



**Pacific Gas and
Electric Company**

Kathy Treleven
Manager
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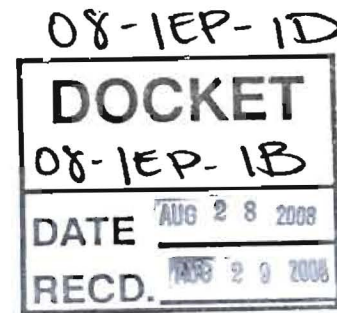
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August 28, 2008

Electronic Delivery

California Energy Commission
Docket Office, MS-4
Attn: Docket No. 08-IEP-1D & 08-IEP-1B
1516 Ninth Street
Sacramento, CA 95814



Re: Docket No. 08-IEP-1D and 08-IEP-1B

Docket Office:

Please find attached PG&E's comments on the workshop held August 18th and August 21st, 2008.

Please contact me should you have any questions. I can be reached at 415/973-4185.

Sincerely,

Kathy Treleven

Attachment

**Comments of Pacific Gas and Electric Company
Regarding Long-Term Procurement Issues and Increasing Renewables
Following CEC IEPR Workshops of August 18th and 21st, 2008**

INTRODUCTION

Pacific Gas and Electric Company (PG&E) applauds the Energy Commission's efforts in addressing the myriad challenges affecting energy procurement, the procurement review process, and how best to achieve higher levels of renewables in California. Below, PG&E addresses several of the issues raised at the August 18th and August 21st Energy Commission workshops.

PROCUREMENT

PG&E would welcome the renewed participation of the Energy Commission in PG&E's Procurement Review Group (PRG). The PRG has been an invaluable resource for providing advice to PG&E on procurement activities, and PG&E believes Energy Commission participation would offer a valuable, additional advice and input. With regard to confidentiality, PG&E observes that releasing utility-specific procurement-related information will undermine its ability to purchase power under the most favorable terms for its customers. Many of the parties seeking access to procurement-related information are entities that generate, sell or market electricity in the California energy market and who, therefore, have a significant commercial and financial interest in obtaining utility-specific information that could have a material effect on price ("market-sensitive information") related to PG&E's planning and procurement strategy information. Information such as PG&E's ERRA forecast, gas hedging plans, RFO bid valuation, and planning assumptions and methodology must be afforded confidential protection. Release of this information will provide market participants and potential counter-parties with knowledge of PG&E's product specifications and requirements, allowing them to price products on the basis of buyer's need, instead of seller's cost, to optimize their profits. Confidentiality of market-sensitive information protects customers from potentially distorted prices, but allows for meaningful public participation in Commission proceedings while still allowing significant amounts of information to be publicly available.

With regard to a potential 33% RPS goal, there are numerous challenges to increasing the amount of renewable energy being deployed in California. Given the remote locations of a substantial portion of the remaining undeveloped renewable resources, significant upgrades in the transmission infrastructure will be required, both in California and throughout the WECC. The adequacy of storage technologies and other measures to address intermittency issues also remain. PG&E contends that addressing these concerns in a holistic manner, as opposed to an incremental approach, will assist in coordination efforts and long-term planning for higher levels of renewables in California. Despite these challenges, PG&E is working hard to put more renewable resources online, and is making progress on contracting for such resources and connecting them to the grid. As of mid-year 2008, PG&E has renewable resources online or contracted for over 21% of its projected 2010 load currently signed¹.

¹ PG&E Corp. (PCG) Form 8-K Filing: Exhibit 99, July 30, 2008.

Feed-In Tariffs (FITs) have been discussed throughout the 2008 IEPR Update as a potential policy measure to incentivize higher levels of renewable resources. With regard to the use of FITs, PG&E believes that the RPS solicitation process is working and is the appropriate vehicle, rather than FITs, to achieve a larger penetration of renewable resources to the grid. In tandem, PG&E currently offers a standard offer contract as part of the AB 1969 implementation for generation up to 1.5 MW at the MPR price. Within the last four months, PG&E has signed 13 contracts for projects of 1.5MW and under for a total of 11MW. Furthermore, PG&E has executed several contracts with renewable generators sized between 1.5MW and 20MW through its competitive solicitations, and feels that ratepayer impacts are addressed most appropriately via this process.

