BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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

PETITION OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902-E) FOR MODIFICATION OF D.04-06-011 (AS MODIFIED BY D.06-02-031 AND D.06.09.021) REGARDING OTAY MESA ENERGY CENTER

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#259348

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Pursuant to the California Public Utilities Commission's ("Commission's") Decision ("D.") 06.02.021 and Rule 16.4 of the Commission's Rules of Practice and Procedure, San Diego Gas & Electric Company ("SDG&E") hereby files this Petition for Modification ("PFM") of D.04-06-011 (as modified by D.06-02-031 and D.06-09-021), the Commission's decision approving SDG&E's Power Purchase Agreement ("PPA" or "Otay Mesa PPA") with Otay Mesa Energy Center, LLC ("OMEC"), a wholly-owned subsidiary of Calpine Corporation ("Calpine"). SDG&E respectfully requests that the Commission finds reasonable and approves the suggested language clarifying that (1) SDG&E is responsible for the Otay Mesa Energy Center plant's[1] ("Otay Mesa" or "Otay Mesa plant") greenhouse gas ("GHG") compliance obligation ("OMEC's GHG compliance obligation") attributed to SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant; (2) any allowances allocated to OMEC will be applied toward OMEC's compliance obligation; and (3) all SDG&E costs under the PPA will be recoverable in rates.

[1] OMEC owns and operates the Otay Mesa plant.

I. INTRODUCTION

In D.04-06-011, the Commission approved a ten-year PPA between SDG&E and OMEC for the Otay Mesa plant as part of a motion by SDG&E for approval of a number of electric resources that were chosen following a request for proposal ("RFP"). The Otay Mesa plant is a 583 megawatt ("MW") natural gas-fired combined-cycle power plant in southern San Diego County. The Otay Mesa PPA was modified on two subsequent occasions, first by D.06-02-031, which found the ten-year Otay Mesa PPA between SDG&E and OMEC to be reasonable, and later by D.06-09-021, which noted that that the PPA had been modified to include Put and Call Options, which give SDG&E the opportunity to own and operate the plant with a 30-year useful life following the expiration of the ten-year PPA.

SDG&E now files this PFM to modify the three previous Commission decisions approving the Otay Mesa PPA to clarify that OMEC's GHG responsibilities, attributed to SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant, will be allocated to SDG&E, and any allocation of GHG allowances received by OMEC will be used to meet OMEC's GHG compliance obligation.

A clear allocation of GHG responsibilities was not specifically included in the original PPA or any of the subsequent PPA modifications because California's GHG regulatory regime was unknown at those times. On October 20, 2011, the California Air Resources Board ("ARB") adopted the final rules for a GHG cap-and-trade program.[2] The program's initial compliance obligation period will commence on January 1, 2013 with the first auctions of allowances

[2] California Air Resources Board, *California Air Resources Board adopts key element of state climate plan*, October 20, 2011, *available at* http://www.arb.ca.gov/newsrel/newsrelease.php?id=245.

beginning in August 2012.[3] As it currently reads, the Otay Mesa PPA does not specifically address which party – SDG&E or OMEC – will be responsible for GHG costs. Before ARB's cap-and-trade system compliance obligations commence on January 1, 2013, the Parties desire contractual clarity regarding how the GHG responsibilities will be allocated between the parties so that the operation and finance of the Otay Mesa plant continues smoothly, without interruptions.

With respect to the timing of this filing, SDG&E acknowledges that the filing exceeds the one year time limit under Rule 16.4(d). Section IV, below, explains that such a delay is justified because the Parties clarified the PPA to reflect the new California GHG cap-and-trade program, which was not in effect at the time the parties initially entered into the PPA.[4]

Finally, Section V, below, sets forth comprehensive suggested revisions to D.04-06-011 (as modified by D.06-02-031 and D.06-09-021) necessary to reflect the allocation to SDG&E of OMEC's GHG compliance obligation for SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant, and the allocation of GHG allowances received by OMEC, if any, toward the compliance obligation.

II. A PETITION FOR MODIFICATION IS THE APPROPRIATE PROCEDURAL VEHICLE FOR OBTAINING COMMISSION APPROVAL OF MODIFICATIONS TO A PREVIOUSLY APPROVED PPA

Requesting approval of the clarifying changes to the Otay Mesa PPA through a petition for modification of D.04-06-011 (as modified) is consistent with prior Commission practice. For example, as discussed above, in D.06-09-021, the Commission approved revisions to the

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[3] California Environmental Protection Agency, *Overview of ARB Emissions Trading Program*, *available at* http://www.arb.ca.gov/newsrel/2011/cap_trade_overview.pdf.

[4] While it appears that electric utilities are being provided an allocation of allowances to cover the compliance cost of purchased generation, there are still parties requesting an allocation of those allowances be given to generators with the inability to pass on GHG cost in their contracts.

previously approved Otay Mesa PPA by granting a petition for modification. More recently, in D.10-09-004, the Commission granted a petition for modification that approved an amendment to a previously approved PPA between Pacific Gas and Electric Company and the Russell City Energy Center, LLC. In both cases, the Commission found that a petition for modification was the appropriate procedural vehicle for addressing changes to a previously approved PPA.

III. BACKGROUND

In D.04-06-011, the Commission approved a motion filed by SDG&E to enter into several new electric resources contracts, including one for OMEC. These contracts were the result of an RFP issued by SDG&E to solicit bids to procure energy to meet its short- and long-term grid reliability needs. The Utility Reform Network ("TURN") and Utility Consumers' Action Network ("UCAN") filed a joint application for rehearing, challenging SDG&E's choice of the Otay Mesa plant as a winning bidder in the RFP. TURN and UCAN alleged that Otay Mesa plant was not selected as a least cost/best fit ("LCBF") resource from the RFP to meet the utility's grid reliability, but instead was selected to meet SDG&E's needs outside the scope of the RFP.

