Decision 06-11-048 November 30, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Approval of Long-term Request for Offer Results and for Adoption of Cost Recovery and Ratemaking Mechanisms.	Application 06-04-012 (Filed April 11, 2006)

OPINION APPROVING RESULTS OF LONG-TERM REQUEST FOR OFFERS

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OPINION APPROVING RESULTS OF LONG-TERM REQUEST FOR OFFERS

I. Summary

We approve the seven long-term agreements to procure 2,250 megawatts (MW) of new generation resources resulting from Pacific Gas and Electric Company's (PG&E) 2004 Long-Term Request for Offers (RFO).[1] We also adopt ratemaking mechanisms for the recovery of the reasonable costs of the approved contracts and projects.

Decision (D.) 04-12-048 adopted a long-term plan for each utility that provides direction on the procurement of resources over a 10-year horizon through 2014. Taking into account the expected load growth and retirements of aging power plants through the turn of the decade, energy efficiency and demand response programs, solar and other renewable development and combined heat and power on-site generation incentives, the long-term procurement plan adopted for PG&E established that there is a need for 2,200 megawatts (MW) of new generation in northern California by 2010. Accordingly, D.04-12-048 directed PG&E to initiate an all-source solicitation to secure these resources.

PG&E conducted its all-source solicitation, receiving over 50 bids for projects totaling in excess of 12,000 MW. Of these, PG&E selected and seeks approval for five power purchase agreements (PPAs) with terms from 10 to 20 years, a Purchase and Sale Agreement (PSA) for the Colusa project that will be

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[1] PG&E first issued the RFO on November 2, 2004, but suspended it on January 7, 2005, in order to conform it to the requirements contained in D.04-12-048, and reissued it on March 18, 2005.

developed by a power plant developer and purchased and operated by PG&E after the plant is operable and has passed performance tests, and an Engineering, Procurement and Construction (EPC) contract for new generation at PG&E's Humboldt Power Plant (Humboldt) which, together, will result in the construction of 2,250 MW of new generation facilities in northern California.

II. Procedural Background

PG&E filed this application on April 11, 2006, seeking an expedited order by November 2006 on the basis that delaying an order until after that time creates the risk that necessary resources will not be on line by the 2009 and 2010 summer peak periods. On May 17, 2006, protests were filed by the following parties:

- Coalinga Cogeneration Company, Salinas River Cogeneration Company and Sargent Canyon Cogeneration Company, filing jointly;
- Constellation Energy Commodities Group, Inc., Constellation Generation Group Inc. and Constellation Newenergy, Inc., filing jointly;
- Division of Ratepayer Advocates (DRA);
- Alliance for Retail Energy Markets (AReM), California Large Energy Consumers Association (CLECA), California Manufacturers & Technology Association (CMTA), Direct Access Customer Coalition, Energy Producers and Users Coalition, Energy Users Forum, Sempra Global and Silicon Valley Leadership Group, filing jointly;
- Western Power Trading Forum;
- Aglet Consumer Alliance (Aglet);
- The Utility Reform Network (TURN);
- California Municipal Utilities Association; and
- Merced Irrigation District and Modesto Irrigation District, filing jointly.

Many of the protests took issue with PG&E's apparent request, implied by the caption of the application and by PG&E's prayer for relief, that the Commission adopt a cost-allocation proposal that was then pending in the Long-Term Procurement Rulemaking (R.) 06-02-013. Specifically, PG&E and other parties jointly proposed, in R.06-02-013, that the Commission allocate the benefits and net costs of resource additions (including those that are the subject of this application) to all customers in PG&E's service territory, not just bundled customers. Some of the protests objected to PG&E's application as an improper attempt to relitigate the issue in this proceeding, while others protested the merits of the cost-allocation proposal. PG&E clarified, in its May 17, 2006, reply and at the May 25, 2006, prehearing (PHC) conference, that it did not intend for the Commission to determine the cost allocation issue in this proceeding.

Four additional parties entered appearances at the May 25, 2006, PHC: Southern California Edison Company (Edison), Calpine Corporation, Coalition of California Utility Employees (CUE) and California Unions for Reliable Energy (CURE), and California Department of Water Resources. (The California Independent System Operator appeared at the August 24, 2006, evidentiary hearing, at which time it requested and was also granted party status.)

The June 1, 2006, scoping memo and ruling of the assigned Commissioner adopted PG&E's, DRA's, TURN's and Aglet's jointly stipulated schedule of the proceeding, determined that the cost allocation issue is outside the scope of this proceeding, and identified the following issues for resolution:

- Should the Commission approve the PPAs, PSA and EPC contract resulting from PG&E's RFO?
- What ratemaking should apply to the costs of the contracts?

- Should the Commission grant a certificate of public necessity and convenience (CPCN) for the proposed Humboldt Bay Power Plant?
- Are the projects exempt from California Environmental Quality Act (CEQA) review by the Commission?
- Does PG&E have the authority to condition concluding the RFO on approval of the cost allocation proposal in R.06-02-013?

On July 20, 2006, the Commission issued D.06-07-029 adopting, with modification, the cost allocation proposal that had been pending in R.06-02-013. D.06-07-029 requires utilities to elect or waive the approved cost allocation mechanism at the time they file an application for approval of power purchase agreements. D.06-07-029 further provides that utility-owned new generation is not eligible for the new cost allocation methodology, but is subject to the 10-year non-bypassable charge established in D.04-12-048. In its prepared rebuttal testimony served on August 11, 2006, PG&E responded to D.06-07-029 by proposing to defer its election with respect to the power purchase agreements presented in this application, and to extend the non-bypassable charge applicable to the utility-owned projects to 30 years; no party opposed the testimony as beyond the scope of this proceeding.

Hearings were held on August 22-25 and 28, 2006. By consensus of the active parties, opening briefs were filed on September 22, 2006, and the proceeding was submitted upon the filing of reply briefs on September 29, 2006.[2]

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[2] DRA's September 22, 2006, motion to file the proprietary version of its opening brief under seal, and Aglet's September 28, 2006, motion to file its reply brief under seal are granted.

The proposed decision of the Administrative Law Judge (ALJ) mailed on October 17, 2006. Comments on the proposed decision were filed on November 6, and reply comments were filed on November 13, 2006. The parties' comments identified a factual ambiguity in the record, namely, whether PG&E had included its proposed owner's contingency, which it sought to have included in the initial capital cost for the Humboldt and Colusa projects, was included in the project bid prices submitted and analyzed in the solicitation and contract selection process. By ruling dated November 11, 2006, the ALJ set aside submission and reopened the evidentiary hearing to take evidence on this factual issue. The record was re-submitted at the conclusion of evidentiary hearing on November 21, 2006.

III. Long Term RFO Results

A. Summary and Review Criteria

The final contracts selected by PG&E in this long term RFO are summarized in the following table:

FACILITY	SIZE (MW)	CONTRACT TYPE	PLANNED OPERATIONAL DATE	TERM (YEARS)
Calpine Hayward	601	PPA	June 2010	10
EIF Firebaugh	399	PPA	Aug 2009	20
EIF Fresno	196	PPA	Sept 2009	20
Starwood Firebaugh	118	PPA	May 2009	15
Black Hills	116	PPA	May 2009	20
E&L Westcoast Colusa	657	PSA	May 2010	life
Wartsila Humboldt	163	EPC	May 2009	life
TOTAL	2,250			

We approve the contracts on the basis that they (1) resulted from a fair, open and competitive bidding process, (2) comport with PG&E's procurement authority granted in our prior decisions, and (3) are cost-effective and reasonable.

Aglet recommends that we include, in this list of review criteria, consideration of whether the bidder can be reasonably expected to meet its contractual obligations. We address Aglet's particular concern with regard to this issue (the viability of the Calpine Hayward contract) in the context of whether the particular contracts reasonably meet the ratepayers' needs.

B. Solicitation and Contract Selection Process

PG&E conducted an open, competitive and fair solicitation and contract selection process. We are pleased to make this finding based on the report of the Independent Evaluator, who monitored and critically reviewed the process,[3] and the general consensus opinion of the active parties to this proceeding.

