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Decision 98-07-092 July 23, 1998

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authorization to Sell Certain Generating Plants and Related Assets Pursuant to Public Utilities Code Section 851. (U 39 E)	Application 98-01-008 (Filed January 15, 1998)

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INTERIM OPINION

Summary

Procedural History

Pacific Gas and Electric Company (PG&E) filed this application on January 15, 1998. PG&E originally requested that the Commission grant it authority to sell and transfer its Hunters Point, Potrero, Pittsburg, and Contra Costa fossil-fuel plants and its Geysers geothermal plants (one set in Sonoma County and one set in Lake County) pursuant to Public Utilities (PU) Code Section 851 in two phases. In the first phase, PG&E requested an interim decision that (a) determines that the proposed sale and transfer of the Hunters Point, Potrero, Pittsburg, and Contra Costa Power Plants and the Geysers geothermal power plant is in the public interest in light of the policy favoring industry restructuring as set forth in Decision (D.) 95-12-053, as modified by D.96-01-009, and in Assembly Bill (AB) 1890 (1996 Stats. ch. 854); (b) finds that the proposed sale process is reasonable; (c) finds that, in the absence of evidence of a significant irregularity in the auction process, the fair market value for the generating plants will be determined by the auction process; (d) finds that the proposed Operations and Maintenance Agreement (O&M Agreement) is reasonable to both PG&E and buyer; (e) finds that the requirement that the buyer enter into a master must-run agreement (MMRA) with the Independent System Operator (ISO) satisfies the requirements of PU Code Section 362 to "ensure that facilities needed to maintain the reliability of the electric supply remain available and operational"; and (f) applies the same accounting and ratemaking treatment as in D.97-09-046. In the second phase, PG&E requests that it be permitted to make a filing that certifies that the prescribed sale process was followed, attaches copies of definitive transaction documents, and provides information concerning the accounting and ratemaking adjustments to be implemented as a result of the proposed sales and transfers. In a final decision, the Commission will be asked to approve the terms and price of each sale and transfer and the proposed accounting and ratemaking adjustments based on the methodology approved in this decision and the actual proceeds and terms of the sales.

The Commission's Energy Division has determined that the proposed transaction is subject to the California Environmental Quality Act (CEQA) and has announced that it will prepare an environmental impact report (EIR).

Protests or responses were filed by the Office of Ratepayer Advocates (ORA), the City and County of San Francisco (CCSF), The Utility Reform Network (TURN), the Southeast Alliance for Environmental Justice (SAEJ), Calpine Geysers Company L.P. and Calpine Corporation (Calpine), Union Oil Company of California, NEC Acquisition Company, and Thermal Power Company (UNT), and the Law Offices of Denise M. Schmidt (Schmidt).

The assigned Commissioners issued a Ruling Pursuant to Article 2.5 of the Rules of Practice and Procedure on March 12, 1998 (Scoping Memo). The Scoping Memo determined that no evidentiary hearings were necessary at this time, defined issues in two phases, and set a briefing schedule for the first 16 issues. The Scoping Memo designated the assigned administrative law judge (ALJ) as the principal hearing officer. PG&E, ORA, CCSF, SAEJ, UNT, and Calpine filed concurrent opening briefs on March 23, 1998, and concurrent reply briefs on March 30, 1998.

A proposed decision was served on the parties on June 2, 1998. On June 2, 1998, SAEJ and CCSF separately moved for a temporary restraining order to delay the submission of first-round bids (discussed below) on June 8, 1998. In the absence of the assigned ALJ, an Assistant Chief Administrative Law Judge (ACALJ) issued a ruling, on June 3, 1998, shortening time to respond to the motions of SAEJ and CCSF, until June 5, 1998. On June 8, 1998, the ACALJ issued a ruling prohibiting PG&E from opening or beginning to process or evaluate statements of qualification and interest that PG&E was scheduled to receive on that date. A hearing was held on June 10, 1998, to further consider the motions. On June 16, 1998, the assigned Commissioners issued a ruling dissolving the restraint imposed by the ruling dated June 8, 1998, and providing an opportunity for CCSF to propose, on or before July 10, 1998, a statement of proposed conditions that would apply to the future operation of the Hunters Point and Potrero plants. Other parties were permitted to file responses to CCSF's proposed conditions on or before July 25, 1998. The Scoping Memo was amended to include an additional issue: Should the Commission condition the transfer of ownership of the Potrero Hill or Hunters Point plant on the buyer's agreement to carry out measures to mitigate or avoid any adverse effects resulting from the operation of these plants?

Comments on the proposed decision were received, on or before June 22, 1998, from PG&E, ORA, CCSF, SAEJ, and UNT. Reply comments were received, on or before June 29, 1998, from the same parties, except for UNT, which did not file reply comments. Commissioners Bilas and Conlon filed an alternate decision on July 9, 1998 for consideration at the July 23, 1998 meeting of the Commission. Comments on the alternate decision were received from PG&E, SAEJ, and UNT.

On July 17, 1998, PG&E filed an amendment to its application which withdrew the Hunters Point plant from the auction, contingent upon the Commission approving certain ratemaking treatment for the plant and other conditions.

We cannot rule on this amended application at this time. We do commit to expeditiously process PG&E's proposed amendment in order that our resolution of PG&E's request will be available to all bidders and other interested parties prior to the receipt of final bids. For purposes of this interim decision only, we will allow PG&E to continue the auction process for its remaining power plants and will defer to later decisions, if necessary, resolution of any issues unique to the Hunters Point project.

Description of the Amended Application

PG&E wishes to offer for sale five electric generation plants: Potrero Power Plant, Contra Costa Power Plant, Pittsburg Power Plant, Sonoma County Geysers geothermal power plants, and Lake County Geysers geothermal power plants. That wish is consistent with our D.95-12-063, as modified by D.96-01-009, in which we required PG&E to submit a plan to voluntarily divest itself of at least 50% of its fossil generating assets. (*Order Instituting Rulemaking/Investigation on the Commission's Own Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation*, mimeo. at 223.) The five plants have a combined generating capacity of 4,289 megawatts (MW), which is all of PG&E's remaining fossil and geothermal generation capacity. PG&E proposes to retain ownership of, and reserve easements for, the transmission facilities and lines from each of the power plants. It proposes to transfer the real and personal property (including spare parts) presently used for the operation of the plants.

PG&E plans to sell the five plants by a competitive open auction bid process in two stages similar to that which it used in the sale of its Moss Landing, Morro Bay, and Oakland plants in Application (A.) 96-11-020.

In the first stage, PG&E would widely advertise the sale of the plants, provide a detailed information package to each interested potential bidder, and solicit statements of interest and qualification from potential bidders. Bidders would be allowed to bid on the plants in any combination (provided, however, that PG&E has determined to offer the Contra Costa Plant only in combination with the Pittsburg Plant, and to require that the Sonoma County Geysers units be bid separately, because of a right of first refusal, discussed below). Based on

PG&E's assessment of each bidder's financial and operational qualifications and indicated bid amount, it would identify five to ten bidders for each plant for a final, binding bid process.

During the second stage of the auction, bidders would have opportunity for further due diligence and could anonymously propose changes to the form of Purchase and Sale Agreement. PG&E would consider the proposed changes, and issue a final form of Purchase and Sale Agreement approximately two weeks before bids were due. Subject to PG&E's reservation of the rights to reject all bids, if none is acceptable, and to retain the plants, if any reviewing agency imposes unacceptable conditions to the transfer, PG&E would sell each plant to the highest bidder, subject to our final approval.

Applicable Legal Standards

Section 851

No public utility may transfer its property that is necessary or useful in the performance of its duties to the public without first having secured the Commission's authorization. (PU Code § 851.) The plants are required for system reliability. Therefore, the plants are presently useful in the performance of PG&E's duty as a public utility, and PU Code Section 851 applies.

Section 362

In proceedings pursuant to Section 851, we must ensure that "facilities needed to maintain the reliability of the electric supply remain available and operational, consistent with maintaining open competition and avoiding an overconcentration of market power." (PU Code § 362.) "In order to determine whether a facility needs to remain available and operational, the [C]ommission shall utilize standards that are no less stringent that [sic] the Western Systems Coordinating Council and North American Electric Reliability

Counsel standards for planning reserve criteria." (*Id.*) The parties refer to such facilities as "must-run."

One of our main concerns in reviewing the sale of the plants is market power. In addition to the dimension of locational market power, which is encompassed by "maintaining open competition," we are also greatly concerned that the sale promote increased competition in the entire wholesale and retail energy market, which is partially encompassed by "avoiding an overconcentration of market power." When we know the results of the auction, we will be in a position to determine whether the outcome raises any overconcentration issue or other market power issue.

We continue to caution all bidders that in making our final determination, we will not approve any sale that merely changes the identity of the possessor of market power from PG&E to another entity.

Section 363

PU Code Section 363(a) requires that we impose as a condition of sale on the plants that the selling utility contract with the purchaser of the facility for the selling utility, an affiliate, or a successor corporation to operate and maintain the facility for at least two years and that the contracts be reasonable for both the seller and the buyer.

CEQA

CEQA applies to discretionary approvals of activities that may cause a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment and that are undertaken by a person who receives contracts, grants, subsidies, loans, or other forms of assistance from one or more public agencies or the issuance of a lease, permit, or other entitlement for use. (Public Resources (PR) Code § 21065.) Such activities are termed "projects."

Because a transfer of utility property that is useful or necessary to the performance of the utility's duties requires our prior approval pursuant to PU Code Section 851, our approval is an "entitlement for use."

When we have reviewed the final EIR, it will be possible to know if all of the potential adverse environmental effects of the transfer of the plants can be avoided or reduced to a non-significant level by imposing appropriate conditions on the transfer. However, we have not yet completed our CEQA review, and it would be inappropriate for PG&E to accept final bids until the specific environmental mitigation measures that may be required are known and approved by a decision of this Commission, because the resulting uncertainty would have a natural tendency to depress bid prices.

Discussion of the Issues in the Scoping Memo

Is the proposed sale and transfer of the Potrero, Pittsburg, and Contra Costa Power Plants and the Geysers geothermal power plant consistent with the policy favoring industry restructuring as set forth in D.95-12-063, as modified by D.96-01-009, and in AB 1890?

PG&E states that the policy underlying electric industry restructuring, as expressed in D.95-12-063, as modified by D.96-01-009, and AB 1890, is to foster a competitive market for generation, and that its proposed sale advances that policy.

