

# *Crossborder Energy*

*Comprehensive Consulting for the North American Energy Industry*

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December 1, 2008

Mr. Paul Douglas  
Mr. Sean Simon  
Mr. Honesto Gatchalian  
Energy Division  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102

Re: Reply Comments of CalWEA / LSA / CCC / Solar Alliance  
on Draft Resolution E-4214 concerning the 2008 Market Price Referent

Dear Messrs. Douglas, Simon, and Gatchalian:

The California Wind Energy Association, the Large-scale Solar Association, the California Cogeneration Council, and the Solar Alliance (collectively, CalWEA *et al.*) hereby submit these brief reply comments on Draft Resolution E-4214, which proposes the 2008 Market Price Referent (2008 MPR). CalWEA *et al.* respond to the opening comments on Draft Resolution E-4214 served by Pacific Gas and Electric (PG&E), San Diego Gas & Electric (SDG&E), and Southern California Edison (SCE). The technical points identified by PG&E and SDG&E should be addressed, and CalWEA agrees with PG&E's proposed solution. However, SDG&E's proposal inappropriately distorts the MPR calculations for 10-, 15- and 20- year contracts, and is inconsistent with the Commission's precedent on MPR calculations. SCE's proposed change should be rejected as inconsistent with the clear intent of the Commission's recent order on the 2008 MPR methodology, D. 08-10-026.

**PG&E.** PG&E's opening comments discussed an error in the natural gas price forecast for the 2008 MPR. PG&E noted that, consistent with D. 08-10-026 on the 2008 MPR methodology, the final years of NYMEX forward gas prices should be used to determine the gas price in 2021 (year 13), not 2020 (year 12). CalWEA *et al.* agree with PG&E that this is an error in the 2008 model that should be corrected.

**SDG&E.** SDG&E's comments focus on the calculation of the 2008 MPR for a 25-year contract. D. 08-10-026 directed the Energy Division to modify the MPR model in order to calculate, for the first time, MPRs for 25-year contracts. SDG&E notes that the MPR for 25-year contracts fails to include certain expenses that the owner of the MPR proxy plant would incur in years 21 through 25, including fixed O&M, property taxes, and taxes on the plant's net income. The proxy plant's costs in years 21 – 25 do not include financing costs, which are recovered over the initial 20 years. CalWEA *et al.* concur with SDG&E that the utility has identified real costs in years 21 – 25 that should be included in the calculation of the 2008 MPR for 25-year contracts.

However, CalWEA *et al.* do not support the way in which SDG&E has modified the MPR model to include these expenses in years 21 – 25, because SDG&E's addition of these expenses in years 21 – 25 inappropriately reduces the calculated MPRs for 10-, 15-, and 20-year contracts. SDG&E admits this in its opening comments. Since its inception, the MPR model has assumed that the proxy plant is financed over 20 years. After 20 years, the long-term financial costs for the proxy plant will have been recovered, and the plant's fixed and variable costs in years 21 – 25 are simply annual, ongoing expenses that should not impact the calculation of the costs for 10-, 15-, or 20-year contracts. The owner of the proxy plant, knowing that the plant is financed over 20 years, will seek a 20-year contract that fully recovers the plant's financing and operating costs over those 20 years. Because the contract is limited to 20 years, the proxy plant owner does not know whether the plant will operate beyond 20 years, and cannot assume that the after-tax cash flows in years 21 – 25 will materialize.

In contrast, SDG&E's approach is not based on a 20-year recovery of the plant's financial costs. Instead, SDG&E calculates the fixed component of the MPR for contracts of all lengths based on a series of escalating fixed prices that produces revenue whose net present value equals the plant's after-tax cash flow over 25 years. In effect, this spreads some of the plant's financing costs to years 21 – 25, which is contrary to the assumption of 20-year financing that the MPR model has always used. A proxy plant owner with a 20-year (or shorter) contract should not be assumed to be willing to defer the recovery of some initial financing costs to years after the initial 20, simply because the plant may have a longer economic life than 20 years. SDG&E's calculation method thus inappropriately reduces the fixed component of the MPR for contracts with terms of 10, 15, or 20 years.