C. MW Amount

We approve as reasonable the amount of new generation that is anticipated to result from the selected contracts. We previously established that there is a need for 2,200 MW new generation in northern California by 2010 and directed PG&E to initiate an all-source solicitation to secure these resources. (D.04-12-048.) Although the 2,250 MW represented by the selected contracts exceed the authorized amount by 50 MW, this discrepancy is minimal and reasonably reflects the practical likelihood that the outcome of the RFO will not exactly match the authorized amount. In addition, the 2,250 MW includes the

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[3] D.04-12-048 requires the use of an independent evaluator in resource solicitations where there are affiliate bidders, bids for utility-built projects, or bids for turnkey projects to be acquired by utility.

163 MW Humboldt project, which is essentially a replacement for an existing, old plant and is designed primarily to serve local reliability needs.[4]

DRA and TURN contend that, taking into account the 530 MW Contra Costa 8 project recently authorized by the Commission (D.06-06-035), PG&E's proposal to add 2,250 MW of new generation exceeds the authorized amount of 2,200 MW by 580 MW (or 417 MW, excluding Humboldt). DRA and TURN contend that PG&E has not justified this excess amount, and therefore recommend that we reject some of the contracts.

We do not count the Contra Costa 8 project against the 2,200 MW authorized in D.04-12-048, as doing so would undermine our commitment to a comprehensive and cohesive process for evaluating the utilities' long-term procurement plans and to a competitive bidding and bid evaluation process for procuring resources pursuant to those plans. D.04-12-048 determined a need for 2,200 MW of new generation and directed PG&E to conduct a competitive bidding process to obtain it. Although we admonished the utilities that negotiated bilateral agreements are discouraged, we provided that such agreements would be evaluated on a case-by-case basis. PG&E's Application (A.) 05-06-029 applied for approval of the Contra Costa 8 project outside of the competitive bidding process, and we evaluated it on its individual merits and approved it without revising our prior procurement authorization. (D.06-06-035.) In the interest of preserving the integrity of our planning and procurement processes, we decline to revise it now.

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[4] D.04-12-048, Ordering Paragraph 4, authorized PG&E to justify to the Commission why higher MW levels may be desirable.

DRA, in its comments on the proposed decision, counters that it will undermine the integrity of the long-term planning process if we do *not* count Contra Costa 8 against the authorized 2,200 MW. DRA's point is well-taken: Long-term planning and competitive solicitation are equally critical to fair and rational energy planning and procurement, and actions that undermine one side of the equation may be as damaging to the process as a whole as actions that undermine the other. In this case, as DRA's witness testified, the general view was that Contra Costa 8 was "a bargain that PG&E was able to snap up and go forward on. It seems to be separate from what is going on in the long-term RFO, if I understand." (Tr. Vol. 3, p. 259, DRA/Burns.) The project was already substantially permitted and partially constructed at the time PG&E acquired it, and its planned operation date is a year in advance of the planned operational dates of any of the projects selected in this RFO. (D.06-06-035, p. 11.) We did not count Contra Costa 8 against the authorized 2,200 MW when we approved the project; balancing the interests and circumstances, we determine that we will not do so now.

In its comments on the proposed decision, TURN charges that this determination is arbitrary and capricious because it is based on a rationale that is made after the issuance of D.04-12-048.[5] This is not error. In our decision approving the Contra Costa 8 project, we acknowledged this issue, raised by the

[5] TURN also claims that the rationale is inappropriate since no party in this proceeding proposed it until PG&E filed its reply brief. We remind TURN that we are bound by the record evidence and the law, not by the parties' characterizations of either. Thus, for example, the fact that no party challenged the ratemaking proposals for Colusa and Humboldt for violating Commission precedent until TURN and others filed comments on the proposed decision – and even if no party had ever done so -- does not bar us from considering that legal basis, as appropriate.

Independent Energy Producers (IEP), of whether, in light of our directive in D.04-12-048 that competitive solicitations are the preferred method for selection of new energy resources, it was appropriate to consider the project outside of such a solicitation. We determined that this issue should be considered in R.06-02-013 "or in another appropriate proceeding." (D.06-06-035, p. 4.) We necessarily address it here.

As a related matter, we note that some parties sought to challenge, in this proceeding, our need determination in D.04-12-048 either on the basis that it overstated need (*e.g.*, because it underestimated departing load) or that it understated it (*e.g.*, because it did not account for demand levels experienced during the recent heat storms of August 2006). We affirm the ALJ's rulings barring testimony on this issue as beyond the scope of this proceeding.[6] Our long term procurement proceedings are intended to monitor changes in forecasts. In order to permit timely action in response to Commission determinations of need for new generation resources, it is crucial that we not be sidetracked by second-guessing recent determinations absent evidence of significant errors.

D. Cost-Effectiveness and Reasonableness

TURN, DRA, and Aglet challenge certain aspects of particular contracts and recommend that the Commission adopt various measures to remedy the alleged deficiencies. We reject their recommendations. It is undisputed that all of the selected contracts are cost-effective. We find that they reasonably meet the resource need identified in D.04-12-048.

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6 *See, e.g., ALJ's Ruling Striking Testimony of Modesto Irrigation District, Merced Irrigation District, and Pacific Gas and Electric Company*, August 15, 2006.

TURN asserts that the Colusa PSA, which provides for the developer to build the plant and then sell it to PG&E, is inferior to a PPA structure for the project, which was also offered to PG&E. Specifically, the Colusa PPA option provided somewhat greater economic benefits according to PG&E's and the Independent Evaluator's quantitative analyses, and would have provided performance guarantees that would require PG&E to pay the seller less if the plant does not perform up to the negotiated standards. TURN recommends that the Commission adopt a set of performance-based ratemaking mechanisms for Colusa to compensate for the PSA's estimated lower value to ratepayers.

We reject TURN's recommendation. PG&E's selection of the Colusa project, as proposed for transfer to PG&E, is reasonable under Commission standards. Among other things, a utility action is reasonable if it comports with what a reasonable manager would do, and if it resulted from a reasonable process; it need not be the optimum act, but must be within the spectrum of reasonable acts.[7] It is undisputed that the Colusa PSA was selected pursuant to a fair and competitive process. We also consider whether the utility action can be logically expected to accomplish the desired result at the lowest reasonable cost consistent with good utility practices,[8] taking into account non-quantitative factors, the choice between a Colusa PPA and a Colusa PSA was at best a "close call."

In its comments, TURN asserts that the proposed decision factually errs in stating that no party disputes that all of the selected contracts are cost-effective. TURN asserts that, to the contrary, the EIR Fresno and

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[7] *Re Southern California Edison Company* [D.90-09-088] 37 CPUC2d 488, 499-500.

Tierra Energy Hayward PPAs are not cost-effective and that this lack of cost-effectiveness formed the primary basis for TURN's recommendation that they be rejected. TURN's statement of its litigation position is contrary to its testimony and briefs. In its opening brief, TURN addressed the relative value of the EIF Fresno and Tierra Energy Hayward PPAs in the context of its position, rejected above, that approval of all of the selected contracts will result in the overprocurement of resources. While TURN's witness Mr. Woodruff characterized the contracts as having the least value of any of the selected contracts, and recommended that the Commission reject them if the Calpine project does not go forward, he did not recommend that they be rejected for not being cost-effective. Notably, neither TURN nor any other party challenged the evidence presented by Aglet that demonstrated, using the Black model, that all seven of the proposed contracts are cost-effective.

DRA recommends that the Commission authorize cost recovery for only nine of the 10 engine generators in the proposed Humboldt replacement project, on the basis that PG&E's own transmission planning personnel recommend replacing the existing 135 MW with no more than 150 MW (as compared to the 163 MW represented by 10 engine generators). The record evidence, however, indicates that PG&E's transmission planning personnel subsequently recommended maximum replacement generation of 168 MW, that the project as proposed was selected through an open, competitive and fair solicitation and contract selection process, and that the 10^{th} engine generator provides value at relatively low incremental price. PG&E's selection of the

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[8] *Ibid.*

10-engine generator Humboldt project is reasonable under the Commission standards described above, and there is not sufficient cause to modify its action.

