oakley projects. These projects together represent the “market price” for determining if the cost of the Upgrade PPAs is reasonable.

Significantly, the Tracy Upgrade project and the LECEF Upgrade project were bid into the 2008 LTRFO. Thus, the two Upgrade projects can be directly compared to the market price as represented by the winners of PG&E’s 2008 LTRFO. In terms of ranking, the Upgrade projects were immediately below the winning bids and ahead of all other short-listed bids.

PG&E determined the market price for each short-listed bid using what it calls “levelized net market value” (hereafter, “net market value”). The net market value is the bid’s benefits, both capacity and energy, minus its costs. The costs are reflected in the offered pricing.

PG&E presented calculations of the net market value of each Upgrade PPA using both the total capacity method and the incremental capacity method. The IE also calculated the net market value for each Upgrade PPA using different assumptions.⁶⁹ The net market values of the two Upgrade projects as calculated by PG&E and the IE are worse than the winning bids in the 2008 LTRFO. CARE,

⁶⁹ The calculated net market values are confidential were admitted under seal.

DRA, and TURN provided confidential testimony that describes in detail why the cost of the Upgrade PPAs is above market and a poor deal for ratepayers.⁷⁰ Based on this information, at this time, we find that the cost of each Upgrade project is above the market price and, therefore, unreasonable.

PG&E contends that the Opposing Parties improperly rely on the incremental capacity method to reach the conclusion that the Upgrade PPAs are overpriced. PG&E's states that the incremental capacity method and the total capacity method should both be used to assess the net market value of the Upgrade PPAs. We do not need to decide whether to use one or both methods, as either approach reaches the same result: the cost of each Upgrade PPA exceeds the market price for projects selected in the LTRFO.

We disagree with PG&E's claim that its 2008 LTRFO demonstrates the Upgrade PPAs are reasonably priced, as it shows they are the least expensive projects available to hedge the risk of project delay and failure. A basic tenet of economics is that the market-clearing price occurs at the intersection of marginal demand and marginal supply. As explained previously, PG&E does not need the Upgrade PPAs to hedge the risk of project delay and failure. Consequently, there is no demand for the supply of new capacity provided by the Upgrade projects. Rather, PG&E's demand for new capacity was established by D.07-12-052, which was filled at a lower market-clearing price by the supply of new capacity provided by the Mariposa, Marsh Landing, and Oakley projects. Thus, the 2008 LTRFO demonstrates unequivocally that the cost of Upgrade PPAs exceeds the market-clearing price for new capacity.

⁷⁰ CARE Exhibit 12-C at 2 - 4, DRA Exhibit 7-C at 9 - 21, and TURN Exhibit 5-C at 13 - 15.

We recognize that the Tracy Transaction and the LECEF Transaction have many benefits, including the novation of DWR contracts, improved fuel efficiency, brownfield development, lower emissions, and the positive net market value of many of the contracts that comprise these Transactions. However, these benefits were insufficient to make these projects winners in the LTRFO.

In its comments on the proposed decision, Calpine asserts that the cost of the LECEF Upgrade PPA is reasonable because its price for capacity, operations, and maintenance is less than the proposed Oakley Project, one of the winning bids from the 2008 LTRFO. Calpine overlooks the benefits of the Oakley Project. PG&E testified that when both costs and benefits are considered, the net market value of the LECEF Upgrade PPA is worse than the Oakley Project.⁷¹

7.2.6. The Relevance of D.08-11-056

PG&E argues that because the Upgrade PPAs replace DWR contracts pursuant to D.08-11-056, none of the provisions in D.07-12-052 apply to the Upgrade PPAs, including the cap on the procurement of new capacity. We find no merit to this argument. D.08-11-056 requires any new PPA that extends the term of a DWR contract to comply with long-term procurement criteria adopted by the Commission pursuant to § 454.5:

[A]ny replacement agreement that would extend the term of a [DWR] contract should also be reviewed by the Commission for consistency with long-term procurement planning criteria, pursuant to Section 454.5. (D.08-11-056 at 81. See also the Implementation ruling at 11.)

⁷¹ PG&E Exhibit 2-C, Chapter 3, Appendix 3.

The Commission adopted “long-term procurement planning criteria, pursuant to Section 454.5” in D.07-12-052.⁷² Each Upgrade PPA is an inseparable element of a transaction that replaces and extends the term of a DWR contract. Thus, D.08-11-056 requires the Upgrade PPAs to be consistent with D.07-12-052. For reasons stated previously in today’s decision, the Upgrade PPAs will not be consistent with D.07-12-052 if the Commission approves the contracts in A.09-09-021, as PG&E would exceed the total capacity allowed in D.07-12-052.