In addition, SDG&E's method of calculating the fixed component of the MPR for contracts of 20 years or shorter is inconsistent with the method used to calculate the variable component. In calculating the levelized variable costs for 20-year contracts, for example, the model does not include or consider in the levelization calculation the variable costs in years 21 – 25. In contrast, in SDG&E's approach to levelizing the fixed component of the MPR, the fixed expenses in years 21 – 25 do affect the levelized fixed component for contracts of 10, 15, or 20 years. Because the plant is financed over 20 years, all of the assumed expenses in years 21 – 25, both fixed and variable, are simply ongoing annual expenses that will only be incurred if the plant has a contract to operate in years 21 – 25. As a result, the expenses in years 21 – 25 should only affect the calculation of the MPR for 25-year contracts.

**SCE.** CalWEA *et al.* first note that SCE did not serve their opening comments on CalWEA or its undersigned consultant, both of whom are on the service list to R. 06-02-012. We obtained SCE's comments late today directly from Energy Division.

SCE maintains that Draft Resolution E-4214 has failed to justify the use of the Handy-Whitman cost indices to escalate the costs for the Cosumnes and Palomar plants to a 2009 start date. SCE wants to return to the use of the USACOE cost indices that

were the subject of extensive criticism in the proceedings leading to D. 08-10-026. The deficiencies in the USACOE indices were well-documented: power plant construction costs have escalated far more rapidly since 2006 than is captured in the USACOE indices. As noted on page 24 of D. 08-10-026, parties also discussed a number of indices, including the Handy-Whitman indices, that better capture the sharp escalation in power plant capital costs in 2006 -2007. The Commission agreed in D. 08-10-026 (with only SCE opposed) that staff should have the discretion to use a different set of cost indices to replace the USACOE indices, in order "...to bring the older cost values more into line with 2008 values."<sup>1</sup> Energy Division has chosen a set of cost indices that accomplish this, as is clearly explained on page 12 of the draft resolution. The Commission should reject SCE's effort to re-litigate an issue decided in D. 08-10-026.

SCE also attempts to argue that the revised Palomar and Cosumnes capital costs must be wrong because they are higher than the costs for the more recent Colusa plant that has been added to the MPR data set. CalWEA *et al.* believe that the more likely circumstance is that the Colusa costs are too low. PG&E acquired Colusa from a developer in a "distress" sale, and it remains unclear the extent to which PG&E was able to acquire Colusa at a discount. CalWEA *et al.* note that D. 08-10-026 required the staff to justify its use of the Colusa cost cap in the MPR data set: if the Commission accepts SCE's argument that the staff has failed to justify its use of the Handy-Whitman indices, it should also reject the staff's use of Colusa, for which the draft resolution provides only the token justification that the inclusion of Colusa would "benefit" the MPR calculation by adding a third plant to the limited data set. The extent to which the Colusa cost cap represents a discount to actual current CCGT capital costs remains a mystery.

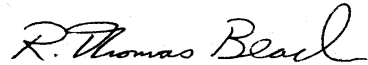
**Conclusion.** CalWEA *et al.* have posted on the CalWEA website (<http://www.calwea.org/publicFilings.html>) a copy of SDG&E's version of the 2008 MPR spreadsheet model, with our recommended change that prevents the fixed expenses in years 21 – 25 from impacting the MPR calculation for contract terms of 20 years or less. This change is highlighted in orange. We appreciate the Commission's attention to these comments, and ask the Commission to make the changes to the 2008 MPR calculation that have been discussed above and in CalWEA *et al.*'s opening comments on Draft Resolution E-4214. We look forward to final Commission approval of the 2008 MPR in the near future.

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<sup>1</sup> D.08-10-026, pp 23-24.

Thank you for your attention to this matter.

Respectfully,

A handwritten signature in cursive script that reads "R. Thomas Beach".

R. Thomas Beach, Principal  
Crossborder Energy

On behalf of  
**California Wind Energy Association,  
Large-scale Solar Association,  
California Cogeneration Council, and  
Solar Alliance**

## CERTIFICATE OF SERVICE

I hereby certify that I have this day caused to be served a copy of the foregoing document, **Reply Comments of the CalWEA / LSA / CCC / Solar Alliance on Draft Resolution E-4214 Concerning the 2008 Market Price Referent**, by Electronic Mail where possible and First-Class Mail where not, on all known parties to R. 06-02-012, named on the service list attached to the original certificate of this document pursuant to the Commission's Rules of Practice and Procedure.

I declare under penalty of perjury that the foregoing is true and correct.

Executed at Berkeley, California, Monday, December 1, 2008.

/s/ Christa Goldblatt

Christa Goldblatt