Aglet recommends that the Commission approve the Calpine Hayward PPA only if PG&E obtains step-in rights in the event Calpine fails to honor the contract, on the basis that Calpine cannot be reasonably expected to meet its contractual obligations as demonstrated by its efforts, in bankruptcy court, to invalidate an existing power purchase contract with PG&E. We are not persuaded that the Calpine Hayward PPA poses an undue or exceptional risk of nonperformance. PG&E is dealing with a Calpine entity that is not in bankruptcy, and one of the parties to the agreement is General Electric, which is undisputed to be one of the nation's soundest counterparties. There is insufficient cause on this record to require PG&E to obtain step-in rights which, at this juncture, could adversely affect project financing and likelihood that the project will be built.

IV. Cost Recovery for Humboldt and Colusa

A. Capital Costs

1. Background and Summary

D.04-12-048 provides that the capital cost of a utility-owned project selected in an RFO shall be capped at the project bid price, and that any savings below the project bid price shall be shared 50/50 between ratepayers and shareholders. D.05-09-022 granted limited rehearing on the issue of the 50/50 sharing mechanism, but provides that the 50/50 sharing mechanism will continue to apply pending the outcome of the limited rehearing, subject to adjustment.

PG&E, Aglet and DRA each propose ratemaking for the capital costs of the Humboldt and Colusa projects that would provide PG&E the opportunity to seek recovery of capital costs in excess of the adopted initial capital cost in a reasonableness review and/or true-up the projects' final capital costs to reflect 100% of any savings below the adopted initial capital cost. The proposed decision noted that, although no party had challenged any of the proposals on this basis, these elements of the parties' proposals appeared to deviate to some degree from D.04-12-048. The proposed decision adopted a variation of these elements of the parties' proposals.

In their comments on the proposed decision, however, TURN, IEP,[9] and DRA challenge the proposed decision for deviating from D.04-12-048 by allowing PG&E to seek recovery of excess capital costs pursuant to reasonableness review. This decision modifies the proposed decision to appropriately conform to D.04-12-048, as discussed below.

In summary, we approve as reasonable and adopt the project bid price as the initial capital cost for the Colusa project, including the fixed contract price, excluding incentive payments, plus PG&E's estimated owner's costs, including owner's contingency. PG&E may not seek recovery of additional costs in excess of the project bid price, except that PG&E may apply for recovery of only those additional capital costs that PG&E may incur as a result of operational enhancements to the project. We direct PG&E to adjust the initial capital cost by advice letter filing to reflect any performance incentive payments actually made, and any performance incentive penalty actually due to it under the contracts. We direct PG&E to retroactively true up the initial capital cost in the next GRC

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[9] We grant IEP's motion, filed concurrently with its comments on the proposed decision, to become a party to the proceeding.

following operation to reflect 50% of any savings relative to the initial capital cost.

We approve as reasonable and adopt, as the initial capital cost for the Humboldt project, the sum of the fixed contract costs, excluding incentive payments, plus PG&E's estimated owner's costs, including a 5% contingency amount. We direct PG&E to adjust the initial capital cost by advice letter filing to reflect any performance incentive payments actually made, and any performance incentive penalty actually due to it under the contracts. PG&E may seek recovery of any additional capital costs upon a showing of reasonableness, and is directed to retroactively true up the initial capital cost in the next GRC following operation to reflect 100% of any savings relative to the initial capital cost.

We address the specifics of the adopted ratemaking for the projects' capital costs below.

2. PG&E's Proposal

PG&E requests that the Commission approve as reasonable an initial capital cost for the Humboldt and Colusa projects equal to the fixed contract costs, including incentive payments, plus PG&E's estimated owner's costs, including proposed owner's contingencies, plus net fuel costs. PG&E proposes that it be permitted to increase the initial capital cost determination for additional costs that PG&E may incur as a result of (1) a delay in the closing date, (2) operational enhancements to the project, or (3) changes to the project due to new regulatory requirements or other external events; PG&E would seek these increases by advice letter filing. PG&E also proposes to file an advice letter to update the initial revenue requirement to reflect the then-current authorized cost of capital, franchise and uncollectibles factors, and property tax factors.

PG&E proposes that it be permitted to seek recovery of any other actual costs in excess of the initial capital cost upon a showing that they are reasonable.[10] Conversely, PG&E proposes to retroactively true-up the initial capital cost in the next general rate case (GRC) following operation to reflect any actual cost savings.

3. Aglet's Proposal

Aglet proposes that the Commission adopt an initial capital cost for the Humboldt and Colusa projects equal to the fixed contract costs, including incentive payments. Aglet asserts that all other non-fuel, estimated capital costs have not been reviewed for reasonableness in this proceeding and should therefore be reviewed in PG&E's next GRC and placed in rate base only if the Commission finds them reasonable and prudent. Aglet proposes that net fuel costs be reviewed in PG&E's next Energy Resources Recovery Account (ERRA) proceeding, and not capitalized as PG&E proposes.

4. DRA's Proposal

DRA recommends that the Commission approve an initial capital cost for the Humboldt and Colusa projects equal to the fixed contract costs, excluding incentive payments, plus PG&E's estimated owner's costs, excluding PG&E's proposed owner's contingencies and certain Humboldt development costs. DRA recommends that PG&E be permitted to adjust the initial capital cost for any performance incentive payments or penalties when they are known. DRA opposes PG&E's proposal to recover other additional costs upon a showing of reasonableness in a subsequent proceeding. Instead, DRA proposes that

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[10] PG&E suggests that it be permitted to seek this recovery "either in this proceeding or a subsequent proceeding."

shareholders be disallowed rate recovery of 10% the first $50 million in excess costs above the initial capital cost, and be subject to reasonableness review only of any cost overruns in excess of $50 million. DRA joins Aglet in opposing PG&E's proposal to capitalize net fuel costs and the heat rate incentive.

5. Discussion

a) Fixed Contract Costs and Incentive Payments

We find the fixed contract costs for the Colusa and Humboldt projects to be reasonable. These costs were vetted through the competitive solicitation and contract selection process, and there is no basis to further review them for reasonableness.

The fixed contract costs, other than incentive payments, shall be included in the initial annual revenue requirement. Incentive payments shall not be included in the initial capital cost until and unless they are incurred. We direct PG&E to file advice letters at that time to adjust the projects' initial capital costs to reflect actual performance incentive payments paid or actual performance penalties due to it under the contracts.

We reject PG&E's request to include potential incentive payments in the pre-approved initial capital cost, for later downward adjustment in the GRC following operation in the event they are not paid. There is no demonstration in the record that the incentive payments are likely to be incurred. The advice letter procedure provides a timely means for adjusting the initial capital cost to reflect actual incentive payments without disadvantage to PG&E. In contrast, including potential incentive payments in the pre-approved initial capital cost would unnecessarily delay any downward adjustment for non-payment until the GRC following plant operation.

Although DRA proposes that PG&E be permitted to adjust the initial capital cost to reflect incentive payments or penalties when incurred, it challenges the proposed decision's adoption of this proposal for being inconsistent with the requirement because it constitutes a "soft cap" on recoverable capital costs in violation of D.04-12-048. DRA's objection is without merit. D.04-12-048 permits recovery of all capital costs in the project bid price. Incentive payments (and penalties) are a part of the fixed contract terms, and therefore constitute part of the recoverable project bid price.

We reject DRA's proposal that the heat rate incentive (if paid) be treated as an operational cost rather than included in the capital cost estimate. The heat rate incentive, like the other contractual incentives, is a fixed contract cost that is appropriately treated like all other fixed contract costs.

b) Estimated Owner's Costs

We find PG&E's estimated owner's costs of the projects to be reasonable. These costs shall be included in the projects' initial annual revenue requirement.