In its opening brief, CCSF addresses a different issue than set out in the Scoping Memo, which is whether the proposed sale is in the public interest. As the Scoping Memo states, the issue that CCSF raises regarding the nature and extent of the public interest determination that is proper in an interim decision was raised in A.96-11-020 and resolved in D.97-09-046. In that decision, the Commission determined that the sales of the Morro Bay Power plant, Moss Landing Power Plant, and Oakland Power Plant were consistent with the policies underlying D.95-12-063, as modified by D.96-01-009, and expressed in AB 1890, but deferred until D.97-12-107 the conclusion that the sale of such plants to a particular buyer was in the public interest, following consideration of a completed mitigated negative declaration prepared under CEQA. In this application, we will defer the public interest conclusion until the EIR has been completed.

SAEJ said only that it does not believe the sale process is consistent with the policies underlying D.95-12-063, as modified by D.96-01-009, and expressed in AB 1890, because it believes that those policies require that deregulation be carried out in a manner that assures reliability, avoids locational market power and is consistent with protecting the environment. SAEJ is correct that AB 1890 requires consideration of reliability issues (consistent with open competition and avoiding an overconcentration of market power) for plants that are required to maintain the reliability of the electric system, and that issue is separately treated pursuant to the Scoping Memo. SAEJ is also correct that protection of the environment is an important policy objective, and that issue is addressed through the EIR and our final decision. SAEJ does not claim that the sale and transfer of the plants would be otherwise inconsistent with the policies underlying D.95-12-063, as modified by D.96-01-009, and expressed in AB 1890.

Neither ORA, UNT, nor Calpine briefed this issue.

In D.95-12-063, as modified by D.96-01-009, we required PG&E to submit a plan to voluntarily divest itself of at least 50% of its fossil generating assets. (*Order Instituting Rulemaking/Investigation on the Commission's Own Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation*, mimeo. at 223.) In D.97-12-107, PG&E received authority to sell and transfer three plants with a combined generating capacity of 3,632 MW, which was approximately 45% of PG&E's fossil generation capacity. Previously, in D.97-09-046, we found that PG&E's application to divest itself of those fossil generating assets was consistent with that request for voluntarily divestiture. PG&E's present application to divest itself of its remaining fossil generation assets and its Geysers units is equally consistent with our call for voluntary divestiture.

Do existing wastewater discharge permits require the Pittsburg and Contra Costa Plants to be offered on a bundled basis?

PG&E represents that the San Francisco Bay and Central Valley Regional Water Quality Control Boards (Boards) have issued Waste Discharge Requirement Orders under the National Pollution Discharge Elimination System (NPDES permits) for the Pittsburg and Contra Costa plants. PG&E further represents that the NPDES permits require the coordinated dispatch and operation of the Pittsburg and Contra Costa plants, including, in general, the preferential use of the Pittsburg Plant's Unit 7, which has closed-cycle, rather than once-through cooling. PG&E represents that the NPDES permits require the other units at the two plants to be loaded sequentially in a manner to minimize the thermal impacts of the combined operation of the two plants. From this, PG&E concludes that it is unlikely that the plants can be dispatched in economic merit order, and, therefore, if the plants were under different ownership, competition between them would be precluded by the overriding requirements of the NPDES permits.

In particular, PG&E argues in its reply brief, the dispatch requirements are brief and general, and it is impracticable to anticipate every possible circumstance so that two owners would know, in advance, when they would be permitted to dispatch any given unit. Furthermore, PG&E believes that the question of whether separate ownership of the two plants would give rise to different environmental impacts would need to be addressed in the EIR. Finally, the Boards must approve the transfer or re-issuance of the NPDES permits, and PG&E believes that this is unlikely if more than one owner exists.

Neither CCSF, SAEJ, UNT, nor Calpine briefed this issue.

ORA argues that the NPDES permits do not directly prohibit the separate ownership of the two plants and that the restrictions on merit-order dispatch are sufficiently limited in their scope so as to permit separate ownership to be feasible. Pursuant to Rule 73, we may take official notice of facts of which courts may judicially notice. Pursuant to Evidence Code Section 452(c), courts may judicially notice official acts of the legislative, executive, and judicial departments of the United States and of any state in the United States. The NPDES permits qualify as such an official act. As ORA provided copies in its opening brief, parties have had a sufficient opportunity to comment on the propriety of taking official notice of the NPDES permits.

The coordinated dispatch provisions of the NPDES permits are focused on the time of year when striped bass may be most affected, generally May 1 through July 15, although the precise dates may vary. During that time, the Pittsburg Unit 7 must be preferentially dispatched. At times when monitoring shows that striped bass densities are below a stated threshold, the units at the two plants may be operated in any combination.

The NPDES permit requirements thus present a situation over which reasonable minds can differ. Focusing on the weeks when striped bass density controls the dispatch, PG&E concludes that it is impracticable to have competition between the two plants. Focusing on the rest of the year and the possibility to coordination between competing users during the fish season, ORA concludes that the NPDES permits are not as great an obstacle as PG&E considers, and recommends that a joint operating agreement, to be drafted by PG&E, be made a condition of sale.

We are tempted to agree with ORA that this is a problem that the market can sort out. In the first place, if one bidder wins both plants, the problem does not arise. If different bidders prevail, each bidder faces identical problems: It may be difficult to obtain the consent of the Boards to the transfer of the NPDES permits; the new owner cannot operate in compliance with the NPDES permits without the cooperation of the other owner; and the new owner cannot discharge its obligation to dispatch the plants at the times required by the ISO if it cannot operate its plant. In combination, the owner of either of the plants has a powerful set of incentives to come to some arrangement that permits joint dispatch. Over the long term, either owner has the option of obtaining new water quality permits and satisfying the Boards that it can operate its plant independently, such as by installing closed cycle cooling systems.

Assuming that the Boards agree to the transfer of the NPDES permits, we think that the winning bidders would be able to find a way of joint operation that meets all the requirements and effectuates the appropriate adjustment to economic costs and revenues necessary to reflect the constraints imposed by the NPDES permits.[1] What is principally required is for the owner of the Contra Costa Plant to agree not to dispatch any of its units at those times when Pittsburg Unit 7 must be preferentially dispatched. We do not agree, however, that these arrangements would best be set out in advance of the auction of the plants. Rather, we believe that the Purchase and Sale Agreement should contain a condition of closing that the buyers of the two plants should have

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[1] In this connection, we note that Section 14.3(a) of the Switchyard and Retained Properties Agreement required as a condition of sale reserves to PG&E the right to discharge stormwater, domestic wastewater, or treated water from PG&E's current or future groundwater treatment system under authority of the NPDES permits.

executed an agreement to jointly operate the plants consistent with the NPDES permits and any agreement with the ISO.

It appears more likely, however, that if the obstacles to joint operation are so great as PG&E suggests (in particular, that the Boards may withhold consent to the transfer of the NPDES permits), the result will be that the bids on individual plants will not be as high as bids for the two plants as a bundle. Therefore, the principal risk to be confronted is that overly optimistic winning bidders for the two plants would be unable to obtain the consent of the Boards. Because the consent of the Boards to the transfer of the NPDES permits is a condition of closing, failure to obtain that consent would prevent the consummation of the sale. As a result, PG&E could incur additional expense to re-auction the two plants on a bundled basis. That added expense would reduce the eventual proceeds from the sale and, to that extent, fall on ratepayers.

This could be addressed by making the failure to obtain the consent of the Boards an event of default under Section 2.8(b) of the Purchase and Sale Agreement for the two plants when sold separately. This would result in payment by the defaulting bidder to PG&E of liquidated damages in the amount of either $5 million or 5% of the bid price, whichever is less, in accordance with the applicable provisions of the Purchase and Sale Agreement. That would be sufficient to offset the costs of re-conducting the auction should the winning bidders for the two plants sold separately fail to obtain the consent of the Boards. It would also have the effect of making it highly unlikely that bidders would bid on the plants individually. For this reason, we believe that PG&E's proposal to bundle the sale of the two plants should be approved.

Should PG&E be required to defer restoration measures at the Montezuma Habitat Enhancement Site so that such activities can be assumed by the buyer of the Pittsburg and Contra Costa plants?

Another permit condition affecting the Pittsburg and Contra Costa plants is that PG&E undertake a Multispecies Habitat Conservation Plan, as mitigation for the potential impacts on threatened and endangered species from operation of the plants. That plan requires PG&E to implement a habitat restoration plan for certain Delta lands known as the Montezuma Habitat Enhancement Site. When the related permits requiring the mitigation measures are issued, in May or June 1998, PG&E is required to complete construction promptly—within 12 months, if possible, but in any event not longer than 24 months. PG&E argues that requiring it to defer the start of construction may cause permits to be revoked.

Neither CCSF, SAEJ, UNT, nor Calpine briefed this issue.

ORA withdrew its objection to PG&E's proposal to proceed with implementation of the plan, based on its understanding that the associated remediation costs of approximately $2 million (excluding the property value of site) would be far less than the costs of mitigation that would be required if new permits were to be issued. PG&E should not be required to defer the start of these restoration measures pending the outcome of the auction.

Considering the auction by Southern California Edison Company of its El Segundo Plant, is the 2% break-up fee feature with respect to the Sonoma County Geysers units necessary in light of the right of first refusal held by UNT?

An agreement between PG&E and UNT provides that UNT has the right of first refusal in the event that PG&E sells its Sonoma County Geysers units. PG&E argues that the right of first refusal constitutes UNT as a silent bidder in the auction, and the only bidder who has the privilege of knowing in advance of committing itself to purchase the units exactly how much it must bid to succeed. PG&E feels that the right of first refusal will have the effect of discouraging bidding, and that compensating the winning bidder with a 2% "break-up" fee in the event that UNT exercises the right of first refusal is necessary to achieve a robust auction.

No party offered expert testimony from an investment banker or other qualified witness that would establish as a factual matter that the break-up fee would, all other things being equal, have the effect of maximizing bid prices. UNT observed that Southern California Edison Company (Edison) sold its El Segundo plant (A.96-11-046) subject to the right of first refusal without such a break-up fee. PG&E rejoins that it is not clear that bidders knew about the right of first refusal, and the right of first refusal was held by an adjoining land owner rather than by a counterparty to an agreement necessary for the operation of the plant in question. PG&E would also have us believe that UNT's objection to the break-up fee (UNT holds the right of first refusal) is evidence that the break-up fee is required.