Calpine and IEP assert that the Commission never intended to make the replacement of DWR contracts subject to D.07-12-056. Both parties are mistaken. The above-cited provision in D.08-11-056 requires replacement contracts such as the Upgrade PPAs to be reviewed for consistency with the long-term planning criteria that were adopted in D.07-12-052.

7.2.7. The Upgrade PPAs Do Not Comply with the Mariposa Settlement Agreement and D.09-10-017

In D.09-10-017, the Commission adopted a settlement agreement that authorizes PG&E to procure 184 MW of new capacity from the Mariposa project. Among other things, the Mariposa settlement agreement limited the amount of new capacity that PG&E may procure from its 2008 LTRFO to no more than 1,512 MW, including the Mariposa project.⁷³ This limit on procurement was explicitly adopted by Ordering Paragraph 1.a of D.09-10-017:

⁷² D.07-12-052 at 14, 290 (Conclusion of Law 1) and 300 (OPs 1, 2, and 4).

⁷³ D.09-10-017 at 4 and Attachment A at 2 and 3.

The total need to be procured from the 2008 Long-Term Request for Offers will be limited to 1,512 megawatts under peak July conditions, inclusive of the 184 megawatt included in the Mariposa Power Purchase Agreement. (D.09-10-017 at 15, Ordering Paragraph 1.a.)

PG&E has signed contracts to procure a total of 1,743 MW of new capacity from the 2008 LTRFO (254 MW from the Upgrade PPAs, 1305 MW from the Marsh Landing and Oakley projects, and 184 MW from the Mariposa project). Consequently, we conclude the Upgrade PPAs do not comply with the Mariposa settlement agreement and D.09-10-017.

In its comments on the proposed decision, Calpine argues that the LECEF Upgrade PPA is not subject to the Mariposa settlement because the LECEF Upgrade was procured through the novation process, and not the 2008 LTRFO. Calpine's argument is unpersuasive. The LECEF Upgrade was bid into the 2008 LTRFO by Calpine, was evaluated extensively by PG&E during the 2008 LTRFO process, and was placed on PG&E's shortlist of offers from the 2008 LTRFO.⁷⁴ Given the provenance of the LECEF Upgrade, we conclude that it is subject to the Mariposa settlement's limit on procurement from the 2008 LTRFO.

7.2.8. Conclusion and Conditional Approval

The criteria for deciding if the Upgrade PPAs should be approved are (1) whether PG&E has a need for the new capacity provided by the Upgrade PPAs, and (2) whether the cost of the Upgrade PPAs is reasonable. For the reasons stated previously in today's decision, we find that:

- PG&E has not demonstrated that the new capacity provided by the Upgrade PPAs is necessary at this time to

⁷⁴ PG&E Opening Brief at 20 – 21.

either (a) hedge the risk of project delay and failure, or
(b) integrate renewable generation.

- If the contracts under review in A.09-09-021 are both approved, then the new capacity provided by the Upgrade PPAs will exceed, at this time, the amount of capacity authorized by D.07-12-056, the Mariposa settlement agreement, and D.09-10-017. PG&E has not demonstrated that it needs more new capacity than already authorized.
- If the contracts under review in A.09-09-021 are both approved, then the cost of the Upgrade PPAs exceed the market price at this time.

Based on the above findings, we conclude that PG&E should not proceed with the Tracy Transaction and the LECEF Transaction until PG&E has an unfilled need for new fossil capacity authorized by D.07-12-052 or subsequent decisions. This could occur under two scenarios. First, PG&E's request for approval of the proposed Marsh Landing Project and/or Oakley Project could be denied in A.09-09-021. Under this scenario, PG&E shall proceed immediately with the Tracy Transaction and the LECEF Transaction, which are "ready to go."⁷⁵ PG&E shall demonstrate its compliance with this requirement by filing a Tier 1 advice letter containing executed copies of the contracts that comprise the Tracy Transaction and the LECEF Transaction⁷⁶ 30 days after the later of

⁷⁵ GWF Opening Comments on the proposed decision at 3, 7, and 13. See also Calpine's Opening Comments at 3 and 7.

⁷⁶ The contracts that comprise the Tracy Transaction and the LECEF Transaction are identified in Section 3.1 and 3.2.1 of today's decision.