Aglet opposes pre-approval of PG&E's estimated owner's costs because they are uncertain. Aglet points out that requiring review of uncertain costs will provide a strong incentive to minimize cost overruns. However, we recognize PG&E's interest in obtaining some amount of certainty of cost recovery before undertaking these large projects, the public interest in avoiding unnecessary regulatory reviews, and the fact that PG&E's capital cost estimates including owner's costs have been scrutinized in this proceeding and, with respect to the Colusa project, in the contract selection process.

We reject DRA's proposed adjustments to disallow recovery of the cost of outside counsel for siting work on the Humboldt project. DRA asserts that this cost is unreasonable because PG&E should be able to perform this work with its in-house counsel, and because PG&E did not support its estimate of the cost with workpapers. However, as PG&E explains, it does not have the in-house experience or expertise because it has not worked on siting issues with the California Energy Commission (CEC) or sited a power plant under CEQA for over 20 years, and based its estimate on discussions with environmental firms that routinely do this work.

DRA recommends that we remove a portion of costs associated with the Humboldt project's electrical and fuel interconnection costs on the basis that they represent a 50% contingency on top of their actual estimated costs. This is not the case. Rather, as PG&E explains, the selected electrical interconnection cost estimate falls near the lower end of the range of its estimated costs. Likewise, the selected fuel interconnection cost estimate falls within the range of its estimated costs, albeit at the top of the range. While PG&E does not explain its disparate choices between the low-end and high-end estimates, we find that the cost estimate ranges are reasonable; PG&E's selected cost estimates fall within those ranges and are therefore reasonable as well. In making this finding, we take into account that the capital cost estimate will be trued up to reflect actual costs if it turns out that PG&E's selected cost estimates overstate them, as discussed further below.

We reject DRA's and Aglet's proposal to exclude the net commissioning fuel cost for Humboldt from the initial capital cost and to instead provide for its recovery through the ERRA. PG&E's proposal to capitalize net fuel costs is consistent with the Federal Energy Regulatory Commission Uniform System of Accounts, and Generally Accepted Accounting Principles call for capitalization of net fuel costs. DRA and Aglet justify their proposal on the basis that it is consistent with ratemaking treatment recently approved for Contra Costa 8 as part of a settlement in D.06-06-035. We reject this justification as contrary to Rule 12.5 of our Rules of Practice and Procedure. ("Unless the Commission expressly provides otherwise, such adoption [of a settlement] does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding.") Although Aglet notes that its proposal is also consistent with D.02-10-062, we find no discussion in that decision explaining the basis for directing the utilities in that instance to recover net fuel costs through the ERRA that would justify similar treatment here.

c) Owner's Contingency

PG&E proposes to include owner's contingencies as part of the projects' initial capital costs. PG&E proposes the contingencies to account for the risk and uncertainty that it has underestimated its owner's costs. DRA opposes any contingency for Colusa capital costs, and recommends cutting the proposed contingency for Humboldt capital costs in half. Aglet recommends that all actual costs incurred (above fixed contract costs) be reviewed for reasonableness in PG&E's next GRC.

With respect to the Colusa project, we approve PG&E's proposed owner's contingency as part of the initial capital cost. PG&E included the proposed contingency in the total Colusa project cost that was evaluated in the contract selection process that led to its selection over other contracts. It is appropriately included in the initial capital cost pursuant to D.04-12-048.

This reasoning does not apply to the Humboldt project. Unlike in the case of the Colusa project, where the project bid price, including PG&E's estimated costs and contingency, was tested against competing offers, PG&E's costs related to the Humboldt project were not tested against a market alternative. Specifically, PG&E received only one offer for a PPA for the Humboldt project, which was found to be ineligible.[11] As a result, there is no competitive basis to pre-approve PG&E's proposed contingency amount or, alternatively, to hold PG&E to a price cap on its owner's costs as contemplated in D.04-12-048.

PG&E argues that its request for a contingency amount is consistent with the Commission's approval of contingencies for other large capital projects. PG&E cites to several Commission decisions, the most relevant of which is D.03-12-059 in which the Commission adopted a contingency amount of 5% of the total project cost for inclusion in the approved capital cost for

[11] We reverse the ALJ's earlier ruling sealing the portion of Tr. Vol. 6 addressing this point. D.06-06-066 does not require its confidential treatment, and it is not otherwise entitled to confidential treatment.

Edison's gas-fired Mountainview Power Project (D.03-12-059).[12] We adopt that same contingency amount here for the Humboldt project initial capital cost. We find PG&E's requested contingency amount, like Edison's in D.03-12-059, to be excessive and contrary to the public interest because it does not encourage PG&E to contain project costs.

In its oral comments on this issue, TURN objects that the Colusa and Humboldt project costs for which PG&E seeks preapproval in this

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[12] PG&E cites to D.06-06-035 as adopting a 4.3% contingency for the Contra Costa 8 project, D.05-02-052 as adopting a 5.1% contingency for the Diablo Canyon steam generator replacement project, D.06-07-027 as adopting a 7.4% contingency for its AMI project, and D.05-12-040 as adopting a 20.7% contingency for the Edison steam generator replacement project.

D.06-06-035 (Contra Costa 8) does not discuss this issue, and adopts a settlement which, pursuant to Rule 12.5, does not constitute approval of or precedent regarding this issue.

D.05-02-052 (Diablo Canyon steam generator replacement) does not make reference to either a 15% contingency, which PG&E cites in its testimony, or a 5.1% contingency, which PG&E cites in its comments on the proposed decision. It does make reference to a 2% contingency on one portion of the project (installation contract) and a 20% contingency on another portion of the project (owner's costs). It does not make reference to any contingency amount on any other portion of the project (e.g., procurement contract). In contrast, PG&E here seeks a contingency percentage on total project costs. It is not apparent that D.05-02-052 and its approval of different contingency factors for discrete portions of the nuclear power plant steam generator replacement project is applicable to PG&E's owner's costs for the Humboldt project.

D.06-07-027 (AMI) concerns advanced metering infrastructure, which the decision describes as consisting of metering and communications infrastructure as well as the related computerized systems and software. It is not apparent that D.06-07-027 and its determination of a contingency factor relate to PG&E's owner's costs for the Humboldt project.

In adopting the contingency amount in D.05-12-040 (San Onofre steam generator replacement), the Commission noted the concern in that proceeding that the utilities had underestimated the project costs. It is not apparent that the considerations in D.05-12-040 are applicable to PG&E's owner's costs for the Humboldt project.

application are not identical to what was included in the projects' initial bid prices. TURN argues, therefore, that PG&E's recovery of the projects' capital costs should be capped at the sum of the fixed contract costs plus PG&E's estimated owner's costs (excluding contingency). We reject TURN's argument. It would be unfair and unreasonable to exclude any contingency from the initial capital cost while at the same time denying recovery of excess costs through reasonableness review. Furthermore, it is reasonable to expect minor contract revisions and changes in owner's cost estimates after contract selection.[13] Absent a finding that such changes would have led to a different contract selection or that the additional cost included in the final project price are unreasonable, we will not disallow them from the cost recovery cap.

d) Cost of Capital and Other Updates

We authorize PG&E to file advice letters to update the initial revenue requirement to reflect changes to the Commission-authorized cost of capital, franchise and uncollectibles factors, and property tax factors prior to the first GRC following operation of the projects.

e) Additional Capital Costs

PG&E seeks authority to recover, through advice letter, an increase in the projects' capital costs that it may incur as a result of (1) a delay in the closing date, (2) operational enhancements to the project, or (3) changes to the project as a result of new regulatory requirements or other external events.

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[13] For example, a comparison of the Colusa PSA capital cost information provided to the Independent Evaluator against PG&E's requested capital costs indicates that, while the PSA cost increased after contract selection, PG&E's owner's costs, including a contingency amount, decreased. No party challenges inclusion of the fixed contract cost in the approved initial capital cost.

PG&E also requests authority to recover any additional capital costs that it may incur pursuant to a reasonableness review.

We authorize PG&E to seek, by application for approval, an increase in the capital cost for reasonable additional costs that it may incur as a result of operational enhancements to the Colusa or Humboldt projects. We deny PG&E's request for authority to recover these costs by advice letter. It is not evident that all "operational enhancements" are cost-effective. In addition, it is not clear what an "operational enhancement" may be, or if it includes increased generation obtained outside of the competitive solicitation process which, consistent with D.04-12-048, is subject to case-by-case review.