ORA argues that the break-up fee is unreasonable and unnecessary. In ORA's view, it is unnecessary because the El Segundo Plant sold at a substantial premium to its book value, in the mid-range of the initial ten plants that Edison sold, and PG&E has failed to explain the significance of the difference in the rights of refusal based on whether the holder is an adjacent landowner or a supplier. (In either event, the winning bidder may be precluded from enjoying the fruits of victory.) Furthermore, ORA points out, the 2% amount appears to have been chosen without regard to the actual costs to be expected from the winning bidder, is not subject to any check to determine whether it bears any relationship to the real expense, and every dollar paid as a break-up fee is a dollar lost to ratepayers.

UNT argues that (1) PG&E has failed to present any competent evidence or convincing argument that the break-up fee is necessary; (2) PG&E has failed to present any evidence or convincing argument that the Edison experience with the El Segundo Plant differs from PG&E's situation; and (3) UNT's objection, by itself, does not prove anything about the need for the break-up fee.

In their reply briefs, PG&E and ORA agree that the break-up fee should be a fixed amount, $2 million, as a means of mitigating the hardship of any winning bidder whose bid is displaced by the holder of the right of first refusal.

In its reply brief, UNT argues that the marketplace and the winning bidder, not the Commission, should decide the incremental risk imposed by the right of first refusal.

Neither CCSF, SAEJ, nor Calpine briefed this issue.

In response to comments, we now believe that a break-up fee is required to deal with the right of first refusal. Theoretically, in an auction, no bidder would want to pay more than the market price for the asset to be acquired. While a bidder who wants to obtain the right to the Sonoma County Geysers units must be prepared to pay more than it thinks that any other bidder, including UNT would be willing to pay, that bidder cannot justify paying a price higher than the market price for the asset to be acquired, particularly given the other investment opportunities available to that bidder, both in this auction (for other plants), and for other investment opportunities (both utility and non-utility). Therefore, both the interested bidder and UNT have an incentive to bid as close to the market price for the asset as possible, but not higher. Given the right of first refusal, UNT has a better advantage relative to other bidders in being able to match the final winning price. A break-up fee helps to compensate for that advantage and should encourage increased bidding at prices close to the market value of the assets to be purchased. Therefore, we approve the use of a break-up fee, capped at the level that ORA and PG&E have recommended.

With respect to the Sonoma County Geysers units, does permitting the 2% break-up fee constitute a taking of private property for public use without just compensation?

UNT claims that the break-up fee is a "bidding scheme designed to eliminate the value of the ... right of first refusal" and would deprive it "of a property right without just compensation." UNT cites *Gregory v. City of San Juan Capistrano*, (1983) 142 Cal.App.3d 72, 87 as authority that a right of first refusal is a valuable property right the deprivation of which without compensation constitutes an impermissible taking of property. In *Gregory*, plaintiff mobile home park owners obtained summary judgment against a municipality and a declaration that a rent-control ordinance that purported to grant residents the right of first refusal in any sale of a mobile home park was unconstitutional. The Court of Appeal agreed that the ordinance took from the plaintiff a property interest, which was the ability to grant a right of first refusal to another person. UNT is on sound ground that its right of first refusal is a property right which may not be taken without compensation.

UNT loses its footing, however, by failing to explain how the break-up fee diminishes the value of its right of first refusal. With or without the break-up fee, UNT has the same right to obtain the plants on the same terms and conditions as the winning bidder. Unlike *Gregory*, state action will not result in the transfer of a valuable property right from the owner to some other person. If UNT exercises its right, a winning bidder will receive a break-up fee. UNT is not being required to pay the winning bidder the break-up fee as a condition of exercising its right of first refusal. On the other hand, if UNT declines to exercise its right, the winning bidder will receive no break-up fee. In either case, UNT can elect, or not, to exercise the same right.

The only logical basis that we can imagine for UNT's objection to the break-up fee is that it would increase bid prices and make the exercise of the first of first refusal more expensive. Even assuming that to be true, however, it would not constitute a taking. The price that UNT must pay to exercise its right is a objective one: It is the price that a bona fide purchaser offers, not any particular price. If UNT had wanted protection against offers that contained a break-up fee provision, it could have bargained for that protection in its agreement with PG&E. For UNT to now claim that permitting the break-up fee is a taking makes no more sense than claiming that PG&E should be limited to advertising the auction by word of mouth, rather than advertisements in *The Wall Street Journal*. UNT's right of first refusal is no more than that; it is not a right to first refusal at the lowest priced offer that can be obtained.

Does Duke Power have sufficient market power such that it should be prohibited from bidding on the plants in this application?

PG&E argues that Duke Energy Power Services, Inc. (Duke Power) does not have sufficient market power, based on the results of PG&E's and Edison's sales to date, to justify barring Duke Power from the auction. PG&E observes that Duke Power has only approximately 22% of the capacity, statewide, that was sold in those auctions, and that in addition to the 12,159 MW of capacity that has already been sold, PG&E is proposing to sell 4,289 MW in this application, and San Diego Gas & Electric Company plans to sell about 2,000 MW. PG&E concedes, however, that in light of the interstate regional market for energy, this Commission is primarily concerned with locational market power issues. However, because the winning bidder must demonstrate to the Federal Energy Regulatory Commission (FERC) that it does not have market power (or has adequately mitigated its market power), market power concerns should be deferred until we know the actual identity of the buyers.

ORA concedes that Duke Power is now the third largest, rather than the second largest, owner of divested generation, but argues that Duke Power has already bought all of PG&E's capacity auctioned to date, so that it now controls 42% of PG&E's pre-divestiture capacity. Allowing Duke Power to proceed further could result in simply substituting one possessor of market power (Duke Power if it adds to its position) for another (PG&E before its divestiture), which we noted that we were unlikely to allow. (D.96-09-046.)

Neither CCSF, SAEJ, UNT, nor Calpine briefed this issue.

We remain unlikely to allow Duke Power to simply step into the shoes of PG&E, but it is not yet time to deal with this issue. Duke Power may already be sated and might not intend to bid at all. It may have its eye only on one plant and be able to show that the sale to it does not raise significant concerns in the context of other sales. In short, we would prefer not to assume the outcome of the auction and to assume, at the same time, that no set of facts would convince us that Duke Power's market position cannot be adequately contained. We might reach that conclusion, eventually, but we should do so only on the basis of the facts, and not assumptions. In addition, the one party that can best make the argument why it should be allowed to acquire more than 40% of PG&E's capacity is Duke Power, which is not yet a party to this proceeding.

Should Calpine be precluded from bidding on the Lake County Geysers units if it does not consent to the disclosure, subject to suitable confidentiality agreements, of relevant information in PG&E's possession regarding the characteristics of the related geothermal field?

In its protest, Calpine stated that its agreement with PG&E prohibited PG&E from disclosing to third parties (including bidders) information in PG&E's possession regarding the characteristics of the related geothermal fields. PG&E and Calpine disclosed, in their briefs, that they have resolved this issue, and they have agreed to permit the disclosure, subject to suitable confidentiality agreements, of this information to bidders. Nonetheless, PG&E moved for the Commission to exercise jurisdiction over a contractual dispute between PG&E and Calpine or to direct PG&E not to entertain bids from Calpine so as to "eliminate Calpine's incentive to try to depress bids on the Lake County Units." PG&E subsequently withdrew its motion, and has advised the Commission that it had resolved its contractual differences with Calpine.

Calpine states that its agreement to consent to disclosure, subject to suitable confidentiality agreements, moots the issue of whether it should be permitted to bid. PG&E agrees.

Neither ORA, CCSF, SAEJ, nor UNT briefed this issue.

For these reasons, we will not bar Calpine from bidding on the Lake County Geysers units.

Is the proposed sale process otherwise reasonable?

PG&E notes that its proposal (aside from wanting to bundle the Pittsburg and Contra Costa plants, starting the related habitat mitigation measures, and the break-up fee) is the same sale process that the Commission found reasonable in D.97-09-046, and should be approved again.

SAEJ argues that "there may be alternative approaches to divestiture ... which avoid or mitigate environmental impacts, increase the reliability of the system and mitigate locational market power" and that if such alternatives are superior, "continuing with the current process would not be reasonable."

CCSF argues that the Commission should not authorize commencement of the auction until the EIR process is complete. PG&E states that it plans on receiving final bids following Commission action on the EIR.

Neither ORA, UNT, nor Calpine briefed this issue.

SAEJ is confusing the issue of whether it is in the public interest to permit PG&E to divest these plants with the issue of whether the process by which it proposes to auction the plants is reasonable. That is, SAEJ treats the Scoping Memo as if it directed the parties to brief the *what* rather than the *how*. We agree with PG&E that its proposed sale process is reasonable and should be approved.

We will require that PG&E not accept final bids until after we have adopted a final EIR, so that all bidders will know the mitigation measures that will be required in connection with any sale and transfer of the plants.

In the absence of evidence of a significant irregularity in the auction process will the fair market value for the generating plants be determined by the auction process?

PG&E notes that D.97-09-046 found that PG&E's auction process in that application would, absent significant irregularity, establish the market value of those plants upon consummation of the sale, and the same conclusion should follow in this application, because the same process is being used.

No other party briefed this issue.

We agree with PG&E that the same conclusions reached in D.97-09-046 should apply to the auction process that we approve in this decision.

Is the proposed Operations and Maintenance Agreement reasonable to both PG&E and buyer?

PG&E notes that D.97-09-046 found that PG&E's form of O&M Agreement in that application was reasonable to buyer and seller, and the same conclusion should follow in this application, because substantially the same form of agreement is being used.

No other party briefed this issue.

We agree with PG&E that the same conclusions reached in D.97-09-046 should apply to the form of O&M Agreement in this application.

> *Does the requirement that the buyer enter into a master must-run agreement with the ISO satisfy the requirements of PU Code Section 362 to "ensure that facilities needed to maintain the reliability of the electric supply remain available and operational," assuming the ISO determines that such an agreement is required?*

PG&E argues that nothing has changed since D.97-11-030, in which the Commission concluded that the MMRA "is sufficient to ensure that plants required for the reliable operation of the transmission system remain available and operational, pursuant to PU Code Section 362."

SAEJ argues that the MMRA does not ensure that facilities needed in the foreseeable future will be available. The basis for SAEJ's position is its belief that the Potrero Plant needs to be replaced with transmission lines and that permitting the plant to be sold will impede such replacement.

