Decision 06-02-031 February 16, 2006

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

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

# OPINION ON REHEARING ON SAN DIEGO GAS & ELECTRIC COMPANY'S APPLICATION FOR APPROVAL FOR THE OTAY MESA GENERATING PLANT

## I. Summary

This decision on rehearing grants the application of San Diego Gas & Electric Company (SDG&E) for approval to enter into a ten-year power purchase agreement (PPA) with Calpine Corporation (Calpine)[1] for electric power from the Otay Mesa Energy Center (OMEC).[2]

## II. Background

In Decision (D.) 04-06-011, the Commission approved the ten-year Otay Mesa PPA, for the output of a yet-to-be completed 573 megawatt (MW) facility,

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[1] Calpine testimony clarified that the PPA would be with Otay Mesa Energy Center, LLC, a wholly-owned subsidiary of Calpine. Schleimer testimony, Exhibit 23, p. 1.

[2] The electric generating facility that Calpine proposes to build and that is the subject of this rehearing has been referred to by numerous names, including the Otay Mesa Generating Plant. In order to clearly distinguish the generating facility from the recently approved Otay Mesa transmission project, we will refer to the plant as the Otay Mesa Energy Center (OMEC) in this decision.

along with several other electric procurement contracts solicited by SDG&E in a request for proposal (RFP) to meet the utility's grid reliability needs. The Utility Reform Network (TURN) and Utility Consumers Action Network (UCAN) jointly filed an Application for Rehearing to D.04-06-011, alleging that the decision was in error in determining that the Otay Mesa PPA should be approved as a "winning bidder" in the RFP. In D.05-06-062, the Commission granted limited rehearing only as to the Otay Mesa PPA, and the remaining electric resource contracts approved in D.04-06-011 remained confirmed. The scope of this rehearing phase is to determine whether or not the Otay Mesa PPA, when viewed as a bilateral contract, is reasonable and provides benefits to SDG&E's ratepayers.

Testimony was submitted by SDG&E, TURN, UCAN, Office of Ratepayer Advocates (ORA), Calpine and the City Of Chula Vista (Chula Vista). Evidentiary hearings (EH) were held October 31 through November 2, 2005. Post-hearing opening and reply briefs were received from SDG&E, Chula Vista, TURN/UCAN, Calpine, and ORA.

## III. Summary of Parties' Positions

SDG&E seeks authorization to enter into a ten-year PPA with Calpine, at a cost of $739 million, for power from the 573 MW Otay Mesa gas-fired plant, OMEC, that will come on line in January 2008.[3] The controversial issue that developed in the rehearing is whether the PPA will provide ratepayer benefits.

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[3] In the earlier proceeding on SDG&E's request for the six electric resource contracts, there was testimony that the Otay Mesa facility could come on line as early as June 2007, but SDG&E has indicated that it does not need the output until January 2008, so Calpine agreed to the later date.

SDG&E presented testimony with supporting data that supports its position that the PPA does provide ratepayer savings, whereas the consumer groups challenged that claim and presented testimony and data indicating that the PPA does not provide the benefits SDG&E claims, especially during the first three years of the contract, 2008 through 2010.

Independently of the Otay Mesa PPA, SDG&E applied for a certificate of public convenience and necessity (CPCN) for the installation of two 230 kilovolt (kV) electric transmission circuits, covering approximately 52 miles, in the same geographic area where the energy center will be located. These circuits will allow the OMEC to connect at the Miguel Substation with SDG&E's Sycamore Canyon Substation and Old Town Substation. In D.05-06-061, the Commission granted SDG&E the requested CPCN for the Otay Mesa Power Purchase Agreement (OMPPA) Transmission Project. While the transmission lines and the PPA for the energy center are separate and distinct, and were reviewed and analyzed by the Commission in different proceedings, the fact that the new transmission lines will be in service by the time the energy center comes on line does impact the evaluation of the PPA.