In D.06-02-031, the Commission approved *de novo* on rehearing SDG&E's request for authorization to enter into a ten-year PPA with OMEC for Otay Mesa. The Commission found that the Otay Mesa PPA, when viewed as a bilateral contract and not as a winning bid in the RFP, was reasonable and provides benefits to SDG&E's ratepayers.

On December 20, 2005, after the Commission conducted evidentiary hearings on the rehearing phase for the Otay Mesa PPA, but before the Commission issued its decision on rehearing, Calpine and many of its affiliates and subsidiaries (but not OMEC) filed voluntary petitions to restructure under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York, Case #05-60199. In light of Calpine's

bankruptcy, OMEC and SDG&E entered into discussions in February 2006 to again modify the Otay Mesa PPA to address the changed financial circumstances. Most significantly, the parties discussed ownership and operating options for the Otay Mesa plant. On June 14, 2006, OMEC and SDG&E reached an agreement whereby the Otay Mesa PPA would be modified to include Put and Call Options, which give SDG&E an ownership option following the expiration of the ten-year PPA.

After reaching an agreement with OMEC, SDG&E continued to negotiate with the other stakeholders – TURN, UCAN and the Division of Ratepayer Advocates ("DRA") – and on July 3, 2006, with the support of TURN, UCAN, and DRA, SDG&E filed a joint petition for modification of D.04-06-011 and D.06-02-031. In the resulting D.06-09-021, the Commission found that the Revised Otay Mesa PPA accomplished "the primary objectives of SDG&E which is to preserve and improve upon the terms of the original PPA and get a state-of-the-art generation facility built in its service territory."[5] In addition, the Revised PPA gave "SDG&E a cost-effective, local area reliable resource, with a lower long-term cost to the utility's ratepayers than the original PPA."[6] Finally, adding the Put and Call Option "create[d] the opportunity for SDG&E to obtain the plant at a fair and reasonable price after the expiration of the ten-year PPA."[7]

A new modification to the Otay Mesa PPA is needed now that the California GHG cap-and-trade program has been finalized. Once the program compliance begins on January 1, 2013, entities that emit more than 25,000 metric tons of carbon dioxide per year, such as OMEC, will

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[5] D.06-09-021 at 4.

[6] D.06-09-021 at 2.

[7] D.06-09-021 at 4.

have an obligation to acquire allowances in an amount equal to their emissions.[8] At the same time, ARB will provide an allocation of allowances of over 6.9 million metric tons to SDG&E on behalf of its customers that it must place into the ARB auction in 2012 and 2013.[9] The revenues from the allowance auction will go to SDG&E to further AB 32 programs and offset compliance costs associated with the cap-and-trade program. When it decided the level of allowances to allocate to SDG&E, ARB assumed that SDG&E customers would be paying for compliance costs for all fossil generation, including the generation of OMEC, either directly or indirectly. In anticipation of these imminent events, SDG&E files this motion to modify D.04-06-011 (as modified by D.06-02-031 and D.06.09.021) by clarifying the current Otay Mesa PPA to provide contractual clarity concerning OMEC's GHG allowance costs.

IV. NEW FACTS IN SUPPORT OF THE PETITION FOR MODIFICATION

Pursuant to Rule 16.4(b), the supporting Declaration of Matt Burkhart is attached to this PFM as Attachment 1. In his declaration, Mr. Burkhart provides the details and circumstances associated with the new facts in support of this PFM. A summary of these new facts is provided below.

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[8] *See* ARB, Art. 5, current as of September 12, 2011, *available at* http://www.arb.ca.gov/regact/2010/capandtrade10/2ndmodreg.pdf.

[9] *See* ARB, Appendix A, posted on July 25, 2011, *available at* http://www.arb.ca.gov/regact/2010/capandtrade10/candtappa2.pdf.

A. The Recent Enactment of California GHG Cap-and-Trade Rules Demands PPA Modifications to Ensure Certainty for Ratepayers and Contracting Parties

After a year of legal limbo, ARB's cap-and-trade program and its final rules have finally been adopted.[10] On August 24, 2011, ARB reaffirmed its commitment to implement its Scoping Plan, including cap-and-trade regulations in California, which will put into practice the California Global Warming Solutions Act of 2006, commonly known as AB 32.[11] According to the final program rules adopted by ARB on October 20, 2011, the initial compliance obligations will take effect on January 1, 2013 with the first auctions of allowances beginning in August 2012.[12] Therefore, the Parties have chosen to clarify their current contracts to ensure that when the cap-and-trade system goes into effect, they will have contractual certainty regarding the costs of compliance and the acquisition and usage of any allowances, offsets or credits.

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[10] ARB's cap-and-trade program has encountered numerous legal challenges over the last year. In December 2010, ARB approved its initial cap-and-trade rules. However, in March 2011, the San Francisco Superior Court sided with the petitioners in *Association of Irritated Residents v. CARB*, Case No. CPF-09-509562, who alleged that ARB had failed to perform the rigorous analysis of alternatives to creating a carbon market required by the California Environmental Quality Act. In May 2011, the Court then enjoined the cap-and-trade implementation until ARB completed a more thorough analysis; the injunction was stayed in June 2011 by the California Court of Appeals. On September 28, 2011, the California Supreme Court voted to let ARB proceed with a cap-and-trade system while the organization appeals the San Francisco Superior Court's order mandated that ARB look closer at alternatives to the cap-and-trade system. While these legal wrangling continued, ARB released a revised analysis on June 13, 2011 and the full board reaffirmed its commitment to the cap-and-trade program and the revised analysis on August 24, 2011. While its appeal is still pending, ARB adopted final cap-and-trade rules on October 20, 2011. *California Agency Reaffirms Cap-and-Trade With More Analysis for Implementing Rules*, DAILY ENVIRONMENTAL REPORT, Aug. 26, 2011, *available at* http://www.bna.com/california-agency-reaffirms-n12884903223/.