(1) today's decision, or (2) the issuance of a Commission decision in A.09-09-021 that rejects the Marsh Landing Project and/or Oakley Project.⁷⁷

Second, if the Marsh Landing Project and the Oakley Project are approved in A.09-09-021, other events could create an unfilled need for the new capacity authorized by D.07-12-052 or subsequent decisions. If this occurs, PG&E may resubmit the Tracy Transaction, the LECEF Transaction, or substantially similar transactions for Commission approval via a Tier 3 advice letter. The resubmitted transaction(s) must meet all of the following requirements:

- The resubmitted transactions do not cause PG&E to exceed the new capacity authorized by D.07-12-052 or subsequent decisions.
- The resubmitted transactions have the same or better pricing structure for ratepayers (i.e., are no more costly to ratepayers in terms of out-of-pocket costs) than the transactions submitted in the instant proceeding.
- The resubmitted transactions provide at least the same level of operating flexibility as the transactions submitted in the instant proceeding.
- All the capacity provided by the resubmitted transactions can support the integration of intermittent renewable generation.

The resubmitted transactions may exclude the novation of existing DWR contracts if PG&E intends to seek, or has already sought, separate Commission approval for the novations.

⁷⁷ This requirement is consistent with TURN's recommendation in its Opening Brief at 1-2, and in TURN's Opening Comments on the proposed decision at 1. See also Calpine's Opening Comments at 11, Fn. 38; GWF's Opening Comments at 12-13; and Calpine's Reply Comments at 4.

PG&E's authority to resubmit the transactions using the Tier 3 advice letter process pursuant to today's decision shall expire the earlier of (1) the issuance of PG&E's next LTRFO for new fossil capacity,⁷⁸ or (2) the issuance of a Commission decision adopting a new LTPP for PG&E.⁷⁹

We conclude that it is reasonable for PG&E to proceed with the transactions under the previously identified scenarios because PG&E at that time will have an authorized need pursuant to D.07-12-052 or subsequent decisions for the new capacity provided by the transactions, and because the new capacity provided by the transactions will have been procured through a competitive process (the 2008 LTRFO) consistent with the Commission's preference for competitive procurement. In addition, the cost for the Upgrades' capacity will no longer be unreasonable, as PG&E at that time will have no cheaper alternatives available through a competitive procurement process. The transactions also comply with the EPS and advance PG&E's GHG reduction strategy.⁸⁰

7.2.9. Novation of DWR Contracts

In D.08-11-056, the Commission determined that it is in the public interest to phase out DWR's role in supplying electric power to utility customers and identified several benefits from doing so.⁸¹ To achieve this goal, D.08-11-056

⁷⁸ The Upgrades may be bid into PG&E's next LTRFO for new fossil capacity.

⁷⁹ The re-submittal of the Upgrade PPAs will be subject to the policies and requirements contained in the Commission's decision adopting PG&E's next LTPP.

⁸⁰ PG&E Exhibit 1 at 3-8 to 3-10, and PG&E Exhibit 2 at 3-7 to 3-9.

⁸¹ D.08-11-056 at 3, 9 - 10, and 29 - 34.

directed the IOUs to novate the existing DWR contracts and/or negotiate new agreements to replace the DWR contracts.

Today's decision does not grant PG&E's request for approval of the Tracy Novation Agreement and the LECEF Novation Agreement because these two agreements are inseparable elements of transactions that are not approved at this time. However, there is no reason why the Tracy Novation Agreement, the LECEF Novation Agreement, or substantially similar agreements, could not be submitted for approval on a standalone basis. Therefore, as contemplated by D.08-11-056, PG&E should work with DWR to novate the existing DWR-GWF Contract and the DWR-LECEF Contract to PG&E. We expect the novation to be accomplished expeditiously, as both contracts contain clauses that allow the contracts to be novated to PG&E upon DWR's request. PG&E may use the Tier 3 advice letter process established by the Implementation Ruling to submit the novated agreements for Commission approval.⁸²

7.3. The Peakers Transaction

The Peakers Transaction consists of the Peakers Novation Agreement and the Peakers PPA. The two agreements must be approved together or rejected together. The Peakers PPA is a long-term contract under which PG&E will procure 502 MW of capacity from existing power plants through 2017, and 325 MW through 2021. The standard of review for the Peakers Transaction is whether PG&E has a need for the capacity, energy, and ancillary services provided by the Transaction and, if so, whether the cost is reasonable.

⁸² Implementation Ruling at 18, Ruling Paragraph 6.

In deciding whether to approve the Peakers Transaction, we only need to consider the Peakers PPA and not the Peakers Novation Agreement. The latter Agreement will be in effect for only a short time. Whatever its merits, they are overwhelmed by the Peakers PPA that will be in effect until December 31, 2021.

7.3.1. PG&E Has a Need for the Peakers Capacity

There is no dispute that PG&E has a reasonable need for the amount of capacity provided by the Peakers PPA. If PG&E did not contract for the Peakers capacity, PG&E would have to obtain 502 MW of capacity elsewhere. In light of these circumstances, we find that PG&E has a need for the capacity provided by the Peakers PPA.