With respect to the Colusa project, we deny PG&E's request for authority to seek recovery of any other additional costs in excess of the initial capital cost. As PG&E explains, its requested contingency amount, which we approve, reflects the risk that unforeseeable factors may adversely affect PG&E's project costs. Pursuant to D.04-12-048, we limit PG&E's recovery of capital costs to the final project bid price, as explained in our discussion above regarding owner's contingencies.

With respect to the Humboldt project, however, we authorize PG&E to file an application to recover any other reasonable costs that it may incur, including additional costs incurred as a result of a delay in the closing date or changes to the project as a result of new regulatory requirements or other external events. As discussed above in our discussion regarding owner's contingencies, there is no competitive basis to hold PG&E to a price cap on its owner's costs as contemplated in D.04-12-048. We note, however, that the pre-approved initial capital costs for Humboldt may be appropriately reviewed in the context of a request for recovery of additional costs. For example, PG&E's

estimate may have overstated its actual costs for some elements of the project. Or, PG&E might have unreasonably neglected new opportunities to reduce some costs such that the incurrence of other costs would not cause it to exceed the pre-approved capital cost. We therefore put the parties on notice that the review of initially-approved Humboldt costs is properly within the scope of a reasonableness review of additional costs for the purposes of determining their reasonableness.

We deny PG&E's request for authority to seek any of these increases through advice letter filings. The advice letter procedure is appropriately used where the requested utility action has been previously approved by Commission decision. Thus, for example, it is appropriate to use the advice letter process for adjustments upon payment or receipt of incentives under the pre-approved terms of the contract. In contrast, there is no record basis to predetermine that additional capital costs associated with a delay in the closing date, operational enhancements, or undefined external events are necessarily reasonable.

We reject DRA's excess capital cost sharing proposal. Pursuant to D.04-12-048, PG&E is not allowed recovery of any capital costs in excess of its Colusa project bid price. Consistent with our treatment of the Mountainview Power Project capital costs, having approved a reasonable owner's contingency amount as part of the Humboldt initial capital cost, we intend to review any additional costs in excess of this amount.

f) GRC True-Up of Capital Cost Savings

PG&E proposes to retroactively true-up the initial capital cost of the Colusa and Humboldt projects in the next GRC following operation to reflect any actual cost savings. We adopt PG&E's unopposed proposal for the

Humboldt project. For the Colusa project, as required by D.04-12-048, any actual cost savings (other than incentive penalty payments) will be shared 50/50 with shareholders.

C. Operations and Maintenance Costs

1. PG&E's Proposal

PG&E requests that the Commission adopt its estimate of ongoing non-fuel Operations and Maintenance (O&M) costs, including fixed and variable O&M costs, plus a contingency factor, for purposes of establishing the initial revenue requirement for the Humboldt and Colusa projects. PG&E proposes to file an advice letter to adjust the initial revenue requirement for changes to its O&M expense forecast that may occur as a result of (1) operating the plants other than as assumed in the forecasts,[14] (2) increased staffing levels due to permitting requirements, and (3) a delay in the commercial operation date, which will delay the timing of the O&M expense streams. PG&E proposes that the Commission continue to scrutinize the reasonableness of the cost of owning and operating the facilities throughout their lives in GRCs, consistent with traditional cost-of-service ratemaking.

2. DRA's Proposal

DRA opposes any contingency factor for Colusa O&M expenses, and recommends a lower contingency factor for Humboldt O&M expenses than PG&E requests. DRA also recommends a lower staffing level assumption for Humboldt O&M expenses.

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[14] Specifically, PG&E assumed that Colusa will operate as a load-shaping resource and that Humboldt will operate consistent with a particular engine loading profile.

3. TURN's Proposal

TURN asserts that the Colusa PPA bid is better for ratepayers than the Colusa PSA bid. In order to at least partly compensate for the Colusa PSA's alleged lower value, TURN proposes performance incentive mechanisms for Colusa's heart rate, availability and capacity, and 50/50 sharing between ratepayers and shareholders of any costs above PG&E's O&M forecast (with contingency) and any savings below PG&E's O&M forecast (without contingency) through ERRA, adjusted for various factors. TURN explains that these incentives are necessary in order to subject this utility-owned generation to similar performance standards as third-party generation projects, which it maintains is particularly necessary here, where PG&E turned down an economically attractive PPA for the same plant in favor of the PSA. As discussed above with respect to whether the projects reasonably meet ratepayers' needs, we reject TURN's premise that PG&E was unreasonable in choosing the PSA over the PPA, and therefore also reject TURN's proposed performance incentive mechanisms.

In its comments on the proposed decision, TURN objects that it does not premise its proposal on the existence of the PPA offer, noting that the Commission adopted similar performance incentives for Edison's Mountainview project and San Diego Gas & Electric Company's Palomar plant. Specifically, TURN points to PG&E's rebuttal testimony, which raises this point and compares TURN's proposed incentives to those adopted for Mountainview and Palomar. PG&E's rebuttal testimony does not persuade us to adopt TURN's proposal. To the contrary, PG&E's rebuttal testimony demonstrates that the penalties under TURN's incentive proposal are more onerous than those adopted for Mountainview and Palomar, and that the incentives may work against ratepayer interests by giving PG&E an incentive to maximize Colusa's availability in order to achieve incentive payment, for example, in good hydro years when PG&E could meet summer energy needs with less cost to ratepayers.

TURN asserts that the proposed decision is arbitrary and capricious for rejecting its proposal without distinguishing Colusa from Mountainview and Palomar. However, the simple fact that the Commission adopted performance incentives for Mountainview and Palomar is not cause to adopt them here for Colusa. TURN did not offer evidence or argument for doing so beyond its argument, which we reject, that PG&E was unreasonable in choosing the PSA over the PPA. We do not err by failing to address a nonexistent showing.

TURN recommends for the Humboldt project, and also for the Colusa project if the Commission rejects its O&M cost sharing recommendation, (1) reducing PG&E's estimated payroll tax burden from 9.8% to 7.84% of labor costs consistent with PG&E's forecast in its pending 2007 test year GRC, (2) one-way balancing account for PG&E's recovery of its proposed contingencies, and (3) including contractual services agreement costs and consumables in ERRA until first GRC after commercial operation.

4. Discussion

a) Initial O&M Cost Estimate

We adopt, for purposes of establishing an initial revenue requirement for the Colusa and Humboldt projects, PG&E's O&M forecast estimate, adjusted to reflect the current payroll tax forecast, and excluding PG&E's proposed contingency factors.

PG&E asserts that the payroll tax forecast adjustment is unnecessary because it would only minimally change the first year O&M estimates, and emphasizes that the O&M estimates are just that: estimates.

Neither explanation justifies our using other than the best information we have at the time we adopt a revenue requirement.

We reject DRA's recommendation that the Humboldt O&M forecast be adjusted to reflect a lower staffing level. DRA asserts that a lower staffing level is appropriate because the developer itself recommended a lower staffing level than PG&E assumes. PG&E explains that it assumes a higher staffing level in order to ensure high reliability and quick start-up and shut-down that is particularly necessary in Humboldt's transmission-constrained area. PG&E's assumed Humboldt staffing level is reasonable.

b) O&M Contingency

PG&E requests that we add contingency factors to its O&M forecast estimate to account for four factors: (1) the O&M forecast estimate assumes no unplanned outage or curtailment-related repair costs, while industry data suggests a 4% outage rate; (2) PG&E has yet to conclude negotiations on its labor contract, so labor costs are uncertain; (3) PG&E has yet to conclude negotiations on its plant maintenance contract, so its plant maintenance costs are uncertain, and (4) the O&M forecast estimate includes escalation based on the Consumer Price Index, which may not reflect actual future inflation. However, with the exception of the outage rate, it is just as likely PG&E's assumptions result in it having overestimated its actual costs as underestimated them. This uncertainty is inherent to the concept of future test year ratemaking, which PG&E proposes and which we generally apply here. This uncertainty can as easily result, in the short-run, in increased shareholder earnings as in unrecovered shareholder costs. It is not cause to adopt a one-way contingency factor.