[11] AB 32, in part, mandates a cap-and-trade system for GHGs. AB 32 was signed into law on September 27, 2006. The full text of AB32 is available at http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_0001-0050/ab_32_bill_20060927_chaptered.pdf.

[12] California Environmental Protection Agency, *Overview of ARB Emissions Trading Program*, *available at* http://www.arb.ca.gov/newsrel/2011/cap_trade_overview.pdf. On June 29, 2011 ARB Chairman Nichols stated before the California Senate Selected Committee on the Environment, the Economy and Climate Change that while ARB plans commencing program requirements as of January 1, 2013, it will start "road testing" the program in mid-2012. Debra Kahn, *California Delays Cap-And-Trade Auctions, Citing Potential Gaming*, N.Y. TIMES, June 30, 2011, *available at* http://www.nytimes.com/cwire/2011/06/30/30climatewire-california-delays-cap-and-trade-auctions-cit-96440.html.

SDG&E and OMEC have a mutual desire to clarify the Otay Mesa PPA to ensure contractual certainty for themselves and ratepayers in future business planning. SDG&E and OMEC have agreed that SDG&E should be responsible for acquiring allowances on behalf of Otay Mesa GHG in a beneficial holding arrangement, and that if OMEC receives any allocation of allowances, said allowances would be applied towards OMEC's GHG compliance obligation.[13] The Parties signed a letter agreement clarifying the PPA on September 21, 2011 for this purpose.[14] The letter agreement would become effective with Commission approval.

Therefore, the Parties request that the Commission allow them to proceed with the Otay Mesa PPA contractual modification. The Parties' proposed modifications insert a new provision into the Otay Mesa PPA which allocates OMEC's GHG compliance obligations to SDG&E for SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant, while providing that any allocation of GHG allowances received by OMEC will be used to satisfy OMEC's GHG compliance obligation.

B. Centralizing OMEC's GHG Compliance Obligation with SDG&E Benefits Ratepayers

In its allocation of GHG allowances to electric utilities, ARB provides SDG&E with an amount equivalent to its expected compliance costs, including the higher costs for OMEC generation related to the GHG allowances costs. Generators with fixed contracts, including Calpine, have requested that ARB revise its rules to provide an allocation of GHG allowances

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[13] Under the cap-and-trade program, generators have responsibility for GHG compliance. Subarticle 5 of the cap-and-trade regulation allows other entities to act as an agent for the generator in acquiring allowances as long as that relationship is disclosed to ARB. When SDG&E acquires allowances for OMEC, it will inform ARB, who will in turn inform Calpine. Within one year, SDG&E must transfer the allowances to Calpine for OMEC's compliance obligation.

[14] September 21, 2011 Letter Agreement between OMEC and SDG&E, attached as Attachment B.

from ARB.[15] Upon adopting the final rules, ARB affirmed that it expects the generators to renegotiate the contracts with the utilities to be compensated for their incurred GHG costs and encouraged ARB's Executive Officer to work with the Commission to encourage resolution between counterparties.[16] Therefore, parties with fixed contracts, like SDG&E and OMEC, have proposed to renegotiate their contracts consistent with the ARB expectation.

The proposed language would compensate OMEC for actual GHG emissions up to a limit, akin to what was done in the AB 1613 contracts.[17] The proposed language would also put OMEC's GHG compliance obligation into the hands of SDG&E. Such an arrangement makes sense for both SDG&E and its ratepayers. First, SDG&E is bidding OMEC electricity into CAISO markets. SDG&E's bid submission sets the criteria for the CAISO to decide how much OMEC will run, which in turn, determines the amount of GHG emissions the plant produces. Second, OMEC is more efficient than the marginal generator in almost any hour it is running.[18] Therefore, paying for actual emissions up to a limit based on the guaranteed heat rate of the Otay Mesa plant will be less expensive for ratepayers than paying market prices because market prices pay for GHG based on the marginal generator. Third, SDG&E will have the expertise to control the risks and costs of its portfolio of GHG allowances (including those from OMEC) because it

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[15] Calpine, the owner of OMEC, filed comments with ARB on September 27, 2011. *See* Calpine Comments at http://www.arb.ca.gov/lists/capandtrade10/1658-9-27-2011_calpine_comments_re_proposed_15-day_modifications_to_proposed_ca_cap_on_ghg_emissions.pdf; *see* comments filed by other generators at www.arb.ca.gov/lispub/comm/bccommlog.php?listname=capandtrade10.

[16] ARB has not responded to any of these comments at the time of this filing. Rather, ARB has indicated that it may make decisions on these contracts on a case-by-case basis. *See* ARB, *Initial Statement of Reasons*, fn22, *available at* http://www.arb.ca.gov/regact/2010/capandtrade10/capisor.pdf.

[17] There are two primary ways for a purchaser to compensate a generator for the GHG costs. One way would be to pay market rates for the power. Because GHG allowance costs will be embedded in the market price, this approach would compensate the generator based on the market price. This approach was taken for the renegotiated contracts with combined heat and power facilities in the QF Settlement, adopted in D.10-12-035. Another approach is to compensate the seller for actual GHG costs incurred up to a limit, as was done for new AB 1613 contracts, adopted in D.11-04-033.