7.3.2. The Peakers PPA Maintains Resource Adequacy

The Peakers PPA extends the use of all existing Peaker capacity and provides PG&E with significantly improved operating flexibility from each Peaker unit. Therefore, we conclude that the Peakers PPA will maintain or improve resource adequacy relative to the exiting DWR contract.

7.3.3. The Cost of the Peakers PPA Is Reasonable

The Commission strongly favors the procurement of long-term PPAs through a competitive process that is open and transparent in order to ensure that the cost of the PPAs is reasonable. That did not occur with the Peakers PPA, which is disconcerting given the large amount of capacity involved, the length of the contract, and the considerable costs.

However, the record of this proceeding contains one market-based benchmark for assessing if the cost of the Peakers PPA is reasonable. Specifically, DRA reports that the average cost of the Peakers PPA over the

11-year contract is within the range of prices of the winning bids from PG&E's most recent intermediate-term RFO.⁸³ This shows the cost of the Peakers PPA is consistent with the current market price for capacity contracts spanning several years.

The record also includes PG&E's calculation of the net market value of the Peakers PPA. PG&E's calculation shows that the Peakers PPA has a positive net market value, which suggests the contract is a good deal for ratepayers. Based on these two benchmarks, we find that the cost of the Peakers PPA is reasonable.

TURN urges the Commission to reject the Peakers PPA because PG&E's calculation of the net market value of the Peakers PPA assumes rising RA prices over the next several years. If RA prices rise less than PG&E forecasts, which TURN believes is likely, then the Peakers PPA is a poor deal.

TURN's argument is unpersuasive. As explained previously, the cost of the Peakers PPA is reasonable when compared to the winning bids from PG&E's most recent intermediate-term RFO and LTRFO.

⁸³ DRA Exhibit 7-C at 6. The range of contract prices from the recent intermediate-term RFO are confidential and were admitted into the record under seal.

DRA argues that the Peakers PPA should be rejected because:

PG&E has not provided sufficient information for DRA to assess whether the modified terms of the [Peakers PPA] Novation are just and reasonable... DRA would prefer to see PG&E novate the [DWR-Peakers Contract] in the near identical form... then reexamine PG&E's need for that contract assuming Calpine submits it in a competitive solicitation after the contract expires in 2011. The cost to ratepayers of extending this existing contract by ten years rather than entering a new long-term contract when the next LTPP proceeding identifies a need, appears to outweigh the benefits. (DRA Opening Brief at 16 – 17.)

DRA does not cite a particular reason why the cost of the Peakers PPA is unreasonable. Instead, DRA seems to imply that PG&E might get a better deal in a future RFO. This is not sufficient grounds to reject the Peakers PPA.

7.3.4. The Emissions Performance Standard

The EPS applies to IOU contracts with generation facilities that have a term of at least five years and an anticipated capacity factor of at least 60%. PG&E presented undisputed testimony that the EPS does not apply to the Peakers PPA because the anticipated capacity factor is less than 60%.⁸⁴

7.3.5. Conclusion and Recovery of Costs

We conclude the Peakers Transaction is just and reasonable under § 451. We therefore approve the Transaction. PG&E is granted authority under

⁸⁴ PG&E Exhibit 2 at 3-8.

§ 454.5(d)(2) to recover the net cost⁸⁵ that it incurs under the Peakers Transaction via the Energy Resources Recovery Account.⁸⁶

We also grant PG&E's unopposed request to recover any future stranded costs associated with the Peakers PPA from customers, including departing load customers. PG&E may recover stranded costs from departing load customers via a non-bypassable charge in accordance with D.04-12-048 and D.08-09-012.

In its comments on the proposed decision, AReM/CLECA urges the Commission to reject the Peakers PPA because it was not procured through a competitive process. We reject this recommendation, as there was no requirement for PG&E to use a competitive process with respect to the Peakers PPA. To the contrary, PG&E was authorized by D.08-11-056 to negotiate new bilateral contracts, without of a competitive RFO, to replace existing DWR contracts, which is what occurred here.⁸⁷

8. Revised Need for Hearing

In Resolution ALJ 176-3243, dated October 29, 2009, the Commission preliminarily determined that hearings were needed in A.09-10-022. Similarly, in Resolution ALJ 176-3244, dated November 22, 2009, the Commission preliminarily determined that hearings were needed in A.09-10-034. The

⁸⁵ The net cost is the sum of the costs that PG&E incurs pursuant to the terms and conditions of the Peakers Novation Agreement and the Peakers PPA, less any revenues (or reduction in costs) that PG&E receives under these agreements.