TRANSMISSION

The biggest need in moving forward from PG&E's point of view is harmonizing transmission plans with commercial realities. From a transmission owner perspective, receiving more information on where and when the development of renewables will occur would assist in better coordination and the overall long-term planning of new transmission. As a transmission owner, this information would provide us additional flexibility in the development of plans that optimize transmission upgrades, to not only interconnect renewable generation, but further improve grid reliability and optimize transmission investments, thus minimizing rate impacts. We hope that these state-wide and region-wide efforts provide a useful platform for this information-gathering.

The availability of new electric transmission capacity is one of the key issues to increasing renewable supply. Given the remote locations of renewable resources, significant upgrades in the transmission infrastructure will be required, both in California and throughout the WECC. New transmission infrastructure will be capital intensive and will require many years to plan, permit and construct, generally considerably longer than it takes to construct a renewable generating facility. For example, one estimate prepared for the Energy Commission determined that costs in California alone would exceed \$6 Billion for a 33% RPS test case, excluding land and right of way costs.² Transmission limitations will have a direct impact on how quickly and at what total cost California will be able to add increased renewables to its resource mix.

Along with the Energy Commission and other stakeholders, PG&E is working hard on the many initiatives through which the state is attempting to resolve transmission questions related to encouraging renewable development. PG&E has been actively participating in the Renewable Energy Transmission Initiative (RETI) and in the Western Governors' Association's Western Renewable Energy Zones task forces, as well as the Northern California Regional Integration of Renewables (RIR) study. PG&E works with the CAISO on regularly updated grid transmission expansion plans and with the CEC and the federal government on transmission corridor planning. PG&E has been a part of the CAISO's effort to reform the transmission queue. PG&E has continued to invest to expand its transmission infrastructure, and has proposed the Central California Clean Energy Transmission Line (C3ET), among other projects, to bring greater access to new clean energy resources currently under development in California and the western States.

² CEC-500-2007-081, "Intermittency Analysis Project: Final Report," July 2007.

MARKET STRUCTURE

Finally, during the August 18th workshop, there was a discussion of the hybrid market in California. PG&E is committed to a hybrid market structure when it comes to utility-owned generation going forward. A balance of merchant generators as well as utility generation is in the best interest of the customers because it promotes competition and the development of cost-effective resources. Yesterday, PG&E sent a letter to the CPUC explaining its support for the hybrid market and detailing the facts that demonstrate the success of the hybrid in California, contrary to the assertions of representatives from other trade organizations. A copy of the letter is attached to these comments. We look forward to further dialogue with the Energy Commission on these issues and to further explaining the benefits and successes of the hybrid market.

Thank you again for the opportunity to submit these comments on long-term procurement issues. We look forward to working with the Energy Commission, CPUC, and other stakeholders to address these important issues as we move towards the 2009 IEPR.

August 27, 2008

Michael R. Peevey, President
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: Response of Pacific Gas and Electric Company to Independent Energy
Producers' August 21, 2008 Letter (A.08-07-018)

Dear President Peevey:

On August 21, the Independent Energy Producers ("IEP") sent you a letter asking the Commission to summarily deny PG&E's application for approval of the 560 MW Tesla Generating Station and proposing that the Commission modify the existing hybrid market structure in California to bar utility ownership of generation, no matter the circumstances. The arguments raised by IEP are not new and the Commission has, after reviewing the facts, consistently rejected them. Setting aside the rhetoric, there are several substantive issues in IEP's letter that need to be addressed.

Contrary to IEP's assertions, the hybrid market is working in California. As shown on the charts attached to this letter, the facts tell a very different story:

- o The northern California market today consists of 24,700 MW of generation. Independent power generators own 64.5% of these resources. PG&E's share of owned generation is 25%, and municipal utilities own 10.5%. This hardly approaches "re-monopolization" or utility dominance of the market as IEP suggests.
- o PG&E has initiated two long-term Request for Offers ("RFOs") since 2003 when it resumed power procurement under its CPUC-approved Long Term Procurement Plan. The first, in 2004, resulted in seven contracts for 2,250 megawatts ("MWs") of new resources, of which five contracts for 1,430 MWs were PPAs (*i.e.*, approximately 64%). The second LTRFO, which was issued in April 2008 and is still ongoing, seeks between 800-1,200 MWs of new generation in 2015.