[18] It would not be more efficient if it was the marginal resource.

will have to acquire allowances for its own generation.[19] Finally, by streamlining the GHG management, SDG&E will minimize the administrative costs of acquiring GHG allowances.[20]

C. Putting OMEC's GHG Compliance Obligation in SDG&E's Hands Is Consistent With SDG&E's and California Utilities' Current Approach to GHG Costs

The modified language presented by the parties is consistent with California public utilities' treatment of GHG allowances and associate costs. For example, the modified language presented herein was derived from SDG&E's form PPA that has been recently approved by the Commission in its Wellhead Margarita (now El Cajon) and JPower Orange Grove contracts.[21] Other California public utilities, such as Southern California Edison, currently use form contracts that similarly allocate the GHG allowances and their associated responsibilities to the utilities.[22] Therefore, the Commission's approval of the proposed language would make the Otay Mesa PPA consistent with other PPAs entered into by SDG&E and other California utilities.

V. THE PRESENTMENT OF THIS OUT-OF-TIME PETITION TO MODIFY IS REASONABLE IN LIGHT OF ARB'S RECENT ADOPTION OF A CALIFORNIA CAP-AND-TRADE SYSTEM.

Rule 16.4(d) of the Commission's Rules of Practice and Procedure states that if more than one year has elapsed since the effective date of the decision, the petitioner must explain why it "could not have been presented within one year of the effective date of the decision." In the present case, AB 32 had not been signed into law yet when the PPA was originally conceived in

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[19] SDG&E has filed its GHG procurement plan with the Commission in the Long-Term Procurement Planning proceeding. R.10-05-006 (SDG&E Testimony, Ryan Miller).

[20] SDG&E has requested funding for two persons to manage GHG portfolio costs and compliance in its General Rate Case. A.10-12-005 (SDG&E Testimony, Sue Garcia.)

[21] D.09-12-026. SDG&E is using the same Commission-approved language in its proposed Escondido Energy Center, Pio Pico Energy Center and Quail Brush Power PPAs, all of which are currently awaiting Commission action. A.11-05-023 (filed May 23, 2011).

[22] *See, e.g.*, Southern California Edison, *Energy Only Toll* (zip file), available at http://www.sce.com/EnergyProcurement/ESM/AllSourceRFO/all-source-rfo.htm. SDG&E derived its GHG language from Edison's form contract.

2004 or when the PPA was last modified in July 2006.[23] ARB will implement a cap-and-trade system in 2012 with compliance obligations starting on January 1, 2013, so the Parties need to resolve now how these costs will be addressed. Indeed, the parties have just negotiated a letter agreement clarifying their PPA to address this matter.

VI. SPECIFIC WORDING CHANGES TO D.04-06-011 (AS MODIFIED BY D.06-02-031 AND D.06.09.021)

The Parties have agreed to clarify the PPA by adding a new Section 8.7 as follows:

8.7. Greenhouse Gas Emissions.

a. New Defined Terms. The following terms shall have the following meaning for purposes of this Agreement.

"GHG Limit" means the GHG Rate times the Maximum Gas Quantity associated with a Dispatch Notice.

"GHG Charges" has the meaning set forth in Section 8.7.b of this Agreement.

"GHG Rate" means the rate in pounds of CO_2 equivalent Greenhouse Gas emitted per MMBtu of natural gas combusted and, with respect to any particular GHG Charges, shall be equal to the rate adopted and/or applied by the Governmental Authority that imposes the requirements resulting in such GHG Charges. For purposes of the cap and trade program approved by the California Air Resources Board ("CARB") on December 16, 2010 (Cal. Code Regs., tit. 17 §§ 95800 *et seq.*), the GHG Rate shall be equal to the rate calculated pursuant to CARB's Mandatory Reporting Rule (Cal. Code Regs., tit. 17, §§ 95100 *et seq.*) and the relevant sections incorporated therein of the United States Environmental Protection Agency's rule for Mandatory Greenhouse Gas Reporting (40 C.F.R. Part 98), as may be amended from time to time.

"Greenhouse Gas" means emissions into the atmosphere of gases that are regulated by one or more Governmental Authorities as a result of their contribution to the greenhouse effect heating of the surface of the earth. Greenhouse gases include carbon dioxide (CO_2), nitrous oxide (N_2O) and methane (CH_4), which are produced as the result of combustion or transport of fossil fuels. Other greenhouse gases may include hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulfur hexafluoride (SF_6), which are generated in a variety of industrial processes. Greenhouse gases may be defined, or expressed,

[23] AB 32 was passed by the California House on August 31, 2006 and by the California Senate on August 30, 2006, and was signed into law by Governor Schwarzenegger on September 27, 2006.

in terms of a ton of CO_2-equivalent, in order to allow comparison between the different effects of gases on the environment.

"Maximum Gas Quantity" means, for any Dispatch Notice, the quantity of Gas (expressed in MMBtu) equal to the sum of (i) the maximum quantity of Gas required for each CAISO settlement period of the Dispatch Notice, calculated by multiplying (a) the Delivered MWh's in such CAISO settlement interval by (b) the applicable Guaranteed Heat Rate; plus (ii) the Start-Up Fuel for each Start-Up in the relevant Dispatch Notice.