On the other hand, we are adopting the initial revenue requirement in this proceeding several years in advance of the projects' operation, and without a timely opportunity to update the O&M estimates on the basis of actual plant operation. It appears likely that the timing of PG&E's next GRC will require PG&E to make its showing on updated O&M costs before Colusa is operational, and possibly before either project is operational. Specifically, Humboldt and Colusa are not expected to be operational until May 2009 and May 2010, respectively. PG&E's next GRC test year is 2010; under the typical GRC schedule, PG&E's testimony in that proceeding would be served in December 2008, before the projects' expected operation.[15] Under the conventional GRC cycle, the next test year is three years later. Thus, it is possible that the earliest GRC opportunity to update the Humboldt and Colusa O&M costs after their operation will not be until December 2011 for purposes of test year 2013.

In order to address these extenuating circumstances, we therefore adopt TURN's recommendations that we place PG&E's requested O&M contingency amount in a one-way balancing account, which PG&E may recover if and when they are actually expended.[16]

c) Advice Letter Adjustments

We authorize PG&E to file an advice letter to adjust the initial revenue requirement for changes to its O&M expense forecast that may occur as

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[15] A pending proposed settlement between PG&E and DRA would extend the next test year to 2011; if approved, PG&E's testimony would be served in December 2009, which is after Humboldt's expected operation date but not Colusa's.

[16] PG&E does not offer any objection to TURN's proposal either in its rebuttal testimony or in briefs.

a result of (1) increased staffing levels due to permitting requirements, and (2) a change in the commercial operation date, which will change the timing of the O&M expense streams.[17] These costs are presumably reasonable. Although allowing these adjustments departs from the concept of future year test year ratemaking, we allow them in recognition of the fact that we adopt the initial revenue requirement in advance of the projects' operation and possibly without the opportunity to update the O&M estimates after operation until GRC test year 2013.

We deny PG&E's request for authority to file an advice letter to adjust the initial revenue requirement for changes to its O&M expense forecast that may occur as a result of deviations from the assumed plant operations. This requested adjustment is redundant of PG&E's requested contingency factor for the possibility of unplanned outages and curtailment-related repair costs, increased inflation, and increased labor and contractual services costs, which we authorize (for recovery in a one-way balancing account) above.

D. Effective Date of Revenue Requirement

The initial revenue requirement for Colusa will begin to accrue in the Utility Generation Balancing Account (UGBA) as of the date of closing of the Colusa PSA, and will be included in rates on January 1 of the following year.

The initial revenue requirement for Humboldt will begin to accrue in the UGBA as of its commercial operation date, and will be included in rates on January of the following year.

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[17] Although PG&E only requests authority to adjust for a delay in the operation date, we direct it to also adjust the revenue requirement in the event that the plants become operational earlier than assumed.

E. Other Ratemaking Details

We approve PG&E's unopposed request for authority to recover fuel costs through the ERRA proceeding. This is consistent with our normal ratemaking treatment of fuel costs.

In the event that it is required to finance transmission upgrades related to Humboldt, PG&E requests authority to file an advice letter adjusting the revenue requirement to allow it to collect any difference between the interest rate used to reimburse PG&E for its finance costs and its then-authorized weighted average cost of capital on a pre-tax basis. No party opposed this request. We approve it as reasonable.

V. Humboldt CPCN

We grant PG&E's unopposed request for a CPCN for the Humboldt facility.[18] The facility will replace the existing power plant at Humboldt Bay, which is at the end of its useful life. The area is transmission-constrained so that it cannot be fully supplied by any other plant. As discussed above with respect to the approval of the results of the RFO, the EPC resulted from a fair, open and competitive bidding process, the project comports with PG&E's procurement authority granted in our prior decisions, and it reasonably meet the needs of PG&E's bundled service ratepayers.

VI. CEQA Exemption

We find that the projects at issue in this proceeding are exempt from CEQA review by this Commission. Under both Pub. Res. Code § 25500 and Pub. Util. Code § 1002(b), the California Energy Commission (CEC) will undertake any necessary environmental review of the projects.

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[18] A CPCN is not required for the Colusa project because it will not be built by PG&E.

VII. Cost Recovery for PPAs and RFO Administrative Costs

We approve PG&E's unopposed request to recover costs associated with the power purchase agreements approved in this decision, including the bridge tolling agreement for the Colusa project, through the ERRA mechanism established pursuant to D.02-12-074. The ERRA was established to determine recovery of PG&E's power costs including PPAs.

We approve PG&E's request to transfer the costs that it has tracked in the Long Term Procurement Memorandum Account, established pursuant to Resolution E-3914, to the ERRA account. PG&E may seek recovery of these costs in a future ERRA proceeding, where it should be prepared to demonstrate that costs are incremental to the GRC approved revenue requirement. DRA opposes PG&E's request on the basis that this record does not support PG&E's request for recovery of these costs. PG&E does not request recovery of these costs, and our authorization for transfer of the costs to the ERRA does not constitute authority for PG&E to recover them. We approve PG&E's request as reasonable.

DRA recommends that we require, in this decision, a mandatory audit for determining whether the costs tracked in PG&E's Long Term Procurement Memorandum Account are incremental to the GRC approved revenue requirement. We reject DRA's recommendations. To the extent that DRA is simply reserving its right to scrutinize PG&E's costs, our Rules of Practice and Procedure and Pub. Util. Code §§ 314 and 314.5 provide that right. To the extent that DRA is requesting something else, it has not sufficiently defined or justified its request.

VIII. Cost Allocation

D.06-07-029 directs utilities to make an election at the time they file an application for approval of PPAs as to whether they intend to use the decision's cost allocation mechanism. PG&E points out that D.06-07-029 issued after it filed this application, and proposes to make its cost allocation election for the PPAs soon after the Commission issues a final decision in the Long-Term Procurement Order Instituting Rulemaking (R.) 06-02-013 containing details of the energy auction mechanism, which is an element of the adopted cost allocation methodology. We grant PG&E's unopposed request. PG&E may defer its election, subject to further Commission direction in the Long-Term Procurement Order Instituting Rulemaking (R.) 06-02-013.[19]

In their comments on the proposed decision, AReM, CLECA and CMTA ask that the Commission specify that, when PG&E makes its election, it must elect the same cost allocation mechanism for all of the PPAs approved in this decision. This issue is beyond the scope of this proceeding. The parties may raise it for the Commission's consideration in R.06-02-013.

With respect to its utility-owned projects, PG&E requests that we adopt a non-bypassable charge for Humboldt and Colusa that corresponds to their commitments lives, or 30 years, whichever is less. PG&E has not justified its request, and we therefore deny it. D.06-07-029 provides that utility-owned new generation is subject to the 10-year non-bypassable charge established in D.04-12-048. Although D.04-12-048 adopts a 10-year recovery period for the non-bypassable charge, it notes that doing so "may still increase costs for captive ratepayers due to the need for the project developer to seek accelerated cost recovery for their investments rather than amortizing these assets over a longer time period." D.04-12-048 therefore allows utilities the opportunity to justify a longer cost recovery period, on a case-by-case basis in which "the Commission will examine the benefits to ratepayers as well as the current state of the customer base." (D.04-12-048, p. 55.) In support of its request, PG&E merely

[19] In its opening brief, PG&E states that it also requests that the Commission adopt a non-bypassable charge for the PPAs corresponding to their contract lives. As PG&E does not address the fact that this request deviates from D.06-07-029 (and its testimony), we assume that, with regard to the PPAs, this statement is an inadvertent error, and not an attempt to relitigate D.06-07-029.

states that a longer cost recovery period will create a greater incentive for the development of long-term contracts to construct new generation facilities. This statement, along with the absence of any showing with respect to the current state of the customer base, does not provide justification for deviating from the adopted 10-year cost recovery period.