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- PG&E has conducted five RFOs for renewable resources, signing approximately 40 Power Purchase Agreements ("PPAs") with independent power producers for almost 3,700 MWs of new, non-utility-owned renewable resources. PG&E has also conducted over a dozen short- and intermediate-term solicitations for existing, non-utility generation and has signed contracts for thousands of megawatts of capacity.
- As shown on the attached chart, PG&E has committed to or proposed approximately 8,000 MW of new generation in northern California since 2004, including renewables, non-utility generation and utility-owned generation. Of this amount, Colusa, Humboldt Bay, Gateway and the Tesla Generating Station would constitute approximately 1,900 MW or 24% of the total. The remaining 76% of new generation is to be provided by independent generators under power purchase agreements with PG&E.

PG&E has proposed to proceed with the Tesla Generating Station to address a serious 900 MW resource shortfall that will occur according to the CPUC's own adopted forecasts by the summer of 2012. The threat to reliability will be even greater by the summer of 2013.

IEP has the audacity to assert that the reliability risk customers face in summer 2012 due to the failure of independent power producers from the 2004 long term RFO is PG&E's fault and that the Tesla Generating Station application should be rejected so that a new long-term RFO for replacement generation can be issued. IEP's assertions again ignore the facts. PG&E is proposing the Tesla Generating Station due to the failure of independent power producers to fulfill their contractual commitments to develop new generation resources in a timely manner. Two of the winning projects from PG&E's 2004 solicitation were terminated by the developers, and a third project has been delayed by the developer for two years, with a request for an amended contract and increased price. PG&E cannot control the timing of developer terminations or delays. These terminations all occurred in 2008. The Commission in D.07-12-052 vested the utilities with the right and the obligation to propose replacement generation for failed projects and expressly sanctioned utility-owned generation when necessary to ensure reliability. PG&E has discharged this obligation by bringing to the Commission for its consideration the most cost-effective and viable source of replacement generation that can be on-line in time to meet the summer 2012 reliability need.

PG&E has demonstrated in the Tesla application that there is a need for new generation to be on-line by 2012. As a result of terminated or at-risk projects, PG&E's planning reserve margin ("PRM") in 2012 is likely to be 15.5% at best and will drop to 13.7% in 2013. For 2012, this is just above the minimum PRM

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established by the Commission of 15% to 17%. Moreover, this does not account for other potential resource failures or delays (which may occur given the track record in the 2004 LTRFO), changes in load, and uncertainty concerning plant retirements, all of which has caused PG&E to ask the CPUC to adopt an even higher PRM going forward. If any of these events occur, PG&E's 2012 PRM will be below the Commission's minimum reliability threshold.

In order to address this summer 2012 reliability risk, PG&E looked at all of its options, including a potential fast track RFO. An RFO for new capacity by summer 2012 was deemed infeasible given the timeframe for 1) conducting the RFO, 2) obtaining CPUC approval, 3) securing development permits, 4) obtaining transmission interconnection priority under the California Independent System Operator's new procedures and 5) securing long-lead time equipment in a time of market scarcity. PG&E thus pursued the most viable and cost-effective alternatives that could be on-line in 2012 and concluded that the most prudent course would be to propose that the CPUC approve two sources of replacement generation: 1) the 560 MW Tesla Generating Station and 2) an amendment to the 601 MW Russell City Energy Center ("RCEC") PPA which, if approved by the CPUC, would allow the project to proceed under a deferred commercial operations date and subject to a price increase. The RCEC PPA amendment will be submitted to the Commission for its review no later than September 19. Both of these projects have the advantage of being well advanced in the permitting process and maintain favorable positions in the ISO transmission queue. There were no other clean and efficient combined cycle projects permitted in Northern California that PG&E found to be viable of development in this timeframe.

PG&E has thus presented the Commission with choices to address the reliability need for summer 2012. As recommended by PG&E, the Commission can and should approve both the Tesla Generating Station and the RCEC amendment, thus advancing the two most viable options for 2012 in Northern California. Alternatively, the Commission can select the most cost-effective and viable of these two projects and take the risk that other reliability risk factors mentioned above will not cause further resource shortfalls. PG&E certainly has not, as IEP accuses, tied the Commission's hands with respect to approval of the Tesla Generating Station.