"Start-Up Fuel" means for each Start-up of a combustion turbine in a Dispatch notice, 11,000 MMBtu.

b. Greenhouse Gas Emissions Charges. Subject to the limitations and qualifications set forth below in this Section 8.7.b, Buyer shall reimburse Seller for taxes, charges, fees, or costs for, or resulting from, Greenhouse Gas ("GHG Charges") attributable to a Dispatch Notice, within forty-five (45) days of Buyer's receipt from Seller of documentation reasonably establishing: (a) that Seller is actually liable for such GHG Charges as a result of operation of the Facility during the Delivery Term; (b) that such GHG Charge was not effective or scheduled to become effective as of the Effective Date; (c) the specific amount of such GHG Charge; (d) that such GHG Charge was imposed upon or incurred by Seller as a result of a requirement issued, enforced or otherwise implemented by an authorized Governmental Authority in whose jurisdiction the Facility is located, or which otherwise has jurisdiction over Seller or the Facility; (e) that Seller has paid the full amount of such GHG Charge for which Seller seeks reimbursement from Buyer under this Section 8.7, and (f) that Seller took all reasonable steps to mitigate the cost or amount of such GHG Charges, provided, the reasonable steps shall not be deemed to require Seller to make capital improvements to the Facility unless the Parties, after meeting and conferring in good faith, agree on an allocation between the Parties of the costs for such capital improvements.

i. If Seller has the right to obtain allowances or credits attributed to the Facility to offset the GHG Charges for the Facility, then Seller shall utilize such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. Furthermore, if allowances or credits are not allocated to or otherwise provided for specific generating units but Seller has the right to obtain allowances or credits attributed to its portfolio of generating units (all or some of the generating units owned, managed, or controlled by Seller), then Seller shall utilize a proportional amount of such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. If Seller is allocated or receives revenues, whether specific to each Facility or to Seller's portfolio of generating units, associated with any allowance or credit associated with Greenhouse Gas emissions attributable to a Dispatch Notice, then Seller shall remit any such revenue or, if allocated to Seller's portfolio of generating units, the proportional amount of such revenue, to Buyer to mitigate any GHG Charge that Buyer is responsible for hereunder. For the purposes of this Section 8.7.b.i, the proportional amount of allowances, credits, or revenues, as applicable, shall be

calculated based on the historical annual Greenhouse Gas emissions (in terms of tons of CO_2-equivalent) of the Facility that would be subject to GHG Charges compared to the sum of the historical annual Greenhouse Gas emissions (in terms of tons of CO_2-equivalent) of all generating units within Seller's portfolio that would be subject to GHG Charges.

ii. If a Greenhouse Gas cap and trade scheme is adopted to control the emissions of Greenhouse Gases, where a Governmental Authority establishes a cap on the amount of Greenhouse Gases that can be emitted and market participants, including generators, are issued or purchase emission allowances or credits representing the right to emit Greenhouse Gases in an aggregate amount equal to the cap, then the Parties intend that Buyer shall be responsible for acquiring the emission allowances or credits associated with Greenhouse Gas emissions attributable to a Dispatch Notice, less any emission allowances or credits that Seller may have acquired and allocated to the Facility under Section 8.7.b.i above. Within a reasonable period after the enactment of such a Greenhouse Gas cap and trade scheme, the Parties shall cooperate and take commercially reasonable actions (including amending this Agreement as reasonably necessary, executing such documents or instruments as reasonably necessary, and complying with all applicable Law that address such Greenhouse Gas cap and trade scheme) to establish procedures to effectuate this intent; provided, however that the failure to agree on these procedures will not relieve the Parties of their respective obligations under this Agreement, and any failure to agree shall be resolved in accordance with the dispute resolution procedures in Article 20.

iii. Notwithstanding the foregoing, in no event shall Buyer be responsible for GHG Charges that exceed the GHG Limit or for GHG Charges that are attributable to any dispatch of the Facility that is not pursuant to a Dispatch Notice or a CAISO order to dispatch.

VII. CONCLUSION

For all the foregoing reasons, SDG&E respectfully requests that the Commission agrees to modify D.04-06-011 (as modified by D.06-02-031 and D.06.09.021) in a manner that is consistent with the specific wording changes listed above, resulting in:

1. the approval of clarifying language concerning SDG&E's responsibility for OMEC's GHG compliance obligations resulting from SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant;

2. the approval that any allowances allocated to OMEC will be applied toward OMEC's compliance obligation;

3. A finding that it is reasonable for SDG&E to enter into agreement;

4. A finding that the modified Otay Mesa PPA's terms and conditions are reasonable; and

5. All SDG&E costs under the PPA are recoverable in rates.

DATED this 16th day of November, 2011, at San Diego, California.

Respectfully submitted,

By: /s/EMMA D. SALUSTRO
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ATTACHMENT A

ATTACHMENT A

DECLARATION OF MATT BURKHART IN SUPPORT OF PETITION OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902-E) FOR MODIFICATION OF D.04-06-011 (AS MODIFIED BY D.06-02-031 AND D.06.09.021) REGARDING OTAY MESA ENERGY CENTER

I, Matt Burkhart, do declare as follows:

1. I am employed by San Diego Gas & Electric ("SDG&E") as Vice President, Electric & Fuel Procurement. My responsibilities include acquiring energy and capacity to serve the company's customers, as well as overseeing the economic dispatch of power plants, power trading, risk control and settlements. I joined the Electric and Fuel Procurement group in September 2002.
2. I received my master's degree in economics from the Harvard University and a bachelor's degree in economics and Russian studies from Claremont McKenna College. My career in electricity has spanned a broad range of functional areas – generation operations, power system control and transmission operations, system resource planning (real-time to two year time horizon), commercial operation (trading and risk management), market analysis, business development, and market design/regulatory efforts in all major U.S. markets and several Asian markets. I have worked at both utility (SDG&E and PG&E) and merchant (Mirant) energy companies, as well as a market service provider (Automated Power Exchange).
3. Pursuant to the Commission's Rule 16.4(b), I am providing this declaration to set forth the facts in support of *SDG&E's Petition For Modification Of D.04-06-011 (As Modified By D.06-02-031 And D.06.09.021) Regarding Otay Mesa Energy Center*. Additionally, as the Vice President of Electric & Fuel Procurement, I am thoroughly familiar with the facts and

representations in this declaration and if called upon to testify I could and would testify to the following based upon personal knowledge.