The interrelationship of the OMPPA Transmission Project with the OMEC became an important focus at the EHs because of SDG&E's claim that the energy center would benefit ratepayers by reducing transmission congestion costs. The evaluation of congestion costs was the primary factor dividing the utility and the consumer groups on evaluating and computing the amount of ratepayer savings.

SDG&E and Calpine strongly urge the Commission to quickly approve the Otay Mesa PPA on the ground that the record demonstrates clear ratepayer benefits. SDG&E developed the record by comparing the Otay Mesa PPA with an alternative option on numerous categories. When some of these categories were viewed individually, the Otay Mesa PPA was not more cost effective than the option. However, when all the factors were considered over the term of the PPA, SDG&E shows a net present value (NPV) benefit to ratepayers of $86.5 million.

SDG&E's analysis of the PPA identified $32 million in additional benefits when reduced costs for transmission congestion savings were included, totaling a NPV of $118.6 million in ratepayer savings.

TURN/UCAN challenge SDG&E's analysis on the transmission congestion savings and claim that reduced transmission congestion costs translate into reduced congestion rents—and therefore ratepayers do not benefit. TURN/UCAN also fault SDG&E's use of an alternatives "proxy" and question whether there are real alternatives that could provide similar or greater portfolio benefits at overall lower cost. TURN/UCAN urge the Commission to reject the Otay Mesa PPA and order SDG&E to fill any short resource need through alternative strategies.

ORA does not challenge the overall benefits of the Otay Mesa PPA, but presents data seriously questioning its economic usefulness pre-2011. Chula Vista agrees with ORA. Both ORA and Chula Vista suggest authorizing the Otay Mesa PPA, but deferring its implementation until 2011.

## IV. Arguments

### A. San Diego Gas & Electric Company

SDG&E defended its decision to enter into a contract with Calpine for the Otay Mesa output on the grounds that the contract will save money by alleviating transmission congestion and will allow the utility to meet its local area reliability (LAR) and resource adequacy (RA) requirements. Under current Commission directives on RA requirements, SDG&E is required to have

115 - 117% of the amount of power and capacity necessary to meet the needs of its bundled customers. At the present time, there is no LAR requirement, but the Commission has signaled its intent to examine the adoption of a LAR requirement in the near future.[4] Conceptually, the LAR requirement would obligate any load serving entity (LSE), including SDG&E, that serves load in a load pocket, to procure a percentage of its capacity in the load pocket. As an example, if the LAR percentage is 50%, then SDG&E would have to acquire at least 50% of its load in the load pocket it serves. For comparison purposes, SDG&E posits that it currently has less than 30% of is resource contracts coming from its load pocket. With OMEC, SDG&E would have almost 45% in its load pocket.[5]

SDG&E compared the costs to its customers with and without the Otay Mesa PPA: Option 1 and Option 2. For both Options, SDG&E compared six categories: capacity & fixed costs; variable costs; ancillary service costs; debt equivalence costs, CO2 costs; and RMR costs. When capacity and fixed costs and debt equivalence costs were viewed individually, the Otay Mesa PPA did not provide benefits to ratepayers, but when all six factors were considered, SDG&E shows a net benefit to ratepayers of $86.5 million.

In addition to the six factors outlined above, SDG&E also analyzed the impact to ratepayers if the costs and benefits of the OMPPA Transmission Project are included in the evaluation for Option 1 and Option 2. A key component of this benefit analysis is reduced transmission congestion costs, and SDG&E and

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[4] R.04-04-003 and/or its successor docket.

[5] SDG&E Opening Brief, p. 13.

Calpine argue that when those cost savings are included with the net value savings, the ratepayer benefits are increased by $32.1 million.

### B. Calpine Corporation

Calpine, as the builder/owner of the proposed OMEC, urges the Commission to approve the Otay Mesa PPA. Calpine argues that the record clearly demonstrates that the PPA is reasonable and provides significant, tangible, economic benefits to the utility's ratepayers of a NPV of $86.5 million over the term of the contract. In addition, Calpine agrees with the testimony and exhibits of SDG&E that show that if the costs and benefits of the OMPPA Transmission Project are also considered, ratepayers will receive benefits of a NPV of $118.6 million over the ten-year term of the PPA.