UNT argues that if PG&E reduces the generation levels of the Sonoma County Geysers units to zero upon commencement of operations of the ISO and Power Exchange (PX), as UNT represents PG&E has threatened to do, it is reasonably foreseeable that the absence of a load to service will damage both the steam fields and the related power plants. In that event, UNT argues, it will not be possible to ensure that such plants remain available and operational.

No other party briefed this issue.

We agree with PG&E that the MMRA is legally sufficient and satisfies the requirements of PU Code Section 362. SAEJ would have us construe PU Code Section 362 in a way that its plain language cannot support. That statute requires, when a utility such as PG&E proposes to transfer its property, that if the property is required to maintain the reliability of the electric supply, it remain available and operational. If the statute read: "In proceedings pursuant to Section ... 851, ... the commission shall ensure that facilities which would be constructed in the future for system reliability purposes would still be constructed" the result would be different, but that is not how the statute reads. Although we may consider such possibilities in evaluating whether it is in the public interest to permit the sale and transfer of the plants, it is not part of our analysis under PU Code Section 362, which is limited in its scope.

UNT's analysis is similarly flawed. The purpose of PU Code Section 362 is not, in and of itself, to ensure system reliability. Rather, it is to ensure that the sale and transfer of utility property is done in a manner that permits the continued availability and operation of those plants that are required for the reliable operation of the system. If PU Code Section 362 read: "In proceedings pursuant to Section ... 851, ... the commission shall ensure that facilities required for the reliable operation of the electric system are restored to their condition prior to the related application under Section 851" the result might be different. But that is not how the statute was written. If PG&E reduces its generation in violation of applicable agreements with UNT and damage to the plants results, UNT will have its legal remedies as provided in the agreements and might also be entitled to equitable relief. Assuming that such damage occurs, however, we do not see the relevance to PU Code Section 362.

Is making the sale and transfer of the plants subject to the agreement with the ISO consistent with maintaining open competition?

In proceedings pursuant to Section 851, we must ensure that "facilities needed to maintain the reliability of the electric supply remain available and operational, consistent with maintaining open competition and avoiding an overconcentration of market power." (PU Code § 362.) "In order to determine whether a facility needs to remain available and operational, the [C]ommission shall utilize standards that are no less stringent that [sic] the

Western Systems Coordinating Council and North American Electric Reliability Counsel standards for planning reserve criteria." (*Id.*) The parties refer to such facilities as "must-run."

Continued Availability and Operation

The MMRA is a bilateral contract between the owner of an electric generating facility and the ISO that permits the ISO to call upon the facility to deliver electricity into the transmission grid, at the times and in the quantities specified by the ISO, and sets out the respective rights and duties of the ISO and the owner. Its essential features are that it is governed by California law, terminable for convenience by the ISO, but not the owner, on 90 days' notice, renewable for successive terms at the option of the ISO, and permits the dispatch and payment obligations to be switched among three different regimes at the option of the ISO or the owner under various circumstances. In D.97-11-030, we found that the form of the MMRA suitably provides for a valid, legal, and binding contract between the ISO and the buyer, enforceable in accordance with its terms. We concluded that must-run plants in that proceeding will remain available and operational consistent with maintaining open competition, if, as a condition of sale, PG&E required that the successful bidder enter into an agreement with the ISO substantially in the form filed by the ISO with the FERC on March 31, 1997 or provide a certificate of the ISO to the effect that it has determined that the related plant is not required for the ISO's purposes.

PG&E, in its brief, states that no party contends that the MMRA is not effective to meet the reliability requirement of PU Code Section 362. However, SAEJ, in its brief, takes the position that the MMRA does not ensure facilities needed in the foreseeable future will be available, and CCSF, in its reply brief, claims that the Commission's determination of the effectiveness of the MMRA was based on "different facts and thus cannot serve as the basis for a similar conclusion here."

No other party briefed this issue.

As discussed above, SAEJ misconstrues PU Code Section 362, by shifting the focus away from facilities whose transfer that the Commission is asked to approve pursuant to PU Code Section 851 to facilities that might be constructed in the future. Since those facilities do not yet exist (nor, indeed, does any party have a contractual right to have such facilities built) such facilities obviously cannot be made subject to the MMRA as a condition of the Purchase and Sale Agreement. Since there is no connection between those facilities and the MMRA, it is equally obvious that the MMRA can do nothing to ensure that such hypothetical facilities contribute toward system reliability. Those facilities are not, moreover, public utility property necessary or useful to the performance of the public utility's duty, and neither PG&E nor anyone else has asked our approval to transfer any such hypothetical facilities pursuant to PU Code Section 851. Without such an application, PU Code Section 362 simply does not apply. In the application that is actually before us, PU Code Section 362 applies to the transfer of the plants, subject to the MMRA, and not to the nontransfer of nonexistent transmission projects that would not be built if the Potrero Plant is transferred.

CCSF is mistaken about the facts on which we based our determination that the MMRA is effective to ensure the continued availability and operation of must-run plants. Those facts do not depend on the nature of the plants, but rather depend upon the content of the MMRA. The same MMRA that we previously approved for PU Code Section 362 purposes is proposed in this proceeding. CCSF also states that "it is quite possible that to ensure that no adverse air quality impacts result from the sale of the Bay Area plants, there will be a need to coordinate operation, refurbishment and/or unit retirement among the units." Therefore, CCSF argues, we cannot conclude that making the MMRA a condition of sale and transfer "adequately addresses all reliability and localized market power concerns."

CCSF assumes a greater scope for PU Code Section 362 than the Legislature intended. That statute gives us the limited task of assuring that must-run facilities, such as the Potrero Plant, are made available to the ISO, "consistent with open competition and avoiding an undue concentration of market power." We continue to find that the MMRA will assure the requirement of PU Code Section 362 for continued availability and operation of must-run plants.

Open Competition

PG&E notes in its brief that in considering the effect of the MMRA on two plants in A.96-11-020, the Commission determined, in D.97-11-030, that the obligation of the Commission pursuant to PU Code Section 362 to ensure the continued availability of must-run plants is qualified by the requirement to do so "consistent with open competition." D.97-11-030 considered several ways in which making a must-run plant subject to the MMRA might be inconsistent with competition. These included the possibility that supply might be withheld from the Power Exchange (PX) or direct access markets when the MMRA required the output of a plant to be dedicated; another possibility was that payments under the MMRA might be sufficient to provide a source to cover operating losses of a plant that engaged in efforts to depress prices and to drive out competition; and a third possibility was that the MMRA provided the financial security for an owner to make improvements to a plant, which would then compete unfairly with other plants.

In D.97-11-030, we dismissed each of these possibilities. We concluded that taking must-run plants out of the market is unlikely to raise the market-clearing price; regardless of the source of funds used to sustain losses; the other conditions needed for successful predatory pricing did not exist; and the MMRA, which is terminable without cause upon 90 days' notice, does not provide sufficient financial security to pose any real issue with respect to open competition.

SAEJ argues that although the ISO may terminate the MMRA on 90 days' notice, it is unlikely to do so because of the long lead time to develop replacement resources, whether they be transmission or generation. Assuming that to be true, the ability of the owner of the Potrero Plant to rely upon cash flow from the MMRA does not, without more, establish an inconsistency with open competition in the generation market.

PG&E also argued that the other issue raised by SAEJ's protest – that the owner of the Potrero Plant might be able to exercise locational market power and command a premium price – is also addressed by the MMRA. Because the only time that the Potrero Plant could exercise locational market power, PG&E contends, would be when it is not dispatched on the basis of its bid to the PX, but its generation is needed for reliability. That, concludes PG&E, is precisely when the MMRA gives the ISO the ability to call upon the Potrero Plant at cost-based rates, and therefore mitigates any locational market power that might otherwise exist.

SAEJ argues that to the extent that the Potrero Plant has capacity in excess of the requirements called for under the MMRA, that the "new owner will have considerable capacity available to sidestep the [MMRA] by securing direct access contracts serving a significant portion of the San Francisco demand, thus avoiding ISO cost controls." Furthermore, such "facilities could take advantage of their apparent independence of the grid with its vagaries and sign-up customers seeking long-term price stability, even at prices higher than the current PX price." If taken at face value, however, SAEJ's contentions do not establish the existence of market power,[2] because the direct access sales and sales from the PX would be for different services. SAEJ has neither assumed nor demonstrated that the Potrero Plant is the sole provider of direct access services in the relevant market.[3]

SAEJ also argues that making the Potrero Plant subject to the MMRA is inconsistent with maintaining open competition because so doing may preclude competition between the Potrero Plant and projects to substitute transmission for generation. Assuming, for the sake of argument, that SAEJ is correct, we need to consider what the Legislature intended by the phrase "open competition."

No other party briefed this issue.

In proceedings pursuant to Section 851, we must ensure that "facilities needed to maintain the reliability of the electric supply remain available and operational, consistent with maintaining open competition and avoiding an overconcentration of market power." (PU Code § 362.) We construe PU Code Section 362 in light of the guidance provided by the Legislature in AB 1890. (*See* PU Code § 365.)

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[2] Market power is the ability of a seller to obtain a price higher than the competition charges for the same service or commodity.

[3] SAEJ recommends that the solution to the possibility that the owner of the Hunters Point Plant would make direct access sales is to require PG&E to retain ownership, require the ISO to provide transmission upgrades, or to direct PG&E to sell the facility to CCSF. CCSF is free to bid on the facility; we cannot direct the ISO to construct facilities; and requiring PG&E to retain ownership is not necessary in the absence of proof that the ability to make direct access sales constitutes market power.

AB 1890 was intended to foster competition in the electric generation market. (PU Code § 330(e).) Delivery of electricity over transmission and distribution systems is to continue to be regulated to ensure system safety, reliability, environmental protection, and fair access for all market participants. (PU Code § 330(f).) In the restructuring of the electric service industry, it is of utmost importance to enhance reliability of the interconnected regional transmission systems. (PU Code § 330(g).) It is also important to maintain sufficient supplies of electric generation to maintain reliable service. (PU Code § 330(h).) Reliable electric service depends on conscientious inspection and maintenance of transmission and distribution systems. (PU Code § 330(i).) Several steps are necessary to achieve meaningful wholesale and retail competition in the electric generation market. (PU Code § 330(k).) Control of the transmission system should be committed to the ISO by PG&E and other electric utilities. (PU Code § 330(m).) Opportunities to acquire electric power in the competitive market must be made available as soon as practicable. (PU Code § 330(n).) Transmission and distribution remain essential services imbued with the public interest. (PU Code § 330(r).)