BACKGROUND

4. In 2003, in response to California Public Utilities Code section 454.5, SDG&E analyzed its long-term resource plan and determined that it would need additional capacity conforming to the Independent System Operator grid reliability criteria starting in 2005.
5. Following the AB 57 guidelines as codified in section 454.5, SDG&E conducted a competitive procurement process by issuing a Request for Proposal ("RFP") on May 16, 2003. The RFP requested bids from all qualified resources, including turn-key natural gas-fired generating units, power purchase agreements ("PPA"), demand reduction products, renewable resources, and any combination of those resources.
6. SDG&E filed a motion on October 7, 2003 seeking Commission approval to enter into five new electric resource contracts it received in response to the RFP. One of those contracts was with the Otay Mesa Energy Center, LLC ("OMEC"). OMEC is a wholly-owned subsidiary of Calpine Corporation ("Calpine").
7. OMEC is a natural gas-fired combined-cycle power plant located in SDG&E's service area, approximately 15 miles southeast of downtown San Diego. Otay Mesa interconnects with SDG&E's electric system at the utility's Miguel Substation, and has a nominal output of 583 MW.
8. In D.04-06-011, the Commission approved SDG&E's request, finding that the PPA between SDG&E and OMEC ("the Parties") provides SDG&E with a "balanced portfolio" while also providing "substantial benefits both to the customers of SDG&E and to the state as a whole."

9. In 2005, TURN and UCAN filed a joint application for rehearing, challenging SDG&E's choice of the Otay Mesa plant as a winning bidder in the RFP process.
10. On December 20, 2005, before a decision on the rehearing had been issued, Calpine, OMEC's parent company, and various affiliates and subsidiaries of Calpine, filed voluntary petitions to restructure under Chapter 11 of the United States Bankruptcy Code, in the U.S. Bankruptcy Court for the Southern District of New York, Case #05-60199. OMEC did not participate in the bankruptcy.
11. In February 2006, the Commission again approved the ten-year PPA between SDG&E and OMEC in D.06-02-031 after finding that the Otay Mesa PPA, when viewed as a bilateral contract and not as a winning bid in the RFP, was reasonable and provides benefits to SDG&E's ratepayers.
12. In light of Calpine's bankruptcy proceeding, SDG&E and OMEC began discussing potential modifications to the PPA immediately after D.06-02-031 was issued, including ownership and operating options for the Otay Mesa plant. On June 14, 2006, the Parties reached an agreement whereby the Otay Mesa PPA would be modified to add Put and Call Options, which gives SDG&E an ownership option in OMEC following the expiration of the ten-year Otay Mesa PPA.
13. After reaching an agreement with OMEC, SDG&E negotiated with the other stakeholders, namely TURN, UCAN and DRA. On July 3, 2006, with the support of TURN, UCAN, and DRA, SDG&E filed a joint petition for modification of D.04-06-011 and D.06-02-031.

14. The Commission granted the joint petition in D.06-09-021 because it found, in part, that the modified PPA gave SDG&E a cost-effective, local area reliable resource, with the option that the utility could own the OMEC plant at the expiration of the PPA.[24]

NEW FACTS

15. No cap-and-trade system existed when SDG&E and OMEC first entered into the Otay Mesa PPA in 2004 or when the PPA was last modified in July 2006.

16. Therefore, the Otay Mesa PPA did not expressly address how the Parties would allocate the costs and risks of compliance with any greenhouse gas ("GHG") emissions program, manage GHG allowances or allocate any of the associated responsibilities, between themselves as it concerns OMEC.

17. The California Air Resources Board ("ARB") recently adopted final rules for the cap-and-trade program. The program's initial compliance obligation will take effect on January 1, 2013 with the first auctions of allowances beginning in August 2012.

18. Once the program compliance begins in 2013, entities that emit more than 25,000 metric tons of carbon dioxide per year will have an obligation to acquire allowances in an amount equal to their emissions. OMEC is expected to exceed the 25,000 metric ton limit, and will therefore need to acquire allowances. At the same time, ARB will provide an allocation of allowances of over 6.9 million metric tons to SDG&E on behalf of its customers that SDG&E must place into the ARB auction in 2012 and 2013. The revenues from the allowance auction will go to SDG&E to further programs designed to meet AB 32 goals and offset compliance costs associated with the cap-and-trade program. As currently drafted, ARB's regulations assume that SDG&E customers would be paying for compliance costs for

[24] D.06-09-021 at p. 2.

all fossil generation required to serve SDG&E load, including the generation of OMEC, either directly or indirectly.

19. In light of the future launch of this system cap-and-trade system, SDG&E and OMEC have modified the Otay Mesa PPA to clarify issues related to the allocation of GHG allowances and to provide contractual certainty regarding the risk and costs of compliance and the acquisition and usage of any allowances, offsets or credits.

20. SDG&E and OMEC have confirmed that SDG&E should be responsible for acquiring allowances on behalf of OMEC in a beneficial holding arrangement, and that if OMEC receives any allocation of allowances, said allowances would be applied towards OMEC's GHG compliance obligation.

21. SDG&E and OMEC have confirmed their agreement with respect to this allocation of responsibilities and the Parties executed the Letter Agreement modifying the PPA on September 21, 2011, which is attached to this declaration as Attachment B.

22. SDG&E believes that this clarification will benefit SDG&E and its ratepayers for several reasons. First, under the terms of the Otay Mesa PPA, SDG&E will be bidding OMEC electricity into CAISO markets, and in doing so, will be deciding how much OMEC will be dispatched, which determines the amount of GHG emissions the plant produces and the amount of allowances it will need to acquire.