Calpine recites the Commission's prior findings that the Otay Mesa PPA will provide the following benefits to ratepayers: reduced RMR costs; a state-of-the-art, low heat-rate, economical, clean power source; increased overall efficiency and reliability in the utility's service area; an "insurance policy" in case of another energy crisis; reduced power shortages; and a way for older units to retire.[6] Calpine argues that these benefits are still viable today and do not depend on whether the Otay Mesa PPA is a winning bidder in a RFP, or the result of a bilateral contract.[7]

Calpine challenges the viewpoint presented by TURN/UCAN and their witnesses' application of the California Independent System Operator's (CAISO) Transmission Economic Assessment Methodology (TEAM) to the Otay Mesa

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[6] D.04-06-011, *mimeo.* at pp. 60, 66, 69, 82.

[7] Calpine Opening Brief, pp. 2, 3.

PPA. As Calpine contends, the TEAM "approach has never been accepted, much less used, to analyze generation projects and there is no reason to do so here. However, as SDG&E demonstrated, even if the TEAM approach is used to evaluate the Otay Mesa PPA—*which it should not be*—the Otay Mesa PPA still results in an "overall benefit" to SDG&E ratepayers and the CAISO."[8]

In its reply brief, Calpine reinforces its position that the TEAM methodology should not be used to evaluate a generation option. However, Calpine argues that if it is, the TEAM approach still shows that reductions in congestion charges will be greater than any reductions in congestion revenues, which leads to overall customer rate decreases.

### C. Office of Ratepayer Advocates

ORA has consistently challenged SDG&E's assertions that it needs more energy in 2008—when the OMEC is scheduled to come on line. Since the PPA is for a ten-year term, and ORA does not see ratepayer benefits for the first three years, 2008-2010, ORA's calculation of ratepayer benefits is a negative NPV of $28.7 million over the ten-year terms. However, since there are demonstrable benefits beginning in 2011, ORA supports the PPA if it commences then.

ORA's analysis of the PPA focuses on the viable alternatives available to SDG&E in lieu of the OMEC. ORA finds fault with the utility's choice of only one alternative for the comparison, and also finds the assumptions for the alternative flawed. In summary, ORA argues that SDG&E overestimated the capacity and fixed costs for the alternative, underestimated the congestion

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[8] Calpine Opening Brief, p. 6.

benefits of the alternative, and gave OMEC RMR credit—credit not expected unless the OMPPA Transmission Project is completed.

ORA looks at SDG&E's service area need for resources to meet grid reliability of 0 MWs for 2008, 10 MWs for 2009 and 103 MWs for 2010 and opines that under the alternative option, the utility would NOT procure the entire 573 MWs of the OMEC's capacity for those three years, yet the utility did that in its comparison table. Without the Otay Mesa PPA, ORA reasons that SDG&E would have the flexibility to procure exactly what it was short, rather than being obligated to take over 500 MWs from the OMEC.

ORA also criticizes SDG&E's presentation of the expected congestion relief that the OMEC would produce using the OMPPA Transmission upgrades. SDG&E did not assume that the alternative procurement option would have the benefits of the new transmission upgrades, and assigned no congestion cost relief to the alternative.

Since it may be assumed that if the PPA is approved, SDG&E will have excess capacity, there was discussion at the EHs that the excess could be sold. In its reply brief, ORA emphasizes that the value of the PPA should not be based on the potential capacity of an investor-owned utility to sell its excess capacity.

From ORA's analysis of the PPA and the alternative option presented by SDG&E, ORA does not agree that the Otay Mesa PPA presents superior ratepayer benefits in comparison to other alternatives and urges the Commission either to reject the PPA outright, or delay it until 2011.