The sale of the Portrero plant and its designation as must-run do not preclude competition between generation and transmission in meeting reliability needs. PU Code §§ 345-350 provide the ISO with sufficient authority to identify the most cost-effective means to ensure that reliability is met. PU Code § 350, for example, requires that the ISO evaluate "the range of cost-effective options that would prevent or mitigate the consequences of major transmission outages." (PU Code § 350(c)), and "identif(y) transmission capacity additions that may be necessary at certain times of the year or under certain conditions" (PU Code § 350(f)). The MMRA agreement binds the plant operator to ensure that the plant is available while allowing the ISO to terminate the MMRA on

90-days' notice. Therefore, nothing in the MMRA precludes the ISO from cancelling the MMRA should cost-effective options to achieve reliability (such as incremental transmission upgrades) become available.

Looked at in light of the Legislature's purpose in enacting AB 1890, the "open competition" requirement of PU Code § 362 manifestly refers to competition among electrical generation facilities, and it would be unreasonable while PU Code §§ 345-350 enable the ISO to embrace competition between transmission and generation for reliability purposes. Accordingly, we will find that making the sale and transfer of the plants subject to the MMRA is consistent with maintaining open competition.

Assuming that Advice Letter 1720-E is approved, should PG&E be required to account for sales of intrastate gas pipeline capacity in accordance with the treatment described in its February 27, 1998 filing?

In its brief, PG&E stated that it had reached an agreed outcome with TURN on this issue. On February 17, 1998, TURN filed a limited protest to the application, seeking further information regarding PG&E's recent acquisition of intrastate gas pipeline capacity for its electric generation plants that are proposed to be divested in this application. TURN also sought clarification regarding the accounting and ratemaking treatment of the costs and potential revenues associated with such pipeline capacity. On March 25, 1998, PG&E and TURN filed a stipulation that provided as follows (the Stipulation):

1. As stated in PG&E's February 27, 1998, Response to Protests to Application 98-01-008, PG&E's Utility Electric Generation Department (UEG) has already sold almost all of the excess intrastate gas pipeline capacity it acquired during the Gas Accord open season. Prior to final divestiture of its fossil plants, UEG plans to use its remaining capacity to serve the plants it continues to own. UEG will sell this capacity on a short-term basis when this capacity exceeds UEG's fossil plant requirements.

Additionally, UEG plans to sell all its remaining intrastate capacity for the period following Power Plant divestiture.

2. Pursuant to the Competition Transition Charge (CTC) Phase I and Phase 2 Decisions (Decisions 97-06-060, 97-11-074, and 97-12-039), PG&E filed Advice Letter 1720-E on December 15, 1997. Advice Letter 1720-E proposes to establish the Must-Run Fossil Plant and Non-Must-Run Fossil Plant Memorandum Accounts (Parts AX and AY, respectively, of PG&E's Electric Preliminary Statement) to record expenses and revenues associated with the operation of the fossil plants. As stated in the memorandum accounts, on a monthly basis, the fuel costs will be equal to the product of the daily [million BTUs] of natural gas consumed and the daily weighted average cost of gas.

3. Consistent with PG&E's former fuel cost accounting practice under the Energy Cost Adjustment Clause (ECAC), the daily weighted average cost of gas will include both intrastate and interstate pipeline reservation charges. It is hereby stipulated that all the intrastate capacity assignment revenues (less any capacity assignment costs) will also be included in the weighted average cost of gas for the purpose of these accounts. Any credit balances in these memorandum accounts will be transferred to the Transition Cost Balancing Account (TCBA), Part AVE of PG&E's Electric Preliminary Statement, on an annual basis. Thus, PG&E's electric ratepayers will receive any benefit from the sale of excess intrastate pipeline capacity. If Advice Letter 1720-E is not approved for any reason, PG&E will propose an alternative ratemaking that achieves this same result.

4. For the period following divestiture of PG&E's fossil plants, UEG plans to sell the excess intrastate capacity for the remaining term of the intrastate capacity contract (through December 31, 2002). Since the Must-Run Fossil Plant and Non-Must-Run Fossil Plant Memorandum Accounts will cease to exist once PG&E divests all of its fossil plants, it is hereby stipulated that PG&E will create the Post Divestiture Fossil Plant Gas Pipeline Capacity memorandum Account to record all remaining expenses and revenues associated with UEG's remaining intrastate capacity. Any credit balances in this account will be transferred to the

TCBA or its successor account at the end of the intrastate capacity contract term.

No other party briefed this issue.

We will approve the Stipulation, subject to the understanding that only credits, and not debits, may be transferred to the TCBA pursuant to paragraphs 3 and 4 of the Stipulation.

In other respects, should the same accounting and ratemaking treatment applied in D.97-09-046 be applied to the transfer and sale of the plants in this application?

PG&E observes that no other party has contended that any different accounting and ratemaking treatment should be applied to the proposed sales than was applied to the sales in A.96-11-020, as determined in D.97-09-046, which found the ratemaking treatment to be just and reasonable.

ORA agrees that the same accounting and ratemaking treatment applied in D.97-09-046 should be applied here, except that the break-up fee should be treated as a transaction cost only to the maximum extent of $2 million.

Neither CCSF, SAEJ, UNT, nor Calpine briefed this issue.

We agree with PG&E and ORA that the same ratemaking treatment approved in D.97-09-046 should apply to this application, except that the fixed break-up fee, should be also allowable as a transaction cost.

Are the claims raised by UNT and Calpine regarding the Sonoma County Geysers units and the Lake County Geysers units, respectively, sufficient to make it imprudent for PG&E to conduct an auction of such units until such claims have been finally determined?

PG&E argues that delaying the auction of the Sonoma County Geysers units or the Lake County Geysers units would not further the goals of timely market valuation of generation-related assets and the earliest possible end to the rate freeze. Bidders, PG&E maintains, can factor the positions of UNT and

Calpine regarding their respective agreements with PG&E for the sale of the steam to operate the related plants into their bids.

UNT disclosed in its brief that it had invoked the dispute resolution mechanism in its agreement with PG&E to resolve certain issues. However, assuming that PG&E adequately discloses the existence of a commercial dispute with UNT to potential bidders, UNT sees no reason why the auction should not proceed. UNT notes that the proposed form of Purchase and Sale Agreement contemplates that PG&E and the buyer of the Sonoma County Geysers units would seek UNT's consent to the assignment of the agreement between PG&E and UNT to the buyer. If, UNT states, the parties are unable to agree on the assignment, the dispute resolution mechanisms in the underlying agreement are available to resolve the issue. The only concern that UNT expresses is what it calls the "unlikely event" that PG&E would make inadequate or misleading disclosures during the auction regarding the commercial dispute between PG&E and UNT.

Calpine takes much the same position as UNT: If PG&E provides a full, complete, and accurate disclosure of the contractual issues that Calpine raises, as Calpine believes that PG&E will do, Calpine believes that the auction of the Lake County Geysers units should proceed.

ORA agrees with UNT and Calpine that disclosure is all that is needed to permit the auction participants to take the pending disputes into appropriate account in formulating their bids.

Neither CCSF nor SAEJ briefed this issue.

Thus, the principals all concur that the auction should proceed, if disclosure is made to bidders of the existence of competing interpretations of the existing contractual arrangements between PG&E and UNT and between PG&E and Calpine. We agree.

Comments of Parties on the Proposed Decision and the Alternate

PG&E

Break-up fee for the Sonoma County Geysers Unit

PG&E criticizes the proposed decision's conclusion that the break-up fee should be eliminated. No evidence was offered[4] by PG&E or any other party that would permit the Commission to decide as a factual matter, based on expert opinion or other competent evidence, just what the magnitude, positive or negative, of the break-up fee would be on the bids. Rather, we are asked to decide this matter on the force of the arguments pro and con. In order to encourage bidding, we are persuaded by PG&E's argument that a "consolation prize," in the form of the fixed break-up fee should be offered.

Bundling of the Pittsburg and Contra Costa Plants

The proposed decision has been clarified, as PG&E suggests[5], to state that Pittsburg and Contra Costa plants should be bundled, because the alternative (to permit separate bidding, subject to a condition that bidders assume the right that permit transfer might not be forthcoming) seemed likely to deter bidding on an unbundled basis. PG&E recommended[6] that Finding of Fact 3 be eliminated from the proposed decision. It will be retained to illustrate the

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[4] PG&E asks us to take official notice of the Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1997 filed by NGC Corporation, to establish the nature of the business relationships among the winning bidders for the El Segundo Plant in the Edison auction and the holder of a first of first refusal. Although we were not persuaded that the Edison auction provided much light on PG&E's proposed break-up fee, one way or the other, we take the notice requested. It does not change our conclusion.

[5] In its reply comments, filed June 29, 1998, PG&E notes that other parties comments indicate that doubt exists regarding whether the proposed decision approved PG&E's proposal to bundle the two plants. The clarification should eliminate any doubt.

[6] ORA, in its reply comments, agreed with PG&E, for different reasons.

impracticality of unbundling the plants and using the mechanism described as a means of protecting ratepayer interests.

Form of Master Must-Run Agreement

PG&E clarifies the alternate decision in that it continues to use the description of the MMRA contained in PG&E's earlier application. As noted in D.97-11-030, FERC has approved, subject to refund, but states that "no one – including the ISO – currently supports that revised MMRA in October 1997.

Settlement between PG&E and Calpine

On April 9, 1998, PG&E withdrew its motion to have the Commission assume jurisdiction of certain contractual issues between PG&E and Calpine. As a result, PG&E recommends that the proposed decision to reflect its change in position relative to Calpine, and the proposed decision has been modified as PG&E suggested in its comments.

Authority Required to Commence Auction

PG&E recommends that Ordering Paragraph 1 of the proposed decision be revised to permit it to *conduct* rather than to *commence* an auction of the plants. PG&E notes that it "started the auction on April 13, 1998." SAEJ opposes PG&E's recommendation on the grounds that allowing the auction to commence before the CEQA process is complete is a violation of CEQA. In light of the Assigned Commissioners' Ruling dated June 16, 1998, our determination that the project, for CEQA purposes, is not the auction, but rather than transfer, and to avoid any interpretation that *conduct* means to "take to completion," we will use the verb *continue*.