⁸⁶ It is unclear if any Peaker units may be used to provide capacity to PG&E under the LECEF Replacement Agreement that PG&E may resubmit for Commission approval. To the extent the same Peaker units are used to provide capacity to PG&E pursuant to two or more contracts, PG&E may recover the cost for the same capacity only once, and only at the lowest contracted price.

⁸⁷ D.08-11-056 at 52 and 75.

Assigned Commissioner's Ruling and Scoping Memo (Scoping Memo) dated January 5, 2010, reversed these preliminary determinations, and determined that hearings were not needed. However, the Scoping Memo left open the possibility that hearings might be held and provided an opportunity for parties to file motions for evidentiary hearings. There were no motions for evidentiary hearings. Accordingly, there is no need for evidentiary hearings.

Rule 7.5 requires the Commission to approve a change to the preliminary determination on the need for hearings. For the preceding reasons, today's decision reverses the preliminary determination in Resolutions ALJ 176-3243 and ALJ 176-3244 that hearings are needed in this proceeding. In accordance with Rule 7.5, today's decision finds that evidentiary hearings are not needed.

9. Comments on the Proposed Decision and Motion

The proposed decision (PD) of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with § 311, and comments were allowed in accordance with Rule 14.3. Comments were filed on May 10, 2010, by AReM/CLECA, Calpine, DRA, GWF, IEP, PG&E, and TURN. Reply comments were filed on May 17, 2010, by AReM/CLECA, Calpine, CURE, DRA, GWF, PG&E, and TURN. These comments have been reflected, as appropriate, in the final decision adopted by the Commission.

On July 9, 2010, Contra Costa Generating Station, LLC filed a motion for party status. This motion is denied because there are no further formal opportunities for parties to participate in this application before the Commission acts on the proposed decision.

10. Assignment of the Proceeding

Michael R. Peevey is the assigned Commissioner and Timothy Kenney is the assigned ALJ in this proceeding.

Findings of Fact

1. PG&E is authorized by D.07-12-052 to procure 1,112 MW to 1,512 MW of new capacity by 2015. To procure the new capacity, PG&E selected three winning offers from its 2008 LTRFO with a combined capacity of 1,489 MW. The winning offers were the Mariposa project (184 MW), the Marsh Landing Project (719 MW), and the Oakley project (586 MW). The Mariposa project was approved by the Commission in D.09-10-017. The Marsh Landing and Oakley projects were submitted for approval in A.09-09-021, which remains pending.

2. The proposed Tracy Transaction and LECEF Transaction will together procure 588 MW of capacity, including 254 MW of new capacity.

3. Since D.07-12-052 was issued, PG&E has requested 1,743 MW of new capacity in multiple proceedings, including 254 MW in the instant proceeding. The requested new capacity is 231 MW more than authorized by D.07-12-052.

4. The main purpose of the 254 MW of new capacity from the proposed Tracy Upgrade PPA and LECEF Upgrade PPA is to hedge the risk that other projects for new capacity might fail or be delayed significantly.

5. PG&E has not demonstrated that the new capacity from the Upgrade PPAs is necessary at this time to (i) hedge the risk that other projects for new capacity might fail or be delayed significantly, or (ii) integrate intermittent renewable generation.

6. The cost of the Upgrade PPAs is unreasonable when compared to the market price for capacity, energy, and ancillary services contained in the winning bids from PG&E's 2008 LTRFO.

7. D.07-10-017 and the Mariposa settlement agreement limit PG&E's procurement of new capacity from the 2008 LTRFO to no more than 1,512 MW.

PG&E has requested authority to procure 1,743 MW of new capacity from the 2008 LTRFO, including 254 MW in the instant proceeding.

8. The Tracy Upgrade project and the LECEF Upgrade project will emit CO₂ at a rate below the EPS limit of 1,100 lbs/MWH.

9. PG&E will have a need to acquire new capacity pursuant to D.07-12-052 if a Commission-authorized project for new fossil capacity fails, the Commission rejects the proposed Marsh Landing Project and/or Oakley Project in A.09-09-021, or other circumstances occur that create an unfilled need for the new capacity authorized by D.07-12-052.

10. The cost of the Upgrade PPAs would become reasonable if a fossil project authorized by the Commission fails or the Commission rejects the proposed Marsh Landing Project and/or Oakley Project in A.09-09-021, as PG&E will not have any cheaper alternatives available at that time from a competitive procurement process to fill the need for new capacity authorized by D.07-12-052.

11. PG&E has a need for the capacity provided by the Peakers PPA.

12. Resource Adequacy will be maintained or improved under the Peakers PPA relative to the existing DWR-Peakers Contract.

13. The cost of the Peakers PPA is consistent with the market prices of the winning offers from PG&E's recent intermediate-term RFO and 2008 LTRFO.