23. Second, OMEC is more efficient than the marginal generator in almost any hour it is running. Therefore, paying for actual emissions up to a limit based on the guaranteed heat rate of the Otay Mesa plant will be less expensive for ratepayers than paying market prices since the market price for GHG allowances should be based on the emissions from the marginal generator.

24. Third, SDG&E will have the expertise to control the risks and costs of its portfolio of GHG allowances (including those from OMEC) because it will have to acquire allowances for its own generation.

25. Fourth, assigning the GHG compliance costs and obligations to the party that will be allocated allowances and will receive the revenue from the sale of allowances properly aligns risk and reward.

26. Lastly, by streamlining the GHG management, SDG&E will minimize the administrative costs of acquiring GHG allowances.

27. When drafting the suggested language to enact these clarifications, SDG&E looked to its other PPA modifications recently approved by the Commission (including the Wellhead Margarita (now El Cajon) and JPower Orange Grove contracts) as well as other California utilities' form contracts addressing this issue. For example, Southern California Edison's form contract similarly allocates the GHG allowances and their associated responsibilities to the utility.

28. The major clarifications of the previously modified Otay Mesa contract are:

- Addition of GHG definitions and terms;
- Allocation to SDG&E of GHG responsibilities and revenues that OMEC may acquire, for SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant; and
- Allocation of GHG allowances received by OMEC to meet the compliance obligation.

Executed this 16th day of November, 2011, at San Diego, California.

/s/ Matt Burkhart
MATT BURKHART
Vice President, Electric & Fuel Procurement
San Diego Gas & Electric Company

ATTACHMENT B

SDGE
A Sempra Energy utility®

Michael R. Niggli
President & Chief Operating Officer

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September 21 , 2011

Otay Mesa Energy Center, LLC
717 Texas Avenue
Houston, TX 94568-3139
Attn: Chief Legal Officer

Otay Mesa Energy Center, LLC
4160 Dublin Blvd., Suite 100
Dublin, CA 94568
Attn: Vice President, West Operation

Re: Greenhouse Gas Compliance Costs

Dear Mr. Makler:

Reference is made to that certain Amended and Restated Power Purchase Agreement, dated as of May 1, 2007 (the "Agreement"), by and between San Diego Gas & Electric Company, a California corporation ("Buyer") and Otay Mesa Energy Center, LLC, a Delaware limited liability company ("Seller"). Capitalized terms used herein but not otherwise defined herein shall have the meanings given in the Agreement.

Although the nature of forthcoming regulatory requirements concerning emissions of carbon dioxide and other greenhouse gases has yet to be finally determined (*e.g.*, cap and trade instead of a carbon tax, or vice versa), the Parties believe it is prudent to provide certainty with respect to how certain greenhouse gases compliance costs shall be addressed under the Agreement. Accordingly, in consideration of the mutual promises and agreements set forth herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Buyer and Seller, intending to be legally bound, hereby enter into this letter agreement ("Letter Agreement") concerning greenhouse gas compliance costs.

It shall be a condition precedent to the effectiveness of this Letter Agreement that no later than March 1, 2012, Buyer shall have received a final and non-appealable order from the CPUC (i) approving the terms and conditions of this Letter Agreement without material alteration of the commercial aspects described herein, and (ii) finding Buyer's entry into this Letter Agreement is reasonable and that payments to be made by Buyer hereunder are recoverable in rates, subject to CPUC review of the Buyer's administration of this Letter Agreement. If the foregoing CPUC order is not obtained on or before the deadline date therefor, then this Letter Agreement shall have no force and effect. Prior to such deadline date, Buyer shall use commercially reasonable efforts to seek such CPUC order through a Petition for Modification of the CPUC's Decision No. 06-09-021. Buyer shall provide Seller an opportunity to review and comment on the Petition for Modification seven days prior to its filing. Buyer shall file the Petition for Modification within

thirty days after both Parties execute this Letter Agreement. Subject to satisfaction of this condition precedent, the Parties hereby agree to amend the Agreement by adding a new Section 8.7 as follows:

8.7. Greenhouse Gas Emissions.

a. New Defined Terms. The following terms shall have the following meaning for purposes of this Agreement.

"GHG Limit" means the GHG Rate times the Maximum Gas Quantity associated with a Dispatch Notice.

"GHG Charges" has the meaning set forth in Section 8.7.b of this Agreement.

"GHG Rate" means the rate in pounds of CO_2 equivalent Greenhouse Gas emitted per MMBtu of natural gas combusted and, with respect to any particular GHG Charges, shall be equal to the rate adopted and/or applied by the Governmental Authority that imposes the requirements resulting in such GHG Charges. For purposes of the cap and trade program approved by the California Air Resources Board ("CARB") on December 16, 2010 (Cal. Code Regs., tit. 17 §§ 95800 *et seq.*), the GHG Rate shall be equal to the rate calculated pursuant to CARB's Mandatory Reporting Rule (Cal. Code Regs., tit. 17, §§ 95100 *et seq.*) and the relevant sections incorporated therein of the United States Environmental Protection Agency's rule for Mandatory Greenhouse Gas Reporting (40 C.F.R. Part 98), as may be amended from time to time.

"Greenhouse Gas" means emissions into the atmosphere of gases that are regulated by one or more Governmental Authorities as a result of their contribution to the greenhouse effect heating of the surface of the earth. Greenhouse gases include carbon dioxide (CO_2), nitrous oxide (N_2O) and methane (CH_4), which are produced as the result of combustion or transport of fossil fuels. Other greenhouse gases may include hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulfur hexafluoride (SF_6), which are generated in a variety of industrial processes. Greenhouse gases may be defined, or expressed, in terms of a ton of CO_2-equivalent, in order to allow comparison between the different effects of gases on the environment.