ORA

Joint Operating Agreement for Pittsburg and Contra Costa Plants

ORA renews its proposal for a joint operating agreement to be included in the auction of the Pittsburg and Contra Costa plants that would set forth the means by which the two plants could be operated consisted with applicable permits under separate ownership. We were unwilling to do this because although it would be possible to specify criteria to achieve the required compliance with permit conditions,[7] we were not confident that those criteria would also represent bargain that independent economic actors would strike. The proposed decision explored, and rejected, an alternative of making the unbundled sale of the plants subject to an event of default for failure to obtain the required permits. While this approach could result in both meeting the permit criteria and reflecting business arrangements satisfactory to the owners, we rejected it for the reasons stated.

The Lake County Geysers Units Break-up Fees

ORA discusses an *ex parte* communication from PG&E and Calpine to the assigned Commissioners that discloses an agreement between PG&E and Calpine granting a right of first refusal to purchase the Lake County Geysers units. Pursuant to Rule 1.2 of the Rules of Practice and Procedure, the Commission shall render its decision based on the evidence of record. An *ex parte* communication, even if filed pursuant to Rule 1.4 is not part of the record of a proceeding. (Rule 1.2.) No party has moved, pursuant to Rule 84, to set aside

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[7] In its reply comments, PG&E expressed its view that it did not believe that it knew how to draft a joint operating agreement that would be effective.

submission. According, the proposed decision has not been modified to address this issue.

Bifurcation

In its reply comments, dated June 29, 1998, to the proposed decision, ORA expresses the concern that sales of plants other than the Potrero plant, which might otherwise be non-controversial, "could be held up for possibly years until legal challenges to the sale" of the Potrero plant are resolved. As a result, ORA believes, "[t]his prospect almost certainly increases the uncertainty and decreases the price bidders will be willing to offer for the " plants other than the Potrero plant.

Pursuant to Rule 77.3 of the Rules of Practice and Procedure, "[c]omments shall focus on factual, legal or technical errors in the proposed decision and in citing such errors shall make specific references to the record. Comments which merely reargue positions taken in briefs will be accorded no weight and are not to be filed." Still less is it proper for a party to attempt to inject issues that it failed to raise in briefing. In any event, we are not moved by ORA's unsupported assertion of any putative effect on price. If we permit PG&E to accept final bids, if PG&E receives bids, and if PG&E requests that the Commission issue separate decisions for transfer of each plant, it would be possible to isolate the more controversial plants from the less controversial plants at the appropriate time.

Evidentiary Hearings

In its reply comments, dated June 29, 1998, to the proposed decision, ORA criticizes the Scoping Memo's determination that no disputed issues of material fact exist that require an evidentiary hearing, and suggests that the lack of evidentiary hearings is a deprivation of due process rights. ORA observes that it has not been "able to explore what non-price factors [CCSF] proposes be considered in any sale." Nor has ORA "been able to fully understand how SAEJ or [CCSF] would reduce the current levels of pollution in San Francisco" in connection with the operation of the Potrero plant.

The purpose of an evidentiary hearing is to obtain evidence that permits the Commission to determine which of two or more competing factual statement is true. An evidentiary hearing is not held as a substitute for discovery, oral argument, or to provide a forum for settlement. The Rules of Practice and Procedure adequately provide mechanisms for those other purposes. Rule 44.2 requires a protest that requests an evidentiary hearing to "state the facts that the protestant would present at an evidentiary hearing to support its request for whole or partial denial of the application."

ORA's protest to the application identified four issues. In its discussion of none of those issues did ORA state a single fact that it would present an evidentiary hearing. Nor did ORA identify a single fact in the prepared testimony of PG&E that ORA disputed and stated that it would be able to refute through the cross-examination of PG&E's witness. The assigned Commissioners did not abuse their discretion in determining, through the Scoping Memo, that no disputed issue of material fact requiring an evidentiary hearing existed.

UNT

UNT supports the proposed decision's recommendation with respect to the break-up fee. In commenting on the alternate decision, UNT argues that because PG&E offered no evidence to provide a factual basis for the conclusion that a break-up fee is necessary, it failed to carry its burden. Furthermore, UNT contends, no evidence exists to show that the mere existence of a right of first refusal will discourage bidders from participating in the auction altogether. Also, since no bidder can know in advance that its bid will be considers both price and non-price factors, with the ultimate result that CCSF would acquire the Potrero plant. CCSF plans to operate the plant at a level that "assures that the current level of emissions are not exceeded, except as may be necessary to meet electric service reliability requirements." CCSF is concerned that PG&E's proposal for sale to the highest qualified bidder fails to address the public interest.

CCSF believes that the "value it is willing to offer for these plant, comprised of both cash and non-cash considerations including significant avoided future rate payer costs, greatly exceeds any value that another purchaser could offer." Furthermore, CCSF asserts, the public interest "is best served through this unique combination of near and long term economic, environmental, and other benefits that could only be delivered by a local jurisdiction motivated more by concerns for the health and well being of its residents and that of its neighboring municipalities than by interests in making profits."

Accordingly, CCSF argues, the Commission should order PG&E to consider both an auction and a non-auction (*i.e.*, negotiated sale) for the Potrero plant, because CCSF will exercise its power of eminent domain, if necessary, to acquire the plant.

In its amended application, PG&E and CCSF have entered into an agreement in which, if approved by the Commission, CCSF has agreed not to bid on either the Portrero or Hunters Point plants. We will therefore defer consideration of this issue until we address PG&E's amended application.

Whether Approval Is Required for the Auction

CCSF argues that determining that the process (as opposed to the outcome) of the auction to be in the public interest is premature, inconsistent with prior Commission decisions, and contrary to PU Code Section 851.

CCSF fails to address a fundamental question under PU Code Section 851: Whether PG&E requires any authority from this Commission at all in order to select a buyer for its assets.[9] CCSF has not cited any of our cases in which a utility came to us with an application pursuant to PU Code Section 851 to transfer its property to a buyer that it had already selected and we have held that entering into the conditional[10] contract for sale was itself subject to PU Code Section 851. It may be that an absolute contract for sale is itself subject to the prohibition in PU Code Section 851 against selling, leasing, assigning, mortgaging, or otherwise disposing of or encumbering utility property. But CCSF has not shown that an auction process is itself subject to that statute if the process is contingent upon final Commission approval of the actual transfer. Nothing in PU Code Section 851 either requires or prohibits PG&E to sell its property by auction or any other means.

CCSF cites examples of transfers of utility property to municipalities to show that the public interest standard is different than when a private investor is the transferee. While those cases have continued vitality when a municipality is proposing to acquire property used to provide public utility service to continue to provide such a service, they shed little light on the acquisition of assets to be deployed in a competitive market for generation of electricity. In the cases cited, such as *Azusa Valley Water Co.* (1993) 49 CPUC2d 482 (1992), in which a municipality acquires all of the assets of a utility in order to operate a municipal utility system, we indeed have few worries that the interests

[9] In its reply comments, PG&E notes that in typical application pursuant to PU Code Section 851, the utility does not even apply to the Commission for approval until after it has signed a contract with the buyers.

[10] The condition being that the consummation of the contract for sale is the prior approval of the Commission.

of the ratepayers and the municipality, which is answerable to the ratepayers as citizens, have any great divergence of interest. Those cases are not analogous to the sale of power plants without the appurtenant transmission and distribution plant."[11] If CCSF proposed to become a municipal utility, as opposed to the municipal owner of non-utility, merchant power plants, its argument might have some vitality. But this is not the case, and we cannot assume that transfer of the plants to CCSF, regardless of the price, should be deemed to be automatically in the public interest.

Nor is a finding that the proposed sale process is reasonable inconsistent with D.97-09-056, in which we declined to conclude that the *sale* of other plants was in the public interest in an interim decision. There is, a vast difference between soliciting binding offers and transferring utility property.

Whether the Auction Is a CEQA Project

CCSF[12] argues that until a "full CEQA analysis is completed, including analysis of changes in operation, potential alternatives and adoption of any mitigation measures, the Commission cannot conclude that the auction and divestiture of the San Francisco plants is in the public interest and allowed under" PU Code Section 851. CCSF is certainly right that the divestiture – the transfer – of the plants cannot occur, if at all, until we have completed the EIR that is in preparation, and the draft decision determines that the sale of the plants will be subject to conditions required to avoid or reduce to non-significant levels

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[11] As PG&E notes in its reply comments, the cases cited by CCSF address the acquisition of complete utility systems, rather than specific assets that will be deployed in a competitive market on a for-profit basis.

[12] ORA agrees with CCSF that the Commission should review final CEQA reports before approving PG&E's initial screening of bidders.

any adverse environmental impacts that we may determine will arise from physical changes reasonably foreseeable in connection with any transfer of the plants.

The auction process, however, is not an "activity" for CEQA purposes. Telephone lines will ring, fax machines will hum, investment bankers will pore over documents, coffee will be spilled over conference tables, and courier packages will fly. "Many shall run to and fro, and knowledge shall be increased. " (Daniel 12:4). These are not the physical changes to the environment that CEQA contemplates. At the conclusion of the auction process, PG&E will present transaction documents to the Commission, whose force and effect depend upon a final decision by this Commission. [13] Therefore, it is the transfer of the plants, not the process by which the transferee is selected, that is the project for CEQA purposes.

Whether to Require PG&E to Apply Non-Price Factors

CCSF believes that the public interest would best be served by a plan to mitigate the environmental impacts of operating the Potrero plant in the short run, and a commitment to develop a long-range energy plan for San Francisco jointly with the ISO, PG&E, the Commission, the community and other

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[13] In its comments on the alternate decision, SAEJ analogizes the decision regarding the auction to the adoption of a general plan for a community. The analogy is faulty. Land use decisions, including zoning changes, for example, must be consistent with the general plan. It would be inconsistent with the general plan, for example, to approve a regional shopping center development in a location that had been designated for low-density residential development. No such consistency constraint applies in this case. Whether or not to permit transfer of the plants is a decision that is entirely independent of whether the transferee is selected through an auction procedure or through a negotiated sale. In either case, the Commission has equal freedom of action, all other things being equal, to approve, approve with conditions, or reject the transfer in its final decision.

stakeholders. CCSF believes that an auction to the highest cash bidder provides no opportunity to explore such issues.