14. The cost of the Peakers PPA is reasonable.

15. All Peaker facilities will operate at a capacity factor of less than 60%.

16. PG&E hired an IE to prepare a report that included an assessment of the Tracy and LECEF projects as well as the IE's opinion on whether the Commission should approve PG&E's request to procure more capacity than authorized by D.07-12-052 for the purpose of hedging the risk that other projects for new capacity might fail or be delayed significantly.

17. In Resolutions ALJ 176-3243 and ALJ 176-3244, the Commission preliminarily determined that there is a need for evidentiary hearings in this consolidated proceeding. This preliminary determination was reversed by the Scoping Memo, but the Scoping Memo also provided an opportunity for parties to file motions for evidentiary hearings. There were no such motions.

Conclusions of Law

1. The Tracy Transaction, LECEF Transaction, and Peakers Transaction are indivisible transactions. Each transaction must be approved in its entirety or rejected in its entirety.
2. The Upgrade PPAs do not comply at this time with D.07-12-052, D.09-10-017, and the Mariposa settlement agreement.
3. The Tracy Transaction and LECEF Transaction are not just and reasonable under § 451 at this time.
4. Pursuant to D.08-11-056, it is in the public interest to novate the DWR-GWF Contract and the DWR-LECEF Contract to PG&E. PG&E should work with DWR to novate these contracts as soon as practical and submit the novated contracts for Commission approval using the Tier 3 advice letter process.
5. If future events create an unfilled need for the new capacity authorized by D.07-12-052, PG&E may be able to procure one or both of the Upgrade PPAs and not exceed 1,512 MW of new capacity. Under this scenario, the Upgrade PPAs would be just, reasonable, and in compliance with D.07-12-052, D.09-10-017, and the Mariposa settlement agreement.
6. If the Commission rejects the proposed Marsh Landing Project and/or the Oakley Project in A.09-09-021, PG&E should proceed immediately with the Tracy Transaction and the LECEF Transaction. To demonstrate its compliance with

this requirement, PG&E should submit executed contracts for both transactions via a Tier 1 advice letter.

7. If events other than those identified in the previous Conclusion of Law create an unfilled need for the new capacity authorized by D.07-12-052 or subsequent decisions, PG&E should be allowed to resubmit the Tracy Transaction and/or the LECEF Transaction, or substantially similar transactions, for Commission approval using the Tier 3 advice letter process. The resubmitted transaction(s) should be subject to the conditions specified in the following order. PG&E should be allowed to exclude the novation of DWR contracts from the resubmitted transaction(s) if PG&E intends to seek, or has already sought, separate Commission approval for the novations.

8. The Tracy Upgrade PPA and the LECEF Upgrade PPA comply with the EPS and are a reasonable fit with PG&E's GHG reduction strategy.

9. The Peakers Transaction is just and reasonable under § 451.

10. The Peakers PPA is not subject to the EPS.

11. The Peakers Transaction should be approved.

12. PG&E should be authorized to recover the net costs it incurs under the Peakers Transaction, including stranded costs.

13. PG&E should be allowed to recover stranded costs from departing load customers via a non-bypassable charge pursuant to D.04-12-048 and D.08-09-012.

14. The IE is not authorized by D.07-12-052 to opine on whether PG&E should be allowed to procure more new capacity than authorized by D.07-12-052.

15. The long-form IE report template for proposed PG&E contracts should be revised as set forth in the body of today's decision.

16. There is no need for evidentiary hearings. The changed determination on the need for hearings should be approved in accordance with Rule 7.5.

17. Contra Costa Generating Station, LLC's July 9, 2010, motion for party status should be denied.

18. The following order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The Peakers Transaction described in Application 09-10-034 is approved.
2. If the Commission rejects the proposed Marsh Landing Project and/or the Oakley Project in Application (A.) 09-09-021, Pacific Gas and Electric Company shall proceed immediately with both the Tracy Transaction described in A.09-10-022 and the Los Esteros Critical Energy Facility Transaction described in A.09-10-034. Pacific Gas and Electric Company shall file a Tier 1 compliance advice letter containing executed copies of the contracts that comprise the Tracy Transaction and the Los Esteros Critical Energy Facility Transaction 30 days after the later of (i) today's decision, or (ii) the issuance of a Commission decision in A.09-09-021 that rejects the proposed Marsh Landing Project and/or Oakley Project.
3. If future events other than those identified in the previous Ordering Paragraph create an unfilled need for the new capacity authorized by Decision (D.) 07-12-052 or subsequent decisions, Pacific Gas and Electric Company may resubmit the Tracy Transaction and/or the Los Esteros Critical Energy Facility Transaction, or substantially similar transactions, for Commission approval via the Tier 3 advice letter process. The resubmitted transaction(s) must (a) not exceed the new capacity authorized by D.07-12-052 or subsequent decisions; (b) have the same or better pricing structure for ratepayers than the transactions submitted in the instant proceeding; and (c) provide at least

the same level of operating flexibility as the transactions submitted in the instant proceeding. All of the capacity provided by the resubmitted transaction(s) must be able to support the integration of intermittent renewable generation. The resubmitted transaction(s) may exclude the novation of existing contracts if Pacific Gas and Electric Company intends to seek, or has already sought, separate Commission approval for the novation(s).