### D. City of Chula Vista

Chula Vista is "home to or adjacent to major gas transportation and electric transmission and generation facilities, including the South Bay Power Plant (SBPP) operated by Duke Energy and the Otay Mesa Energy Center

(OMEC) proposed by Calpine."[9] The OMEC is located very near the border of Chula Vista and the infrastructure needed to support the facility crosses through extensive portions of the City. Chula Vista is supportive of the OMEC, and supported the OMPPA Transmission Project, because the City's long-term goal is to replace the SBPP, "a nearly 50-year old antiquated and inefficient unit located on Chula Vista's bayfront property …[that] results in significant reliability must run (RMR) payments by customers of SDG&E to the operators of SBPP."[10] Chula Vista also supports the OMEC because the City intends to implement a community choice aggregation (CCA) program and become a LSE. As an LSE, the City will be required to demonstrate resource adequacy, and the OMEC would allow Chula Vista to meet its LAR obligations. As Chula Vista frankly states, it does not care whether SDG&E, or another entity purchases the power from OMEC; the City will benefit if the energy center is built.

However, Chula Vista's support of the OMEC is not without restrictions: the City does not see the need for, or benefits to, SDG&E's bundled customers until 2011—the same time frame advocated by ORA. Chula Vista does not agree with the utility that OMEC will produce tangible benefits in 2008. Chula Vista reasons that by SDG&E's own data, the utility is already fully resource adequate, the utility assumed no load loss for the creation of a CCA provider during the term of the PPA, and SBPP is not certain to retire before 2011. The City supports the PPA if its start date is deferred until 2011, if the OMEC becomes a RMR unit

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9 Initial Brief of Chula Vista, November 30, 2005, p. 2.

10 Chula Vista brief, p. 4.

and there is a one-for-one reduction of RMR status for the SBPP unit with OMEC and there is no departing load charge for any CCA for the costs of the PPA.

In its reply brief, Chula Vista proffers suggestions of other potential energy providers that are within San Diego's geographic area that possibly could provide energy that would meet LAR requirements. This is new information that was not vetted during the EHs, was not subject to cross-examination, and is presented too late in the proceeding to allow for comments. We therefore do not give it any evidentiary weight.

### E. TURN/UCAN

In summary, TURN/UCAN claim SDG&E did not present sufficient, credible evidence to support the reasonableness of the Otay Mesa PPA and suggest that the utility fill its identified resource needs through alternative strategies. Specifically, TURN/UCAN urge the Commission to reject the PPA and require the utility to comply with the directives set forth in D.04-12-048 and use the competitive process to procure least-cost/best-fit resources following the loading order preferences established in the Energy Action Plan (EAP).

In particular, TURN/UCAN criticizes SDG&E's analysis of ratepayer savings from the "congestion benefits" of the Otay Mesa PPA. While TURN/UCAN do not claim that there will not be savings from reduced congestion on the transmission lines, their position is that this does not translate into a ratepayer benefit. Rather, congestion relief results in reductions in Congestion Revenues to be collected by the CAISO. Congestion Revenues are then generally credited to SDG&E ratepayers to reduce transmission rates.[11]

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[11] TURN/UCAN Opening Brief, p. 6.

In addition to not providing positive benefits for SDG&E ratepayers, TURN/UCAN also oppose the Otay Mesa PPA because of the utility's flawed modeling of alternative resource options. Like ORA and Chula Vista, TURN/UCAN question the need for the PPA pre-2011 and challenge SDG&E's assumption that they would procure as much as 573 MWs of replacement capacity beginning in 2008 if the PPA is rejected. TURN/UCAN claim it makes little sense for the Commission to approve a ten-year contract that is slated to be severely under-utilized in the beginning three years. Also, TURN/UCAN do not support SDG&E's choice of the Otay Mesa PPA because the utility did not consider the evolution of technology and likely improvements in generation facilities in its alternatives analysis, overstated debt equivalence costs, and did not consider utility-owned projects.

And finally, TURN/UCAN are concerned about Calpine's financial stability and some conditions precedent SDG&E put on its willingness to proceed with the PPA. In its reply brief, TURN/UCAN argue that Calpine's financial condition should cause the Commission concern due to the performance risks and litigation costs that would be associated with a bankruptcy proceeding. To ameliorate this risk, TURN/UCAN propose that if the Commission does approve the PPA that it not pre-approve the expenditure of ratepayer funds for SDG&E's involvement in a Calpine bankruptcy proceeding to preserve the PPA.