PG&E's proposal also fails to accomplish any number of other worthwhile public goals, but that is irrelevant. Divestiture of ownership by PG&E of electrical generation is designed to address a specific public policy objective that this Commission established in D.95-12-053, as modified by D.96-01-009: The establishment and promotion of a competitive market for electrical energy generation. In those decisions, we asked that PG&E voluntarily divest itself of at least 50% of its fossil-fuel plant ownership. That is the basis for the proposed decision's finding that the proposed auction, sale, and transfer is consistent with those decisions.

Any such transfer must also be consistent with CEQA's objective of avoiding or minimizing adverse environmental effects that are reasonably foreseeable as a direct or indirect result of the transfer. Nothing in CEQA requires, however, that existing adverse environmental effects, if any, be reduced or eliminated as a condition of transfer. (*See, e.g.*, Public Res. Code § 21068 ("'Significant effect on the environment' means a substantial, or potentially substantial, adverse *change* in the environment." (*emphasis added*).)

Nor is this Commission charged with long-range energy planning, which is the responsibility of the California Energy Commission. PG&E, as a local distribution utility, rather than a vertically integrated electric utility, has a diminishing role in long-range energy planning. CCSF's position, were it adopted, would require this Commission to assume powers, in the name of furthering the public interest, that the Legislature has expressly delegated to another agency. (*See* Public Res. Code § 25216.)

Whether to Delay Sale Pending Resolution of Issues in Connection with Must-Run Agreements Pending before the FERC

CCSF's comments raise an issue that does not appear in the Scoping Memo or previously in the pleadings: Whether the FERC will permit the owner of a plant subject to a MMRA to recover in rates from the ISO any "premium" that it pays over the book value of the related plant.

SAEJ

Whether the Auction Process is Subject to CEQA

SAEJ[14] argues that for "the Commission to decide that an auction process is reasonable, before considering alternatives, including a no-project alternative, is a direct affront to the CEQA process." SAEJ's argument fails for the same reason as CCSF's similar argument. Because an auction process that is subject to further review and approval by this Commission, including the imposition of conditions required to avoid or mitigate adverse environmental consequences, produces no physical changes in the environment, it is not a "project" and CEQA does not apply to our consideration of the process by which a proposed transferee is selected. If the *transfer* of one or more plants gives rise to one or more significant environmental effects that cannot be avoided or reduced to non-significant levels, we will consider alternatives to the transfer or whether we are able to adopt a statement of overriding considerations.

SAEJ also argues that the proposed decision would create an "irreversible momentum" to approve the transfer of the plants and that we should consider the EIR before taking a decision that preordains the outcome. SAEJ's concerns are misplaced. Nothing in this decision makes it impossible, or

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[14] In its reply comments, filed June 29, 1998, CCSF endorsed SAEJ's position.

even difficult, for the Commission to conclude, ultimately, that the transfer of the plants might not be in the public interest and should not be approved. We are not in the position of a public agency that has committed substantial resources toward one construction project that is contingent upon the completion of another construction project for which no EIR has yet been prepared. No irreversible momentum exists.

SAEJ cites a number of cases in its comments on the alternate decision to show that a "project" for CEQA purposes includes activities that may involve no construction. All of these cases involve projects under Public Resources Code Section 21080(a) that were to be carried out by public agencies or which involved the enactment and amendment of zoning ordinances, general plan amendments and the like. Inasmuch as zoning ordinances must be consistent with general plans, it was easy for the courts in those cases to hold that the change in general plans represented a "reality" rather than possible future action. (*See Bozung v. Local Agency Formation Comm. Of Ventura Co.*, (1975) 13 Cal.3d 263, 282.) Those cases are not applicable to decisions that do not involve the amendment of land use ordinances by public agencies.

SAEJ attempts to find in PU Code Section 701 the jurisdiction to approve the auction process if the Commission so elects and to read into our order that PG&E not accept final bids until further order of the Commission as that election. The reason for that order is that if PG&E accepted final bids before we have determined what means are necessary to satisfy PU Code Section 362 we might well be compelled to reject approval of the sale and transfer. That order is not an assumption of any jurisdiction we might enjoy pursuant to PU Code Section 701 to create a special approval process for the method of selling property under PU Code Section 851, and SAEJ's argument has no merit.

If we understand SAEJ correctly, it argues that it is a foregone conclusion that the Commission will approve the transfer of the plants to the winning bidder.[15] If that is SAEJ's position, SAEJ is failing to observe its duties under Rule 1 of the Rules of Practice and Procedure. SAEJ's related argument, that the auction is a necessary first step toward the transfer of plants, does not convert an action for which no approval is required into an action for which a discretionary approval is required.

SAEJ argues that the Commission is required to consider a no-project alternative, and in this SAEJ is correct. The no-project alternative consists of declining to approve the sale and transfer of the plants; that is not, however, the same as a "no-auction" alternative. We consider alternatives to actions that we are required to approve, if necessary to avoid significant environmental effects. We do not consider alternatives to actions that we are not required to approve. Our duties under CEQA confer upon us no additional jurisdiction over activities that we do not already possess.

SAEJ is concerned that the use of the term "imposition of conditions required to avoid or mitigate adverse environmental consequences" rules out alternatives. It will clarify matters to describe the alternatives that the Commission has: (1) it may disapprove the sale and transfer; (2) it may approve the sale and transfer as proposed; or (3) it may approve the sale and transfer with conditions. We do not know what different alternatives SAEJ has in mind.

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[15] In its comments on the alternate decision, SAEJ states "PG&E is hardly representing to the bidders that it would be mere speculation that the Commission will approve the winner of the auction."

Whether SAEJ was Deprived of Due Process

SAEJ was aggrieved that PG&E accepted bidders' statements of qualification and interest before issuance of a draft EIR, as contemplated by the Scoping Memo. SAEJ was granted an expedited hearing on that point by the assigned Commissioners, and their decision was not to prohibit PG&E from accepting such statements. In its comments on the alternate decision, SAEJ withdrew its objection to that decision.

Whether the June 16, 1998 Assigned Commissioners' Ruling Requires the Proposed Decision to be Withdrawn

SAEJ[16] claims that the issue added by the assigned Commissioners in their June 16, 1998 ruling deprives bidders of an opportunity for briefing. Assuming that bidders move to become parties to the proceeding, they will have the same rights as any other party to brief this issue in the responses due July 25, 1998. Nothing at this point either requires the Commission to accept any of the proposed conditions or prevents the Commission from making one or more of the proposed conditions a condition of the sale and transfer of any of the plants.

Whether the Auction Process Is Unreasonable

SAEJ argues that the auction process precludes CCSF from purchasing the Potrero plant. However, CCSF did submit a preliminary bid. (Tr. 6/10/98, p. 34.) As a public agency, CCSF cannot make a final decision whether to purchase the plants without following the CEQA process; but it is not clear why CCSF cannot use the EIR that is now in preparation. In any event, the

[16] In its reply comments, filed June 29, 1998, CCSF endorsed SAEJ's position.

auction process does not preclude the exercise of the power of eminent domain by CCSF.

SAEJ also argues that the prospect of an eminent domain proceeding by CCSF will lessen the chances that the auction will result in market value for the Potrero plant. CCSF admitted that it is impossible to know what effect the prospect of eminent domain would have on the auction price. (Tr. 6/10/98, p. 46.) SAEJ took the position that an "auction under the shadow of an eminent domain action will give you the market price when there is a shadow of an eminent domain action." (Tr. 6/10/98, p. 48.) Furthermore, where "that compares to the theoretical market price that might have occurred before that, how that compares to what a court can do, you have plenty of experience on that." (*Id.*) To the extent that this remains an issue following the agreement between PG&E and CCSF in the form filed on July 16, 1998, we are not convinced that the possibility of an eminent domain proceeding has an effect on the outcome of the auction that we can determine, at least on the grounds urged by SAEJ.

Whether the Auction Process Violates Federal Law

SAEJ[19] argues that the auction will have a disproportionate impact on persons of color by perpetuating and exacerbating environmental pollution and health problems in the Bayview-Hunters Point community that SAEJ attributes to the Potrero plant. SAEJ asserts that such disproportionate impact is prohibited under the United States Constitution and Title VI of the Civil Rights Act of 1964, as amended. For the same reason that the auction is not a CEQA project, it can have no disproportionate impact. The auction process, by

[19] In its reply comments, filed June 29, 1998, CCSF endorsed SAEJ's position.

itself, will do nothing to affect existing environmental pollution and health conditions. The transfer of the plant *could* have an effect, which would have to be considered in light of the measures available to avoid or reduce the effect.

In its comments on the alternate decision, SAEJ continues claims that the auction will have a disproportionate impact. SAEJ has introduced no facts to support its conclusion that the method by which the plant is sold has any effect on the operation of the plant in the future.

Findings of Fact

1. The policy underlying electric industry restructuring, as expressed in D.95-12-063, D.96-01-009, and AB 1890, is to foster a competitive market for generation.

2. The coordinated dispatch provisions of the NPDES permits are focused on the time of year when striped bass may be most affected, generally May 1 through July 15, although the precise dates may vary. During that time, the Pittsburg Unit 7 must be preferentially dispatched. At times when monitoring shows that striped bass densities are below a stated threshold, the units at the Pittsburg and Contra Costa plants may be operated in any combination.

3. Making failure to obtain permission for transfer of the NPDES permits to separate owners an event of default under the Purchase and Sale Agreement would permit the Pittsburg and Contra Costa plants to be separately sold, but is likely to deter bidding on the plants as separate units.

4. The proposed sale process (except with respect to the break-up fee, which should be fixed at $2 million) is reasonable.

5. The proposed Operations and Maintenance Agreement is reasonable to both PG&E and buyer.

6. Parties agree that all plants are required for the reliable operation of the electric system until the ISO determines otherwise.

7. The MMRA is a bilateral contract between the owner of an electric generating facility and the ISO that permits the ISO to call upon the facility to deliver electricity into the transmission grid, at the times and in the quantities specified by the ISO, and sets out the respective rights and duties of the ISO and the owner. Its essential features are that it is governed by California law, terminable for convenience by the ISO, but not the owner, on 90 days' notice, renewable for successive terms at the option of the ISO, and permits the dispatch and payment obligations to be switched among three different regimes at the option of the ISO or the owner under various circumstances.

8. Making the sale and transfer of the plants subject to the MMRA is consistent with maintaining open competition.

9. TURN and PG&E have entered into the Stipulation.

10. Disclosure by PG&E of the claims of UNT and Calpine to bidders is required to adequately describe the property to be sold.