IX. Authority to Condition Conclusion of RFO on Particular CPUC Action

The June 1, 2006, scoping memo and ruling of the assigned Commissioner identifies, as one of the issues for resolution in this proceeding, the following question: Does PG&E have the authority to condition concluding the RFO on approval of the cost allocation proposal in R.06-02-013? Although no party elected to address this issue either in testimony or in briefs, we necessarily address it here. We conclude that PG&E does not have the authority to condition concluding the RFO on approval of its proposed cost allocation in R.06-02-013, or on any other Commission action with respect to cost recovery for the results of the RFO.

Pub. Util. Code § 451 provides, "Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities, including telephone facilities, as defined in § 54.1 of the Civil Code, as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public." We have found, after extensive public review pursuant to our authority, practices and procedures, that PG&E requires 2,200 MW to serve the public need, and we directed PG&E to conduct this RFO to procure it. PG&E does not have the discretion to decline to conclude the RFO on the basis of dissatisfaction with our orders.

X. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with § 311 of the Pub. Util. Code and Rule 14.2(a) of the Commission's Rules of Practice and Procedure. Comments were filed on November 6, 2006, and reply comments were filed on November 13, 2006, by PG&E, TURN, CUE and CURE (jointly), DRA, AReM, CLECA and CMTA (jointly), and IEP. In response to these comments, we have made changes to the decision as appropriate.

In addition to addressing the merits of the proposed decision, PG&E, CUE, CARE and DRA urge the Commission to reverse the ALJ's October 17, 2006, ruling denying their motion to accept a late-filed motion for approval of their partial settlement. The ALJ denied the motion for failure to show good cause, noting that consideration of the proposed settlement would delay resolution of the proceeding to January 2007, causing contractual milestones for the projects to lapse and the risk that urgently needed generation resources are not on line by the 2009 and 2010 summer peak period, that it is not joined by all of the parties who litigated the issues which the settlement would resolve, and that it would not resolve all of the disputed issues in the proceeding. These comments are procedurally improper and accorded no weight pursuant to Rule 14.3(c). They also give further cause for denying the motion to consider the late-filed settlement: As the comments point out, the partial settlement would provide the opportunity for PG&E to recover capital costs for Colusa in excess of its project bid price which, as discussed previously and according to DRA, would violate D.04-12-048.

XI. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Hallie Yacknin is the assigned ALJ in this proceeding.

Findings of Fact

1. PG&E requested an expedited Commission order on this application by November 2006 on the basis that delaying an order until after that time creates the risk that necessary resources will not be on line by the 2009 and 2010 summer peak periods.

2. PG&E conducted an open, competitive and fair solicitation and contract selection process.

3. The 2,250 MW represented by the selected contracts reasonably meets the 2,200 MW procurement amount authorized in D.04-12-048.

4. PG&E selected and negotiated the bilateral agreement for the Contra Costa 8 project, which was authorized in D.06-06-035, outside of the competitive bid solicitation and contract selection process.

5. The Commission evaluated and approved the bilateral agreement for the Contra Costa 8 project on its individual merits, without revising our prior procurement authorization.

6. The selected contracts reasonably meet the resource need identified in D.04-12-048.

7. Taking into account non-quantitative factors, the Colusa PSA is comparable to the optional Colusa PPA.

8. The 163 MW represented by the 10-engine Humboldt replacement project falls within the maximum replacement generation recommended by PG&E's transmission planning personnel.

9. The 10th engine generator provides value at a relatively low incremental price.

10. The counterparties to the Calpine Hayward PPA are bankruptcy-remote from the Calpine entity that is currently in bankruptcy, and include General Electric, which is one of the nation's soundest counterparties.

11. The Humboldt and Colusa fixed contract costs were vetted through the competitive solicitation and contract selection process.

12. PG&E's estimated owner's costs for the Colusa and Humboldt project were reviewed for reasonableness in this proceeding. PG&E's estimated owner's costs for the Colusa project were also included in its project bid price analyzed in the contract selection process.

13. It will not be known, until operation of the projects, whether performance incentive payments will be paid or performance incentive penalties will be due to PG&E under the Humboldt and Colusa contracts.

14. The advice letter procedure provides a timely means for adjusting the initial capital cost to reflect actual incentive payments or penalties without disadvantage to PG&E.

15. PG&E bases its need for outside counsel for Humboldt project siting work on the fact that it has not worked on such issues for over 20 years.

16. PG&E bases its estimate of outside counsel costs for Humboldt project siting work on discussions with environmental firms that routinely do this work.

17. PG&E's estimate of electrical interconnection costs falls near the lower end of the range of its estimated costs.

18. PG&E's estimate of fuel interconnection costs falls within the range of its estimated costs, albeit at the top of the range.

19. Net commissioning fuel costs are capitalized under the Federal Energy Regulatory Commission Uniform System of Accounts and Generally Accepted Accounting Principles.

20. The project bid price for the Colusa project included PG&E's proposed owner's contingency for the project.

21. All eligible project bids for the Humboldt project were for utility ownership. As a result, PG&E's estimated owner's costs and proposed contingency for the Humboldt project were not evaluated in the contract selection.

22. The record does not support a predetermination that additional costs resulting from operational enhancements to the Colusa or Humboldt projects are necessarily reasonable.

23. The record does not support a predetermination that additional costs of the Humboldt project resulting from delay in the closing date or undefined external events are necessarily reasonable.

24. The payroll tax factor from PG&E's current GRC (7.84%) is the most current payroll tax forecast.

25. PG&E's O&M estimate assumes a higher staffing level than recommended by the developer in order to ensure high reliability and quick start-up and shut-down that is particularly necessary in Humboldt's transmission-constrained area.

26. If Humboldt and Colusa become operational by their planned operation dates of May 2009 and May 2010, respectively, PG&E's current GRC schedule will not permit update of their O&M costs on the basis of actual operation until test year 2013. If the Commission approves a proposed settlement between PG&E and DRA to extend the next test year from 2010 to 2011, it will be possible

to update Humboldt's, but not Colusa's, O&M costs on the basis of actual operation.

27. The costs of increased staffing levels due to permitting requirements and of a change in the timing of the O&M expense stream are presumably reasonable.

28. An O&M adjustment to reflect additional costs that result from deviations from the assumed plant operations is redundant of an O&M contingency factor for the possibility of unplanned outages and curtailment-related repair costs, increased inflation, and increased labor and contractual services costs.

29. The Humboldt project will replace the existing power plant at Humboldt Bay, which is at the end of its useful life.

30. The Humboldt Bay area is transmission-constrained so that it cannot be fully supplied by any other plant.

31. PG&E requests to transfer the costs that it has tracked in the Long Term Procurement Memorandum Account, established pursuant to Resolution E-3914, to the ERRA account, and to seek recovery of these costs in a future ERRA proceeding.

32. D.06-07-029, which directs utilities to make an election at the time they apply for approval of power purchase agreements as to whether they intend to use the decision's cost allocation mechanism, issued several months after PG&E filed this application.

33. PG&E's offer in support of its request to extend the 10-year non-bypassable charge established in D.04-12-048 consists of its statement that a longer recovery period will create a greater incentive for the development of long-term contracts to construct new generation facilities.

34. PG&E makes no showing with respect to the current state of its customer base, as required in D.04-12-048, to justify a longer cost recovery period than the 10-year non-bypassable charge.

Conclusions of Law

1. The selected contracts should be approved as reasonable.

2. An initial capital cost for the Colusa project equal to the sum of its fixed contract costs (excluding incentive payments or penalties) plus PG&E's estimated owner's costs and PG&E's proposed contingency should be adopted and approved as reasonable.

3. An initial capital cost for the Humboldt project equal to the sum of its fixed contract costs (excluding incentive payments or penalties) plus PG&E's estimated owner's costs and a 5% owner's contingencies should be adopted and approved as reasonable.

4. PG&E should be authorized to adjust the initial capital cost by advice letter filing to reflect any performance incentive payments paid under the Humboldt and Colusa contracts.

5. PG&E should be direct to adjust the initial capital cost by advice letter filing to reflect any performance incentive penalties due to it under the Humboldt and Colusa contracts.