## V. Discussion

The Commission must balance the conflicting positions of the utility and the intervenors in light of the scope established for this rehearing: is there evidence that the Otay Mesa PPA is beneficial to SDG&E ratepayers and is reasonable? SDG&E presented testimony comparing the costs to customers with and without the Otay Mesa PPA. In its analysis, Option 1 was with Otay Mesa and Option 2 relied on combined cycle contracts, new peaking capacity and local unit contracts. As referenced earlier, SDG&E then compared Option 1 against Option 2 in the categories of capacity costs, energy costs, ancillary services costs, financial risks associated with green house gas emissions, debt equivalence and RMR costs. SDG&E did assume adding the same amount of capacity to its resource plan under both options and both options utilized resources within the utility's service area. Taken on its own without challenge from opposing parties, SDG&E's testimony presented a convincing record that the Otay Mesa PPA gave its ratepayers a NPV savings of $86.5 when those six factors were evaluated between Option 1 and Option 2; when transmission congestion cost savings were included, the PPA produced an additional $32.1 in ratepayer benefits.

However, several parties countered SDG&E's position. TURN/UCAN, ORA and Chula Vista all questioned the wisdom of approving a ten-year PPA that gave SDG&E 573 MW of capacity starting in 2008, when the utility hardly needs any of that energy until 2011. If we limited our analysis to whether or not the utility needed all that energy to meet its grid reliability needs, we would have to conclude that the PPA should be deferred until 2011. By that date, most of the Department of Water Resource (DWR) contracts will have expired and the SBPP should have been retired. When these assumptions are coupled with the region's expected growth and the potential for other aging power plants to retire, the need is real and apparent.

TURN/UCAN also suggested that if the arrangement with Calpine was for a turn-key, utility-owned project, with a useful life expectancy of 30 years, having excess energy for three out of 30 years would not have the same negative impact on the ratepayers as the proposal in front of us. TURN/UCAN also suggest that if SDG&E waits until 2011 to procure a new resource, new technologies might be available with lower hear rates and higher efficiencies than OMEC.

However, those are not options before us for consideration. What is before us is a negotiated ten-year PPA between SDG&E and Calpine with an in-service date of January 1, 2008. Calpine's testimony indicated that Calpine has completed 80% of the engineering for the project, all permits have been secured and foundations have been poured. Equipment for the plant has been purchased and is sitting in boxes at the site.[12]

So if a three-year delay is not practical, what will SDG&E do with the Otay Mesa output during 2008-2010? SDG&E presented testimony that having the capacity available from OMEC would provide grid reliability and allow the aging and inefficient SBPP to retire, would reduce RMR payments by SDG&E customers for the more expensive power from SBPP and other less efficient producers, and would meet the utility's resource adequacy requirements. In addition, if there is still excess energy, the utility can sell it to another ESP, and the net would go to the ratepayers.

SDG&E's analysis of the "congestion benefits" of OMEC is also subject to differing interpretations. As previously discussed, the Commission approved the OMPPA Transmission Project in D.05-06-061 and that project is slated to go forward whether or not the Otay Mesa PPA is approved. However, if the PPA is approved, there will be "double" benefits resulting from the combination of the OMEC and the new transmission lines. Delivery of power from OMEC will travel free of congestion, thereby saving SDG&E ratepayers from paying

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[12] Calpine Opening Brief, p. 9.

congestion costs that could result from alternative energy sources, including the ones modeled in SDG&E's Option 2. Congestions costs appear to be a two-edged sword: while ratepayers benefit from reduced congestion costs, that means that the CAISO collects less Congestion Revenues from the utility, revenues that are then generally credited to the ratepayers to reduce transmission rates.