4. Pacific Gas and Electric Company's authority to resubmit the Tracy Transaction, the Los Esteros Critical Energy Facility Transaction, or substantially similar transactions pursuant to the previous Ordering Paragraph shall expire the earlier of (i) the issuance of Pacific Gas and Electric Company's next long-term request for offers for new fossil capacity, or (ii) the issuance of a Commission decision adopting a new long-term procurement plan for Pacific Gas and Electric Company.

5. Pacific Gas and Electric Company may not proceed with the Tracy Transaction and the Los Esteros Critical Energy Facility Transaction unless there is an unfilled need for new capacity under the circumstances set forth in Ordering Paragraphs 2 and 3.

6. Pacific Gas and Electric Company shall work with the California Department of Water Resources (DWR) to novate to Pacific Gas and Electric Company as soon as practical DWR's existing contracts to purchase power from the Tracy Facility and the Los Esteros Critical Energy Facility. Pacific Gas and Electric Company may submit the novated agreements for Commission approval using the Tier 3 advice letter process.

7. Pacific Gas and Electric Company may recover via the Energy Resources Recovery Account the net costs it incurs under the Peakers Novation Agreement and the Peakers Power Purchase Agreement, including any stranded costs. The

recovery of stranded costs, if any, from departing load customers shall be implemented via a non-bypassable charge in accordance with Decision (D.) 04-12-048 and D.08-09-012.

8. The Energy Division is directed to revise the long-form template used by Independent Evaluators to report on proposed contracts submitted for Commission approval by IOUs as set forth in the body of today's decision.

9. There is no need for evidentiary hearings in this proceeding.

10. Contra Costa Generating Station, LLC's July 9, 2010, motion for party status is denied.

11. Application (A.) 09-10-022 and A.09-10-034 are granted and denied to the extent set forth above.

12. Application (A.) 09-10-022 and A.09-10-034 are closed.

This order is effective today.

Dated July 29, 2010, at San Francisco, California.

MICHAEL R. PEEVEY
President

JOHN A. BOHN
TIMOTHY ALAN SIMON
NANCY E. RYAN
Commissioners

I reserve the right to file a dissent.

/s/ DIAN M. GRUENEICH
Commissioner

I reserve the right to file a concurrence.

/s/ NANCY E. RYAN
Commissioner

**Dissent of Commissioner Dian M. Grueneich
July 29, 2010 Business Meeting, Agenda ID# 3258, Item 41**

Today we have before us two major procurement decisions, Decision (D.)10-07-042 and D.10-07-045, both involving Pacific Gas and Electric Company (PG&E).

D.10-07-042 is Administrative Law Judge (ALJ) Kenney's Proposed Decision (PD) in Application (A.) 09-10-022/ A.09-10-034, seeking approval, among other issues, for novation of contracts from the Department of Water Resource to PG&E, and procurement of 254 MW of expanded generation from the associated GWF Tracy and Calpine Los Esteros natural gas-fired powerplants. This procurement before us in tandem with the procurement considered in D.10-07-045, if approved in full, would add a total of 1,559 MW of new natural-gas, fossil-fired plants to PG&E's system.

The agenda today does not have us address these items concurrently, though the central issue in the two PDs is the same – whether PG&E ratepayers should fund thousands of millions of dollars of new fossil-fired generating capacity in the PG&E service area. Instead we now take up now the novations PD – that of ALJ Kenney. Our agenda shows that we will address later in this meeting the Long Term RFO PD, that of ALJ Farrar, in D.10-07-045.

Let me begin with my conclusion. On D.10-07-042, the ALJ Kenney novations PD, I do not support the outcome presented in the revised proposed decision, which – given the ALJ Farrar Long Term RFO PD before us today – approves procurement of 254 MW of expanded generation. I do, however, support the original novations PD from ALJ Kenney which found PG&E did not have a need

for the 254 MW and denied the matter without prejudice. Thus, I will vote no on the novations PD from ALJ Kenney.