6. PG&E should be authorized to apply for recovery of additional capital costs for the Humboldt and Colusa projects that are attributable to operational enhancements to the project upon a showing of reasonableness.

7. PG&E should not be authorized to seek recovery of other additional costs of the Colusa project.

8. PG&E should be authorized to seek recovery, through application, of other additional costs of the Humboldt project upon a showing of reasonableness.

9. PG&E should be directed to retroactively true up the projects' initial capital cost in the next GRC following operation to reflect 50% of any other savings relative to the initial capital cost for Colusa and 100% of any other savings relative to the initial capital cost for Humboldt.

10. PG&E's O&M forecast estimate (excluding PG&E's proposed O&M contingency factors), adjusted to reflect a 7.84% payroll tax factor, should be adopted for purposes of establishing an initial revenue requirement for the Humboldt and Colusa projects.

11. PG&E's requested O&M contingency amounts should be placed in a one-way balancing account, which PG&E may recover if and when they are actually expended prior to revision in the GRC following operation.

12. PG&E should not be authorized to adjust the initial revenue requirement for changes to its O&M expense forecast that may occur as a result of deviations from the assumed plant operations.

13. PG&E should be authorized to file an advice letter to adjust the initial revenue requirement for changes to its O&M forecast estimate that may occur as result of (1) increased staffing levels due to permitting requirements, and (2) a change in the commercial operation date, which will change the timing of the O&M expense streams. PG&E should be directed to file an advice letter to also adjust the revenue requirement in the event that the plants become operational earlier than assumed.

14. PG&E should be authorized to file an advice letter to adjust the initial revenue to reflect changes to the Commission-authorized cost of capital, franchise and uncollectibles factors, and property tax factors prior to the first GRC following operation of the projects.

15. The initial revenue requirement for Colusa should begin to accrue in the UGBA as of the date of closing of the Colusa PSA, and should be included in rates on January 1 of the following year.

16. The initial revenue requirement for Humboldt should begin to accrue in the UGBA as of its commercial operation date, and should be included in rates on January 1 of the following year.

17. PG&E should be authorized to recover fuel costs for the Humboldt and Colusa projects through the ERRA proceeding.

18. In the event that it is required to finance transmission upgrades related to Humboldt, PG&E should be authorized to file an advice letter adjusting the revenue requirement to allow it to collect any difference between the interest rate used to reimburse PG&E for its finance costs and its then-authorized weighted average cost of capital on a pre-tax basis.

19. PG&E should be granted a CPCN for the Humboldt project.

20. The projects at issue in this proceeding are exempt from CEQA review by this Commission.

21. PG&E should be authorized to recover costs associated with the power purchase agreements approved in this decision, including the bridge tolling agreement for the Colusa project, through the ERRA.

22. PG&E should be authorized to transfer the costs that it has tracked in the Long Term Procurement Memorandum Account, established pursuant to Resolution E-3914, to the ERRA account and to seek recovery of these costs in a future ERRA proceeding upon a showing that costs are incremental to the GRC approved revenue requirement.

23. PG&E should be permitted to defer its election of cost allocation mechanism for its power purchase agreements until after the Commission issues

a final decision in R.06-02-013 or upon further Commission direction in that proceeding.

24. PG&E's request for a non-bypassable charge for the Humboldt and Colusa projects that is longer than the 10-year period adopted in D.04-12-048 should be denied.

25. PG&E does not have the authority to condition concluding the RFO on approval of its proposed cost allocation in R.06-02-013, or on any other Commission action with respect to cost recovery for the results of the RFO.

26. An order in this proceeding should be effective immediately.

27. Application 06-04-012 should be closed.

O R D E R

IT IS ORDERED that:

1. The five power purchase agreements (PPAs), the Humboldt Power Plant (Humboldt) Engineering, Procurement and Construction (EPC) contract, and the Purchase and Sale Agreement (PSA) for the Colusa project are approved as reasonable.

2. Pacific Gas and Electric Company (PG&E) is granted a certificate of public convenience and necessity for the Humboldt project, subject to compliance with this decision and California Energy Commission permitting requirements.

3. An initial capital cost for the Colusa project equal to the sum of its fixed contract costs (excluding incentive payments or penalties) plus PG&E's estimated owner's costs, including PG&E's proposed owner's contingency, is adopted and approved as reasonable.

4. An initial capital cost for the Humboldt project equal to the sum of its fixed contract costs (excluding incentive payments or penalties) plus PG&E's estimated

owner's costs, including a contingency equal to 5% of the fixed contract and estimated owner's costs, is adopted and approved as reasonable.

5. PG&E is authorized to adjust the initial capital cost by advice letter filing to reflect any performance incentive payments paid under the Humboldt and Colusa contracts.

6. PG&E is directed to adjust the initial capital cost by advice letter filing to reflect any performance incentive penalties due to it under the Humboldt and Colusa contracts.

7. PG&E is authorized to apply for approval, and recover the reasonable costs, of operational enhancements to the Humboldt and Colusa projects.

8. PG&E is authorized to apply for recovery of additional capital costs for the Humboldt project upon a showing of reasonableness.

9. PG&E is directed to retroactively true up the projects' initial capital cost in the next GRC following operation to reflect 50% of any other savings relative to the initial capital cost for Colusa and 100% of any other savings relative to the initial capital cost for Humboldt.

10. PG&E's Operations and Maintenance (O&M) forecast estimate (excluding PG&E's proposed O&M contingency factors), adjusted to reflect a 7.84% payroll tax factor, is adopted for purposes of establishing an initial revenue requirement for the Humboldt and Colusa projects.

11. PG&E's requested O&M contingency amounts shall be placed in a one-way balancing account, which PG&E may recover if and when these amounts are actually expended prior to revision in the GRC following operation.

12. PG&E is authorized to file an advice letter to adjust the initial revenue requirement for changes to its O&M forecast estimate that may occur as result of (1) increased staffing levels due to permitting requirements, and (2) a change in

the commercial operation date, which will change the timing of the O&M expense streams.

13. PG&E is directed to file an advice letter to adjust the revenue requirement in the event that the plants become operational earlier than assumed.

14. PG&E is authorized to file an advice letter to adjust the initial revenue to reflect changes to the Commission-authorized cost of capital, franchise and uncollectibles factors, and property tax factors prior to the first GRC following operation of the projects.

15. The initial revenue requirement for Colusa shall begin to accrue in the Utility Generation Balancing Account (UGBA) as of the date of closing of the Colusa PSA, and shall be included in rates on January 1 of the following year.

16. The initial revenue requirement for Humboldt shall begin to accrue in the UGBA as of its commercial operation date, and shall be included in rates on January 1 of the following year.

17. PG&E is authorized to recover fuel costs for the Humboldt and Colusa projects through the Energy Resources Recovery Account (ERRA) proceeding.

18. In the event that it is required to finance transmission upgrades related to Humboldt, PG&E is authorized to file an advice letter adjusting the revenue requirement to allow it to collect any difference between the interest rate used to reimburse PG&E for its finance costs and its then-authorized weighted average cost of capital on a pre-tax basis.

19. PG&E is authorized to recover costs associated with the power purchase agreements approved in this decision, including the bridge tolling agreement for the Colusa project, through the ERRA.

20. PG&E is authorized to transfer the costs that it has tracked in the Long Term Procurement Memorandum Account, established pursuant to

Resolution E-3914, to the ERRA account and to seek recovery of these costs in a future ERRA proceeding upon a showing that costs are incremental to the GRC approved revenue requirement.

21. PG&E may defer its election of cost allocation mechanism for its power purchase agreements until after the Commission issues a final decision in Rulemaking 06-02-013 or upon further Commission direction in that proceeding.

22. PG&E is directed to conclude the results of the RFO as approved in this decision.

23. PG&E's request for a non-bypassable charge for the Humboldt and Colusa projects that is longer than the 10-year period adopted in Decision 04-12-048 is denied.

24. Application 06-04-012 is closed.

This order is effective today.

Dated November 30, 2006, at San Francisco, California.

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