This is not just a simple analysis. To begin, congestion benefits depends on who is the transmission owner (TO) or holds the Congestion Revenue Rights (CRR). SDG&E's witness explained that there was considerable uncertainty as to who would hold the CRRs post 2007 when CAISO institutes a market redesign technology update (MRTU). CAISO is still deciding how rights to the transmission lines will be determined. In summary, there could be TOs and holders of CRRs on the transmission lines. The holders of the CRRs would pay the TOs for the rights to use the line, and then the CRR would collect congestion rents for use of the lines. If SDG&E is a TO, the amount a holder might bid for CRR could depend on whether the line is expected to be congested or not. So, if the combination of the OMPPA Transmission Project and the OMEC reduces congestion, there could be lower sale revenues flowing to SDG&E—if the CRRs are allocated to LSEs.

While it is important that the Commission properly evaluate the effect the reduction in transmission congestion costs could ultimately have on congestion revenues as we evaluate the benefits of the Otay Mesa PPA, this proceeding can not become a disguised rulemaking for a complete vetting of the many different dimensions of congestion relief. We will not decide any principles concerning transmission congestion relief, transmission congestion revenues, their relationship with one-another, or the application of the TEAM approach to generation options in this decision.

What we will evaluate here is the ratepayer benefit from paying less in commodity rates. Customer rates include both a transmission rate and a commodity rate. Reduced congestion charges should reduce the CAISO commodity charge and therefore reduce SDG&E's commodity rate. Whether that benefit is offset by a loss of congestion revenues is too speculative at this time to accurately assess due to the uncertainty surrounding what the CAISO will do with the MRTU and ownership and holder rights.

Setting aside the issue of "rents," there are benefits to ratepayers from reduced transmission congestion: the likelihood of potential reliability problems are decreased and ratepayers have the opportunity to receive the most efficient and economical energy to serve load, rather than having cheap energy shut-out due to transmission path constraints.

We conclude that the Otay Mesa PPA would be a state-of-the-art, low heat-rate, economical, clean power, in-service-territory "insurance policy." The question we have to answer is, whether it is the best policy at this time for the cost. Is it better to go with a project that comes with a reasonable certainty of being built within a two-year time frame,[13] in a location that is well suited for the utility's needs, including LAR, grid reliability, RA, RMR requirements, G-1/N-1 requirements and deliverability, but has low expected capacity factors the first

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[13] At the time we are considering this PPA there is wide-spread publicity concerning possible financial problems Calpine might be experiencing. Our understanding is that the PPA has provisions built into it that protect SDG&E and its ratepayers, including credit support requirements and step-in-rights. (SDG&E Opening Brief, pp. 28-29.) These protections should ensure that the physical facility gets built no matter what the financial status is of Calpine. This understanding allows us to base our decision on the record of the proceeding and not on the daily news.

three years of the ten year PPA and might contribute to reduced transmission congestion revenues? Or, is it prudent to reject this PPA and see if there are alternatives that become available by 2011 that can provide the same, or perhaps even superior benefits to the ratepayers, but at a reduced cost?

As we discussed earlier, the intervenors urge us to wait. While we are as optimistic as TURN/UCAN that there will be technological advances creating more efficient energy options by 2011, we do not know what they are, where they will be, or what they will cost. Unless a viable option presents itself in SDG&E's load pocket, it may not help with congestion or LAR.

As we have had to do in previous procurement decisions, we need to evaluate the resource presented to us for consideration, under the terms that come with the resource, and either approve it, or reject it. As SDG&E stated in its reply brief, "a "delay" to 2011 is equivalent to denying the contract."[14] While we may give direction to a utility about how to go about procuring resources and give guidance about types and categories of resources, we cannot remake a contract to suit our view of what would be ideal for the utility and its ratepayers. Specifically, we cannot approve the PPA, but tell SDG&E that they should not pay for or take power until 2011, nor can we tell Calpine to build OMEC and then sell it to the utility as a turn-key project.