IEP further asks that an investigation be opened into utility procurement practices and accuses PG&E of intentionally undermining the procurement process to cause independent generators to fail with the objective of appropriating market opportunities for its own utility-owned generation. Again, the facts belie these assertions. The procurement process is already subject to a number of measures to ensure active and effective Commission oversight of utility power procurement. Under the Long Term Plan Process implemented by the Commission in 2004, PG&E's need for new

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long-term resources is vetted in public and established by the Commission. The resulting long-term and renewable RFOs are developed jointly with the utility's Procurement Review Group ("PRG") and an Independent Evaluator, before being issued. The PRG includes non-market participants and the Commission's Energy Division Staff. After a solicitation is issued, the Independent Evaluator monitors all aspects of the solicitation process, including bid review, negotiations and ultimately the selection of winning bidders. The PRG is actively involved in reviewing bids and recommending final selections. All of the contracts with winning bidders are then reviewed and approved by the Commission, either through the advice letter process or an application.¹

IEP and other market participants have repeatedly urged the Commission to modify its hybrid market policy that allows both utilities and independent power producers to participate in the development and operation of generating resources. The Commission has rejected the attempts of generators to corner the market, recognizing that utilities serve an important reliability function and that it would be irresponsible to repeat past mistakes and rely exclusively on the market to ensure reliability. PG&E has proposed to proceed with the 560 MW Tesla Generating Station in furtherance of this backstop reliability role endorsed by the Commission. PG&E has no intention of dominating the generation market, but it will take all necessary steps to keep the lights on for our customers. PG&E supports the hybrid market structure and our contracting actions since 2003 clearly demonstrate our commitment to the independent power generation industry. As recently as seven months ago, the Commission issued a decision rejecting IEP's proposals to limit utility owned generation, continuing its endorsement for the hybrid market and establishing clear rules for the development of new resources. The Commission should not entertain IEP's latest attempt to eliminate the hybrid market.

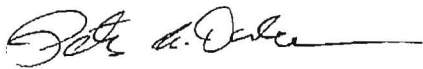
In closing, PG&E reiterates its request that the Commission issue an interim order by September 18, 2008, confirming that, if the Commission ultimately denies the application for the Tesla Generating Station, PG&E is able to recover its reasonable termination costs in rates as "abandoned project." The interim order is necessary because PG&E has made certain early commitments to secure long-lead time

¹ When it reviewed the results from PG&E's 2004 long-term solicitation, the Commission concluded: "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, and the general consensus opinion of the active parties to this proceeding." (Decision 06-11-048, page 7)

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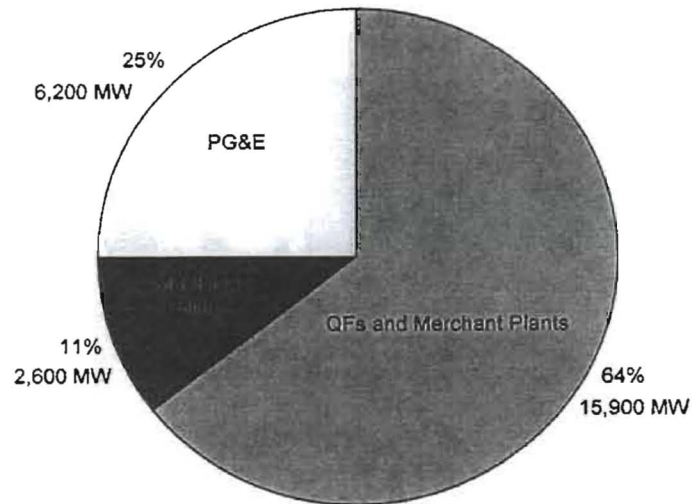
equipment needed for the Tesla Generating Station. Securing this equipment will reduce project costs while ensuring that the Tesla Generating Station is able to commence commercial operations when needed in summer 2012. If PG&E did not make these commitments (and does not continue to make on-going progress payments), PG&E would be unable to commence operations of Tesla Generating Station by summer 2012, and it would be unable to hold the project's initial capital cost at or below \$850 million. PG&E's request for an interim order is well-supported by Commission precedent in similar circumstances. As The Utility Reform Network ("TURN") commented in its response, the Tesla Generating Station "represents the best available option from a ratepayer standpoint. . . ."

Sincerely,



cc: Commissioner Dian M. Grueneich
Commissioner John Bohn
Commissioner Rachelle Chong
Commissioner Timothy Alan Simon
Administrative Law Judge Timothy J. Sullivan

**Power Plant Ownership in Northern California
by Percentage of Net Qualifying Capacity**



**PG&E-Owned new Resources and PG&E PPAs in Northern California
by Percentage of Capacity**