The past two years have been marked by the largest economic downturn since the Great Depression, substantially reducing demand for electricity. At the same time, the commission has invested heavily in ambitious energy efficiency, demand response, distributed generation, and advanced metering programs that will significantly reduce demand. While I anticipate that demand for energy services will be revived by the upswing in the state's economy, these demand side investments will temper against the risk of a steep increase as seen in the past. Without a doubt, these demand side program effects will continue to increase during the coming years.

The arguments to approve the full procurements at issue in these PDs rely on an outdated forecast of demand that was completed in 2007 based on 2006 data. This forecast -- which predates the economic downturn -- assumes PG&E will need between 928 and 1328 MW of new generation by 2020. I direct your attention to the table presented overhead titled "2007 Long Term Procurement Plan Range Adjustments." On the first line, it presents this range of need determination.

I will use this table to illustrate that there are at least four reasons why authorization of the full procurement proposed by PG&E is not reasonable. Those items are shown on the table, in the "adjustments" category. All of these matters have been presented in the record before us.

First, let me start with the line entitled "Path 26 Mistake." A CEC analysis released in October of 2008 -- a full year before CPUC review of these

applications began – concludes that PG&E’s 2007 need determination overstated the amount of peak power flowing from north to south on path 26 by at least 1900 MW. As the report states, “the 3000 MW north to south capacity flow assumption... used in the CPUC’s LTPP decision D.07-12-052 is clearly not correct.” This single error in the 2007 need determination cancels out PG&E’s entire authorized need.

The second line of adjustments is labeled “2009 CEC forecast adjustment.” The CEC 2009 forecast determined that PG&E’s forecasted demand in 2015 is now 567 MW lower than anticipated by the commission in 2007 due to a revised economic forecast and the CPUC’s 2009 approval of the 2010 – 2012 expanded energy efficiency portfolios. For the PG&E service area alone, ratepayers are committed to spend over \$1 billion for energy efficiency programs through 2012. Given this expenditure, it makes no sense to assume zero savings from these programs.

The third adjustment takes into account energy efficiency savings between 2013-2020. This uses information from a may 2010 CEC report that finds that the state’s lowest quantity of energy efficiency savings that can be expected to occur will avoid an additional 1,731 MW of peak demand between 2013 and 2020 in the PG&E territory. Like the first two items, this avoided demand is not accounted for in the 2007 need determination.

Finally, the fourth adjustment shows the impact of the commission’s recent approval of PG&E’s request to build 500 MW of solar PV. This 500MW is above and beyond the contribution of renewables assumed in the 2007 procurement authorization. The number in this table assumes a 40% capacity factor, resulting in 200 MW of peak capacity and further reducing the need for new generation.

The result, as you can see, is clear. Rather than PG&E needing 928-1,328 MW of new procurement, PG&E's need is negative, between 2,500 MW to almost 3,000.

Over-procurement creates at least two major problems. First, it burdens ratepayers by making them pay for assets that will be underused. In these difficult economic times, we must be mindful of the strain this puts on Californians. And second, over-procurement contradicts the policy of procuring preferred resources from the loading order adopted by the Commission. If PG&E over-procures fossil generation, the cost-effectiveness of preferred resource programs diminishes.

Both PDs decline to revisit the 2007 procurement authorization on the theory such a revisit – though clearly warranted by current facts – will disturb the settled expectations of the market. Nonsense! Settled expectations of the market have flown out the window since 2007.

The global economy has suffered, and is continuing to suffer, through the worst economic downturn since the Great Depression. Virtually every business, large and small, and virtually every individual, rich or poor, has adjusted their expectations and altered their spending habits to conform to the realities of markets turned upside down, decreased demand and shrinking budgets. Approval of PG&E's proposed procurements will wrap us in a time warp to continue business as usual. Such approval even walls us off from the impacts of our own recent decisions. Our obligation is not to ensure that generators can continue as if the economic crisis never happened or we never learned of the mistakes and omissions in our 2007 need determinations. Our obligation is to ensure that our decisions have a legitimate factual basis, and that ratepayers' interests are protected.

Since 2005, this commission has allowed PG&E rates to rise 28%. As many of you know, I am very disturbed that our actions sometimes reflect the belief we hold an ever-expanding checkbook of ratepayer money. We should use a standard for our decision making that we only approve rate increases on a clear demonstration of necessity. That standard is not met here.

I am very sympathetic to the economic situation of the cities that would host these fossil-fired powerplants and their desire to create jobs. But, as my fellow commissioners remind me, we are not a job creation agency. The price per job from these powerplants is exceptionally high, and we have no basis on which to choose using ratepayer money to create jobs for one city but not another.

I, therefore, dissent to the novations PD from ALJ Kenney.

Dated July 29, 2010, at San Francisco, California.

/s/ DIAN M. GRUENEICH
DIAN M. GRUENEICH
Commissioner