We find Calpine's argument persuasive: we previously found in D.04-06-011 that the Otay Mesa PPA brought advantages to ratepayers and we enumerated a litany of benefits. Those benefits are the same now, as they were

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[14] SDG&E Reply Brief, p. 1.

in June 2004, and are the same whether the PPA is evaluated as a winner bidder in a RFO, or as a bilateral contract.

We found[15], and again find that the Otay Mesa PPA will provide the following benefits:

a. Provide substantial benefits both to the customers of SDG&E and to the state as a whole.

b. Allow [SDG&E] to reduce its RMR costs.

c. Provide state-of-the-art, low heat-rate, economical, clean power to SDG&E's service territory.

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

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

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

It has been eighteen months since our decision in D.04-06-011, and since that time the state has become even more concerned and focused on resource adequacy, not just for the three investor-owned utilities, but for all LSEs. We are also looking at LAR requirements.[16] The OMEC is located in an ideal location to address reliability and resource concerns for all LSEs in the San Diego area. With its ability to connect with the OMPPA Transition lines, OMEC becomes an attractive replacement for the aging, less clean and less efficient, power plants the utility now has to rely on for RMR output.

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[15] Calpine's Opening Brief, pp. 2-3, citing D.04-06-011.

[16] R.04-04-003 and/or its successor docket.

So, despite the vexing issue of low expected capacity factors for 2008 through 2010, and the possibility of lost congestion rents, we find that the Otay Mesa PPA presents SDG&E with an energy resource that is reasonable and provides ratepayer benefits. We authorize SDG&E to execute the agreement with Otay Mesa Energy Center, LLC, a wholly-owned subsidiary of Calpine. There is no evidence in the record that a comparable facility, with the positive factors associated with the PPA, but without the negatives, is a realistic enough option to support our rejection of this PPA. No other project has come forward indicating that it is poised to be constructed in SDG&E's service territory in the near term, even though price and other key commercial terms related to the Otay Mesa PPA were known.

We also find reasonable TURN/UCAN's proposal concerning the financial risks associated with a possible Calpine bankruptcy, and adopt their provision that the utility does not have pre-approval to expend ratepayer funds for intervention in a Calpine, or in its wholly owned subsidiary Otay Mesa Energy Center, LLC, bankruptcy proceeding to preserve the PPA.

SDG&E should record costs relating to the Otay Mesa PPA in its Electric Resource Recovery Account (ERRA) for recovery of those costs through commodity rates. This is consistent with our previous policies for similar contracts.

## VI. Motions

TURN/UCAN brought a motion for admission of two confidential exhibits into the evidentiary record. The two exhibits were attached as confidential Appendices A and B to the confidential version of the motion. The exhibits had been deemed confidential by SDG&E pursuant to the amended protective order in this proceeding approved by Judge Walwyn in a December 1, 2003 ruling in

R.01-10-024. TURN/UCAN seek the removal of the confidentiality designation to "promote "public access" to critical materials with direct bearing on the reasonableness of the Otay Mesa PPA."[17]

In the absence of any subsequent protective orders in this proceeding, the operative one is the December 1, 2003 ruling. Currently, the Commission has an open proceeding, R.05-06-040, which is designed to address the issues surrounding confidentiality vs. public access that pervades all the procurement proceedings and raises its head in many others. Evidentiary hearings have already been held in the confidentiality rulemaking and a decision is anticipated spring of 2006.

Because of this open rulemaking and the fact that this rehearing phase on the Otay Mesa PPA is concluded, TURN/UCAN's motion is denied. It is not denied, however, because of the persuasiveness of SDG&E's arguments in favor of confidentiality. Based on the utility's presentation alone, there was no overriding need presented that justified keeping the exhibits confidential. They are being kept confidential only because this rehearing proceeded without the use of those documents, no party claimed prejudice because they were confidential, and TURN/UCAN effectively argued their position without need to use them.

TURN/UCAN also brought an additional motion, concurrent with its reply brief, to have an additional exhibit received into the record. The exhibit referenced Calpine's financial situation. As previously discussed, the Commission is aware of the news accounts on Calpine and is proceeding to

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[17] TURN/UCAN Opening Brief, p. 2.

decide the Otay Mesa PPA without reference to those articles. TURN/UCAN's motion is denied.