"Maximum Gas Quantity" means, for any Dispatch Notice, the quantity of Gas (expressed in MMBtu) equal to the sum of (i) the maximum quantity of Gas required for each CAISO settlement period of the Dispatch Notice, calculated by multiplying (a) the Delivered MWh's in such CAISO settlement interval by (b) the applicable Guaranteed Heat Rate; plus (ii) the Start-Up Fuel for each Start-Up in the relevant Dispatch Notice.

"Start-Up Fuel" means for each Start-up of a combustion turbine in a Dispatch notice, 11,000 MMBtu.

b. Greenhouse Gas Emissions Charges. Subject to the limitations and qualifications set forth below in this Section 8.7.b, Buyer shall reimburse Seller for taxes, charges, fees, or costs for, or resulting from, Greenhouse Gas ("GHG Charges") attributable to a Dispatch Notice, within forty-five (45) days of Buyer's receipt from Seller of documentation reasonably establishing: (a) that Seller is actually liable for such GHG Charges as a result of

operation of the Facility during the Delivery Term; (b) that such GHG Charge was not effective or scheduled to become effective as of the Effective Date; (c) the specific amount of such GHG Charge; (d) that such GHG Charge was imposed upon or incurred by Seller as a result of a requirement issued, enforced or otherwise implemented by an authorized Governmental Authority in whose jurisdiction the Facility is located, or which otherwise has jurisdiction over Seller or the Facility; (e) that Seller has paid the full amount of such GHG Charge for which Seller seeks reimbursement from Buyer under this Section 8.7, and (f) that Seller took all reasonable steps to mitigate the cost or amount of such GHG Charges, provided, the reasonable steps shall not be deemed to require Seller to make capital improvements to the Facility unless the Parties, after meeting and confering in good faith, agree on an allocation between the Parties of the costs for such capital improvements.

i. If Seller has the right to obtain allowances or credits attributed to the Facility to offset the GHG Charges for the Facility, then Seller shall utilize such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. Furthermore, if allowances or credits are not allocated to or otherwise provided for specific generating units but Seller has the right to obtain allowances or credits attributed to its portfolio of generating units (all or some of the generating units owned, managed, or controlled by Seller), then Seller shall utilize a proportional amount of such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. If Seller is allocated or receives revenues, whether specific to each Facility or to Seller's portfolio of generating units, associated with any allowance or credit associated with Greenhouse Gas emissions attributable to a Dispatch Notice, then Seller shall remit any such revenue or, if allocated to Seller's portfolio of generating units, the proportional amount of such revenue, to Buyer to mitigate any GHG Charge that Buyer is responsible for hereunder. For the purposes of this Section 8.7.b.i, the proportional amount of allowances, credits, or revenues, as applicable, shall be calculated based on the historical annual Greenhouse Gas emissions (in terms of tons of CO_2-equivalent) of the Facility that would be subject to GHG Charges compared to the sum of the historical annual Greenhouse Gas emissions (in terms of tons of CO_2-equivalent) of all generating units within Seller's portfolio that would be subject to GHG Charges.

ii. If a Greenhouse Gas cap and trade scheme is adopted to control the emissions of Greenhouse Gases, where a Governmental Authority establishes a cap on the amount of Greenhouse Gases that can be emitted and market participants, including generators, are issued or purchase emission allowances or credits representing the right to emit Greenhouse Gases in an aggregate amount equal to the cap, then the Parties intend that Buyer shall be responsible for acquiring the emission allowances or credits associated with Greenhouse Gas emissions attributable to a Dispatch Notice, less any emission allowances or credits that Seller may have acquired and allocated to the Facility under Section 8.7.b.i above. Within a reasonable period after the enactment of such a Greenhouse Gas cap and trade scheme, the Parties shall cooperate and take commercially reasonable actions (including amending this Agreement as reasonably necessary, executing such documents or instruments as reasonably necessary, and complying with all applicable Law that address such Greenhouse Gas cap and trade scheme) to establish procedures to effectuate this intent; provided, however that the failure to agree on these procedures will not relieve the Parties of their respective obligations under this Agreement, and any failure to agree shall be resolved in accordance with the dispute resolution procedures in Article 20.

iii. Notwithstanding the foregoing, in no event shall Buyer be responsible for GHG Charges that exceed the GHG Limit or for GHG Charges that are

attributable to any dispatch of the Facility that is not pursuant to a Dispatch Notice or a CAISO order to dispatch.

Except as set forth expressly herein, each of Buyer and Seller agrees that nothing in this Letter Agreement shall be construed as amending, supplementing, impairing or otherwise modifying any representation, warranty, agreement, indemnity or other obligation set forth in any other agreement executed and delivered in connection with the Agreement or the Facility.

This Letter Agreement shall be binding upon and shall inure to the benefit of each of Buyer and Seller and its respective successors, assigns and other transferees. This Letter Agreement may not be assigned by either party except in connection with a permitted assignment of the Agreement. All parties hereto represent and warrant that they have all requisite power and authority to enter into this Letter Agreement, that this Letter Agreement is enforceable in accordance with its terms, and that no further consents are required to give effect to the matters agreed herein. This Letter Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. This Letter Agreement shall be governed by, and construed in accordance with, the laws of the State of California.

Please indicate your agreement to the terms and conditions of this Letter Agreement by executing the appropriate acknowledgment below.

Sincerely,

SAN DIEGO GAS & ELECTRIC COMPANY

By: _____
Name: Michael R. Niggli
Title: President & COO

The undersigned acknowledges and consents to the foregoing.

OTAY MESA ENERGY CENTER, LLC
a Delaware limited liability company

By: _____
Name: Alexandre Makler
Title: Vice President