11. The claims raised by UNT and Calpine regarding the Sonoma County Geysers units and the Lake County Geysers units, respectively, are not sufficient to make it imprudent for PG&E to conduct an auction of such units until such claims have been finally determined.

Conclusions of Law

1. The conclusion that the sale of any plant to a particular buyer is in the public interest should be deferred until the EIR has been completed.

2. PG&E's present application, to divest itself of its remaining fossil generation assets and its Geysers units, is consistent with our call for voluntary divestiture and the policy underlying electric industry restructuring, as expressed in D.95-12-063, D.96-01-009, and AB 1890.

3. PG&E should not be required to defer restoration measures at the Montezuma Habitat Enhancement Site so that such activities can be assumed by the buyer of the Pittsburg and Contra Costa plants.

4. The break-up fee feature with respect to the Sonoma County Geysers units is necessary in light of the right of first refusal held by UNT.

5. Duke Power should not be precluded from bidding on the plants.

6. Calpine should not be precluded from bidding on the Lake County Geysers units unless it does not consent to the disclosure, subject to suitable confidentiality agreements, of relevant information in PG&E's possession regarding the characteristics of the related geothermal field.

7. The proposed sale process (except with respect to the break-up fee, which should be fixed at $2 million) should be approved.

8. PG&E should not accept final bids until after we have adopted a final EIR.

9. In the absence of evidence of a significant irregularity in the auction process the fair market value for the generating plants will be determined by the auction process.

10. The form of the MMRA suitably provides for a valid, legal, and binding contract between the ISO and the buyer, enforceable in accordance with its terms.

11. The requirement that the buyer enter into a master must-run agreement with the ISO satisfies the requirements of PU Code Section 362 to "ensure that facilities needed to maintain the reliability of the electric supply remain available and operational," assuming the ISO determines that such an agreement is required.

12. As a condition of sale, PG&E should require that the successful bidder enter into an agreement with the ISO substantially in the form filed by the ISO with the FERC on March 31, 1997 or provide a certificate of the ISO to the effect

that it has determined that the related plant is not required for the ISO's purposes.

13. We construe PU Code Section 362 in light of the guidance provided by the Legislature in AB 1890.

14. The "open competition" requirement of PU Code Section 362 refers to competition among electrical generation facilities, while the ISO has sufficient authority to evaluate competition between transmission and generation for reliability purposes.

15. The Stipulation should be approved, subject to approval of Advice Letter 1720-E, subject to the understanding that only credits, and not debits, may be transferred to the TCBA pursuant to paragraphs 3 and 4 of the Stipulation.

16. The same accounting and ratemaking treatment applied in D.97-09-046 should be applied to the transfer and sale of the plants in this application.

17. PG&E should make disclosure to bidders of the existence of competing interpretations of the existing contractual arrangements between PG&E and UNT and between PG&E and Calpine.

18. PG&E should require the successful bidder to disclose to the Commission all other generation assets in California under common ownership or control with the bidder.

19. The form of O&M Agreement should be approved and should be required as a condition of sale under the Purchase and Sale Agreement.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) may continue an auction of the Potrero Power Plant, Pittsburg Power Plant, Contra Costa Power Plant, Sonoma County Geysers units, and Lake County Geysers units, but shall not accept final bids until further order of the Commission.

2. PG&E shall disclose to bidders the existence of competing interpretations of the existing contractual arrangements among PG&E and Union Oil Company of California, NEC Acquisition Company, and Thermal Power Company and among PG&E and Calpine Geysers Company L.P. and Calpine Corporation.

3. If we approve the transfer of the plants, the sale of the plants shall be subject to conditions that we may require to avoid or reduce to non-significant levels any adverse environmental impacts that we may determine will arise from physical changes reasonably foreseeable in connection with the transfer of the plants.

4. The sale of the plants shall be subject to the Operations and Maintenance Agreement substantially in the form attached to the application.

5. PG&E shall require as a condition of sale that the successful bidder disclose to the Commission all other generation assets in California under common ownership or control with the bidder.

6. PG&E shall not treat Duke Energy Power Services, Inc. or Calpine Geysers Company L.P. and Calpine Corporation differently from any other bidder.

7. If the plants are sold, PG&E may apply the accounting and ratemaking treatment described in this application.

8. The sale of each plant shall be subject to an agreement with the ISO substantially in the form filed by the ISO with the Federal Energy Regulatory Commission on March 31, 1997, unless buyer provides a certificate of the ISO to the effect that it has determined that the related plant is not required for the ISO's purposes.

9. Upon approval of Advice Letter 1720-E, the stipulation between PG&E and The Utility Reform Network, filed on March 25, 1998, is approved, subject to the understanding that only credits, and not debits, may be transferred to the

Transition Cost Balancing Account pursuant to paragraphs 3 and 4 of the stipulation.

This order is effective today.

Dated July 23, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

I will file a partial dissent.

/s/ JESSIE J. KNIGHT, JR.
Commissioner

A.98-01-008
D.98-07-092

Commissioner Jessie J. Knight, Jr., Dissenting in Part:

Although I support this order in almost every respect, I must point out one area on which I disagree and elaborate on another issue which I had initial concerns that need some clarification that may prove to be helpful for parties in future proceedings.

First, I do not support the adoption of the $2 million break-up fee that would compensate a potential bidder who could lose the auction if Union Oil Company, NEC Acquisition Company and Thermal Power Company (UNT) exercise a right of first refusal for the Sonoma County Geyser units. After careful consideration of this matter, I find the arguments put forth by both PG&E for the break-up fee and UNT against the fee, speculative in nature. PG&E's primary arguments are: 1) an assertion that a break-up fee is needed in order to compensate bidders for alleged higher than normal due diligence costs incurred when bidding on a geothermal plant, as compared to the costs incurred for other types of energy facilities, and 2) the speculation that a break-up fee will attract more bidders, thus stimulating a proposed effect of generating bidding that yields higher market values for the Geyser units. While thought provoking, these arguments are either not on the record of the case or undocumented with any factual information in order to make an objective determination.

UNT argues that a break-up fee could lower the ultimate sale price of the plant, because bidders will try to bid just enough to lose to UNT and collect the break-up fee. This hypothesis is also based on speculation and is just as unconvincing, in my view. It is folly to believe that anybody will ever know the validity of either argument.

Nevertheless, since neither argument is supportable, I prefer to err on the side of caution and not inject additional financial elements such as a break-up fee into this auction process, particularly when it has to be funded by captive ratepayers. Since speculation in this circumstance is the order of the day on this subject, I too will speculate on a far more likely scenario. I believe that approval of a break-up fee could potentially promote gaming in this auction. This speculation is far more likely to occur, based on past regulatory history.

Furthermore, a right of first refusal clause is not uncommon in commercial contracts and never necessitate countervailing measures such as a break-up fee in order to bring an auction to completion. Rather, it is the norm for interested buyers to bear their own transaction costs when bidding on an asset and not to expect compensation if they do not prevail. Moreover, in this case, this opportunity is not available to all bidders, only to the final bidder. Why the final bidder should be entitled to some recovery and not others seems unfair, unnecessary and arbitrary.

In my opinion, the Commission will never know, nor does the record truly reflect the real reasons why both of these parties are arguing for or against the $2 million break-up fee. Neither party has to pay the $2 million fee that the majority has approved, which should give one pause as to the veracity of the arguments presented. The simplicity of a pure auction should have prevailed.

Also, for interested parties and for the record, I was prone to disagree with the order's conclusion on the issue of offering the Pittsburg and Contra Costa plants for sale only as a bundled package. At my first exposure to this issue, I had several immediate reactions that led me to disagree with the proposed order's conclusion to allow the plants to be sold together.

On first impression, I agreed with the Office of Ratepayer Advocates (ORA) that current permits requiring coordinated plant dispatch did not need to be an impediment to the sale of the plants to separate entities. My initial acceptance of their argument was fueled by my strong belief that the market could work out a superior solution to this permitting and dispatch problem, particularly since the dispatch restrictions appeared to be only seasonal. To maximize competition in the nascent generation market, this rationale would suggest that the plants should be sold separately, in order to maximize the chances of producing more competitors on a nominal basis, competitors who would operate the plants in direct competition with each other.

Using this premise, the Commission should encourage competition through separate owners, particularly since these plants are non-contiguous properties. Further, I reasoned that potentially more bidders would step forward with an interest in these plants if they were not offered in block. If only sold as a package, I surmised that fewer parties would be interested in the bundled offering, thereby depressing bid prices, and ultimately negatively impacting ratepayers by decreasing the payment of transition costs. Why interfere with market based solutions and even more importantly, why should the sale of assets be hamstrung by governmental permits when the plants could be permitted separately for new buyers? These and other like questions crossed my mind.

Nevertheless, despite my fervent market-based orientation, I realize that above all, this divestiture is a voluntary one. It is reasonable to assume that

PG&E is doing everything it can to maximize the sale price of the Pittsburg and Contra Costa plants because it too wants to pay off transition costs. Therefore, I will not second guess the company's judgment on this matter. While I initially presumed bundling might depress bid prices, I recognize this is highly speculative since equally compelling arguments can be made that bundling will yield a higher price, notably due to a lack of uncertainty regarding the permits.

Thus, I net out in support of the order on this issue, but for me, it was certainly a close call. While I prefer to see competition enhanced through a greater number of buyers, I can accept that bundling may yield a greater sales price for these uniquely situated plants.

Dated this July 23, 1998 at San Francisco, California.

/s/ Jessie J. Knight, Jr.

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Commissioner

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Using this premise, the Commission should encourage competition through separate owners, particularly since these plants are non-contiguous properties. Further, I reasoned that potentially more bidders would step forward with an interest in these plants if they were not offered in block. If only sold as a package, I surmised that fewer parties would be interested in the bundled offering, thereby depressing bid prices, and ultimately negatively impacting ratepayers by decreasing the payment of transition costs. Why interfere with market based solutions and even more importantly, why should the sale of assets be hamstrung by governmental permits when the plants could be permitted separately for new buyers? These and other like questions crossed my mind.

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Dated this July 23, 1998 at San Francisco, California.

Jessie J. Knight, Jr.
Commissioner

CORRECTION !!

THE PREVIOUS DOCUMENT(S) MAY HAVE BEEN FILMED INCORRECTLY .....

RESHOOT FOLLOWS

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Dated this July 23, 1998 at San Francisco, California.

Jesse J. Knight Jr.

Jessie J. Knight, Jr.
Commissioner