TURN and UCAN also filed a motion to admit additional evidence on January 17, 2006 for the limited purpose of allowing the Commission to consider a motion filed by Calpine in its bankruptcy proceeding, Case No. 05-60200(BRL), pending in the U.S. Bankruptcy Court Southern District of New York. Since this filing is a matter of public record, it is not necessary to admit it as an additional exhibit, and TURN's motion is denied.

Any other motions not already ruled on or mentioned in this decision are deemed denied.

## VII. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. SDG&E, DRA, Calpine, and TURN and UCAN (jointly) filed opening comments on January 17, 2006. SDG&E, Calpine, and TURN and UCAN (jointly) filed reply comments on January 23, 2006. We have considered and incorporated comments as necessary throughout the decision.

## VIII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Carol Brown is the assigned ALJ in this proceeding and principal hearing officer in this portion of the proceeding.

## Findings of Fact

1. SDG&E is seeking approval of a ten-year PPA with Calpine, at a cost of $739 million, for power from the 573 MW Otay Mesa gas-fired, combined-cycle power plant, that will come on-line in January 2008.

2. The Otay Mesa EC will connect at the Miguel substation with SDG&E's new transmission lines, approved in D.05-06-061, that connect SDG&E's Sycamore Canyon Substation and the Old Town Substation.

3. SDG&E's service area does not need all of the output from the Otay Mesa PPA for its grid reliability needs 2008 through 2010, assuming all existing generation remaining in place.

4. Even with low capacity in the first three years of the PPA, we find that SDG&E established ratepayer benefits over the ten-year term of the contract.

5. We find that the benefits that supported our decision in D.04-06-011 to approve the Otay Mesa PPA then, are still viable today. The benefits are: reduced RMR costs; a state-of-the-art, low heat-rate, economical, clean power source; increased overall efficiency and reliability in the utility's service area; an insurance policy in case of another energy crisis; a reduction in power shortages; and a way for older units to retire.

6. We find that the record does not provide any evidence that there will be an option available in 2011 that will provide all the ratepayer benefits of the Otay Mesa PPA, and without any of its deficiencies.

7. We find that the Otay Mesa energy center is in a location that will allow SDG&E to meet its grid reliability needs, its resource adequacy requirements, its local area requirements, if adopted, reduce RMR costs, meet the G-1/N-1 requirements and be fully deliverable.

8. SDG&E established that the Otay Mesa PPA is reasonable and provides ratepayer benefits.

9. SDG&E should record costs relating to the Otay Mesa PPA in its ERRA for recovery of those costs through commodity rates.

## Conclusions of Law

1. It is reasonable to approve the Otay Mesa PPA and for SDG&E to record the costs relating to the PPA in its ERRA for recovery through commodity rates.

2. The Otay Mesa PPA benefits ratepayers, is reasonable and is in the public interest.

3. It is reasonable to protect ratepayers from unknown litigation costs by not pre-approving SDG&E's expenditure of ratepayer funds to preserve the PPA in a Calpine or Otay Mesa Energy Center, LLC, bankruptcy proceeding.

## O R D E R

**IT IS ORDERED** that:

1. San Diego Gas & Electric Company (SDG&E) may execute the Otay Mesa Power Purchase Agreement (PPA) with Otay Mesa Energy Center, LLC, a wholly owned subsidiary of Calpine Corporation.

2. SDG&E is authorized to record the costs of this PPA in the Electric Resource Recovery Account and recover the costs through commodity rates.

3. SDG&E may file advice letters, or tariffs, as appropriate and necessary to implement the orders, conclusions and results reached in this decision.

4. SDG&E may not spend ratepayer funds preserving the Otay Mesa PPA in a Calpine or Otay Mesa Energy Center, LLC, bankruptcy proceeding without seeking prior Commission authorization.

5. Rulemaking 01-10-024 is closed.

This order is effective today.

Dated February 16, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners