

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Application of Pacific Gas and Electric  
Company (U 39E) for Approval of an  
Amendment of its Power Purchase Agreement  
with Starwood Power-Midway, LLC and for  
Authority to Recover the Costs of the  
Amended Agreement In Rates

**Application No. 12-09-\_\_\_**

**APPLICATION OF  
PACIFIC GAS AND ELECTRIC COMPANY (U 39-E)  
FOR APPROVAL OF AN AMENDMENT OF  
ITS POWER PURCHASE AGREEMENT WITH  
STARWOOD POWER-MIDWAY, LLC**

**PUBLIC VERSION  
(Confidential Appendices A and B)**

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DATED: September 26, 2012

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Power Purchase and Sale Agreement (**Confidential**)

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

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**Application No.**

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**PUBLIC VERSION  
(Confidential Appendices A and B)**

**I. INTRODUCTION AND OVERVIEW OF APPLICATION**

Pacific Gas and Electric Company (“PG&E”) seeks California Public Utilities Commission (“Commission”) approval of an amendment (“Amendment”) to the Power Purchase Agreement (“PPA”) between Starwood Power – Midway, LLC (“Starwood”) and PG&E in this Application (“Application”) being filed pursuant to Article 2 of the Commission’s Rules of Practice and Procedure (“Rules”). The PPA was approved by Commission Decision (“D.”) 06-11-048.

The Amendment provides that PG&E will pay Starwood an amount that Starwood will apply towards its Assembly Bill (“AB”) 32 carbon dioxide compliance costs that result from PG&E’s dispatch of Starwood’s generating facility under the PPA (“Defined CO<sub>2</sub> Costs”) in exchange for a contract price reduction.

Through an Assigned Commissioner’s and Administrative Law Judges’ (“ALJs”) Ruling (“ACR”) issued in the Greenhouse Gas (“GHG”) Rulemaking,<sup>1</sup> the Commission recently stated it would review the issue of GHG compliance cost recovery for power purchase agreements executed before the passage of AB 32 that have no such mechanism. However, the ACR encouraged parties “to reach agreement on contract terms rather than ask for terms to be imposed by this Commission.”<sup>2</sup> Accordingly, Starwood and PG&E entered into negotiations and have agreed that PG&E will compensate Starwood with Defined CO<sub>2</sub> Costs in exchange for a contract price reduction for the benefit of PG&E’s customers.

The Amendment merits prompt unconditional Commission approval because it takes account of the balance of costs and benefits as agreed upon during contract negotiation and subsequently represented in the PPA, provides substantial benefits for PG&E’s customers compared to the potential outcomes of regulatory or adversarial proceedings that would be risked in the absence of a negotiated compromise, and demonstrates that parties to a pre-AB 32 PPA can successfully agree to realign their obligations for AB 32 costs or “GHG compliance costs” so that regulatory intervention is unnecessary. Amendment approval is sought by application because the Amendment term exceeds five years.<sup>3</sup>

Accordingly, PG&E respectfully requests the Commission to approve the Amendment, to find that its terms are reasonable and in the interests of PG&E’s customers, and to authorize rate recovery by PG&E of costs incurred under the PPA as amended (“Amended PPA”), subject only to Commission review of the prudence of PG&E’s administration of the Amended PPA.

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<sup>1</sup> *Rulemaking to Address Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions* (“R.”) 11-03-012.

<sup>2</sup> *Assigned Commissioner’s and Administrative Law Judge’s Ruling Amending Scoping Memo* (“ACR”) , R.11-03-012, Aug. 2, 2012, pp. 6 and 7.

<sup>3</sup> “Contracts with duration five years or longer must be submitted with an application to the Commission for preapproval.” D.04-12-048, p.108. The Amended PPA will have a remaining term of approximately eleven years.

## II. DESCRIPTION OF THE STARWOOD TRANSACTION

### A. Existing Power Purchase Agreement

PG&E executed the PPA with Starwood in April 2006. Prior to and during the PPA negotiation time frame, the issue of GHG compliance costs was well known and discussed in the marketplace. For example:

- The Intergovernmental Panel on Climate Change First Assessment Report was completed in 1990.<sup>4</sup>
- The United Nations Framework Convention on Climate Change took effect in 1994.<sup>5</sup>
- The Kyoto protocol was signed in 1997.<sup>6</sup>
- In 1991, a broad coalition of consumer and environmental advocates, led by the National Association of State Utility Consumer Advocates and Natural Resources Defense Council, sent an open letter to managers of the U.S. utility industry emphasizing resource planning taking into account the risks with continued growth in greenhouse gas emissions, and warned that utilities should manage the risk, or bear the risk.<sup>7</sup>
- Later that same year (1991), Southern California Edison and Los Angeles Department of Water and Power jointly announced their plans to each reduce their carbon dioxide emissions by 10 percent by 2000 and 20 percent by 2010.<sup>8</sup>
- In 2004, the CPUC proposed GHG cap-and-trade in Order Instituting Rulemaking R. 04-04-003 (“OIR”). In their comments on the OIR, the Independent Energy Producers Association (“IEPA”) mentioned independent generators internalizing the costs of GHG emission reductions in offers submitted into utility procurement processes.

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<sup>4</sup> See [http://www.ipcc.ch/publications\\_and\\_data/publications\\_and\\_data\\_reports.shtml#1](http://www.ipcc.ch/publications_and_data/publications_and_data_reports.shtml#1) for a timeline of IPCC publications.

<sup>5</sup> See [http://unfccc.int/essential\\_background/convention/items/2627.php](http://unfccc.int/essential_background/convention/items/2627.php).

<sup>6</sup> See [http://unfccc.int/kyoto\\_protocol/items/2830.php](http://unfccc.int/kyoto_protocol/items/2830.php).

<sup>7</sup> NASUCA and NRDC, *An Open Letter to the Managers of the U.S. Utility Industry, Re: Implications of the Greenhouse Challenge for the Utility Planning, Financial Risks, and Future Prudence Reviews*, January 31, 1991.

<sup>8</sup> *Opinion Adopting PG&E, Southern California Edison Company and San Diego Gas & Electric Company's Long - Term Procurement Plans* (“LTPP Decision”) D.12-04-046, at pp. 60-61.

- The European Union ETS (2005), the Acid Rain Trading Program (1995), and RECLAIM (1994) are all “source-based” programs in which the generator is the point-of-regulation.
- In December of 2004, AB 32 was introduced into the California Legislature.
- In June of 2005, GHG emission reduction targets were established for California by the Governor’s executive order.
- In pre-enactment versions of AB 32, there is direct reference to a cap, the generation of electricity, and the distribution of allowances.

All of the sellers entering into long term power purchase agreements with PG&E in this time frame assumed responsibility for GHG compliance costs. The Starwood PPA’s contract price takes into account Starwood’s responsibility for GHG compliance costs. The Amendment preserves the value of the PPA by providing a contract price reduction to PG&E in exchange for PG&E’s payment of Starwood’s Defined CO<sub>2</sub> Costs under circumstances specified by the Amendment.

**Basic Terms of the Amended PPA**

Generating Facility	Starwood
Resource type	Simple Cycle Gas Turbine
Location	Firebaugh, CA
Nameplate Capacity	120 MW
Expected Deliveries	Dispatchable
Delivery Point	Panoche Substation
Term	5/1/2009 through 5/1/2024 with approximately 11 years remaining
Amendment Start Date	Earlier of the start of the Cap and Trade Program compliance period (currently expected to be 1/1/2013) or date Amendment receives CPUC Approval



### III. CONSISTENCY WITH COMMISSION DECISIONS

#### A. CPUC Consideration of GHG Cost Responsibility

In 2011, the California Air Resources Board (“CARB”) adopted the “California Cap on GHG emissions and Market-Based Compliance Mechanism,” commonly known as California’s “Cap and Trade” regulation.<sup>2</sup> In its Final Statement of Reasons regarding Cap and Trade, CARB indicated that insofar as existing contracts might not include provisions allowing full pass-through of carbon costs associated with Cap and Trade, its staff believed that bilateral contract negotiations would provide the best resolution of the issue.<sup>10</sup>

In its recent decision in the long-term procurement plan proceeding, R.10-05-006, the Commission considered the request of IEPA to determine the treatment of GHG compliance costs associated with contracts executed between independent generators and utilities prior to the passage of AB 32 that do not include a mechanism for recovery of such costs. In response, the Commission stated, “(C)ontracts negotiated and executed when AB 32 was working its way through the legislature should have taken the potential impacts of AB 32 into consideration.

Even those negotiating contracts shortly before then might also have reasonably foreseen that this issue could arise.”<sup>11</sup> It declined to make the requested determination and instead stated,

The parties should be able to renegotiate any contracts that currently do not address the allocation of AB 32 compliance costs, so that the contracts are modified to be consistent with Commission policy. Rather than rewrite the existing contracts based on the limited record before us, we direct the utilities to renegotiate the contracts at issue so that they reasonably address the allocation of AB 32 compliance costs.<sup>12</sup>

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<sup>2</sup> “The purpose of this article is to reduce emissions of greenhouse gases associated with entities identified in this article through the establishment, administration, and enforcement of the California Greenhouse Gas Cap-and Trade Program by applying an aggregate greenhouse gas allowance budget on covered entities and providing a trading mechanism for compliance instruments.” Title 17, California Code of Regulations (“CCR”), Section 95801.

<sup>10</sup> CARB, *California’s Cap and Trade Program -- Final Statement of Reasons* (“FSOR”), Oct. 2011, at p.25. <http://www.arb.ca.gov/regact/2010/capandtrade10/fsor.pdf>

<sup>11</sup> *Opinion Adopting PG&E, Southern California Edison Company and San Diego Gas & Electric Company’s Long-Term Procurement Plans* (“LTPP Decision”) D.12-04-046, p.61.

<sup>12</sup> *LTPP Decision*, D.12-04-046, p.62.

If the parties were unable to reach agreements within 60 days, the Commission would address and resolve those issues in the GHG Rulemaking.<sup>13</sup> On August 2, 2012, the ACR amended the scope of the GHG Rulemaking to:

... include a determination of the issues concerning treatment of GHG compliance costs associated with contracts executed between independent generators and utilities prior to the passage of AB 32 that do not include a mechanism for recovery of such costs. The scope of this proceeding is expanded to include information reasonably necessary for the Commission to make findings related to this issue.<sup>14</sup>

The ACR specified that:

“Parties seeking relief on this issue should not construe our consideration of the issue to mean that relief will or will not ultimately be granted;

“Parties should be aware that a Commission decision on these issue (sic) is likely to apply equally to all parties, regardless of their existing contract terms and is unlikely to address the unique situations or contracts of each party; and

“For this reason, among others, it is appropriate and desirable for signatories of bilateral contracts to reach agreement on contract terms rather than ask for terms to be imposed by the Commission.”<sup>15</sup>

On August 7, 2012, the ALJs issued a further ruling stating that, “contract disputes are best resolved by the parties to the contract” and warned that, “if a solution were to be adopted, it is highly likely that such solution would be applied equally to all contracts, an outcome that may be less than ideal in particular cases, depending on the terms and conditions of each specific contract.”<sup>16</sup>

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<sup>13</sup> *LTPP Decision*, pp. 60-61.

<sup>14</sup> *ACR*, p. 6.

<sup>15</sup> *Ibid*, pp. 6-7.

<sup>16</sup> *Administrative Law Judge’s Ruling Setting Forth Next Steps in Track 1 Phase 2 of this Proceeding* (“ALJs’ Ruling”), R.11-03-012, Aug. 7, 2012, at p. 3.

Both the Commission and CARB have encouraged contracting parties to resolve the issue of responsibility for GHG compliance costs in pre-AB 32 power purchase agreements through bilateral negotiations. Here, a dispute arose between PG&E and Starwood as to whether the PPA addresses GHG compliance costs. PG&E contends (consistent with the parties' negotiations) that the PPA does so and that it allocates such costs to Starwood. Starwood, however, disputes PG&E's position and sought compensation from PG&E for its GHG compliance costs. To resolve this dispute, and pursuant to the Commission's guidance, the parties agreed to compromise their dispute. Specifically, PG&E and Starwood negotiated a contract price reduction to retain value for PG&E's customers in exchange for compensating Starwood with Defined CO<sub>2</sub> Costs. PG&E and Starwood have memorialized their agreement in the Amendment, which will become effective upon final approval by the Commission.

**B. Consistency with Commission Rulings**

PG&E and Starwood's bilateral negotiation of a mutually satisfactory resolution of responsibility for GHG compliance costs is precisely what was encouraged by CARB and the Assigned Commissioner and ALJs' rulings in the GHG Rulemaking proceeding. Starwood has sought to reopen its contract to obtain compensation for its GHG emissions costs from the Facility from PG&E, and PG&E considered Starwood's overtures based upon guidance in the ACR and ALJs' Ruling. The parties have discussed the merits of their respective positions on GHG compliance cost allocation and negotiated a compromise in the form of the Amendment. The Amendment allows the parties to avoid a broad-brush regulatory solution that would not necessarily preserve the value of the negotiated terms and conditions of the PPA and could result in a less valuable PPA for PG&E's customers. The Amendment also avoids a dispute process between the parties that could be lengthy and costly. The Commission should find that PG&E acted prudently in negotiating the Amendment.

**C. PG&E's Customers Benefit from the Amendment**

Although PG&E will pay Starwood for Defined CO<sub>2</sub> Costs under the Amendment, value from Starwood's pre-existing obligation is recognized because the Amendment includes a purchase price reduction. The actual commercial terms of the Amendment are described in detail in confidential Appendix A and the Amendment itself is provided as Appendix B to this Application. Altogether, PG&E's negotiated resolution of Starwood's claim for assistance with its GHG compliance costs merits Commission approval.

**D. Procurement Review Group Participation**

On July 17, 2012, PG&E informed its Procurement Review Group ("PRG") that it had engaged Starwood and two other counterparties with which it had executed PPAs prior to the enactment of AB 32 on the issue of GHG compliance cost allocation. PG&E also summarized the status of negotiations at its September 11, 2012 PRG meeting. PG&E received confidential PRG feedback on its negotiations with Starwood.

**IV. THE AMENDMENT**

**A. General Deal Structure**

PG&E will compensate Starwood for Defined CO<sub>2</sub> Costs resulting from PG&E's dispatch of the facility through either payments or physical transfer of compliance instruments such as allowances or offsets. In exchange, Starwood will accept a reduction in certain contract payments. Starwood must demonstrate to PG&E that it actually has a compliance obligation to CARB for the Facility and must provide PG&E with its Facility Emissions Report when it makes its filing with CARB.

**B. Amendment Terms**

The following is a general description of the major terms of the Amendment. The Amendment terms are market -sensitive and proprietary to Starwood and PG&E; therefore, the details and analysis of these terms are provided in Confidential Appendix A to this Application.

Capitalized terms have the meaning ascribed to them in the PPA or Amendment, unless otherwise stated.

**1. New Section 9.3 Concerning Carbon Dioxide Costs**

The scope and mechanics of PG&E's compensation for Defined CO<sub>2</sub> Costs resulting from PG&E's dispatch of the Facility are explained in this addition to the PPA.

**2. PG&E's Contract Payments Are Reduced**

The PPA's contract price is reduced in consideration of PG&E compensation to Starwood for Defined CO<sub>2</sub> Costs. The negotiated price will become effective as of the earlier of the start of the Cap and Trade Program compliance period or Commission approval of the Amendment. This reduction will be fixed for the remaining contract term whether or not the Cap and Trade Program is in effect, unless otherwise modified in a future amendment.

**3. The Amendment Clearly Defines PG&E's AB32 Compensation to Starwood**

The Amendment will provide Starwood compensation only towards its carbon dioxide emissions resulting from PG&E's dispatch of the Facility at the contractually guaranteed heat rate.

**4. The Amendment Covers Certain Contingencies**

If Starwood receives GHG emissions credits with respect to the Facility, it will credit them to PG&E.

**V. REGULATORY PROCESS**

**A. Requested Effective Date**

PG&E respectfully requests the Commission to approve this Application as soon as practicable but no later than February 2013 so that the Amendment will take effect in March 2013. Although PG&E has proposed a schedule, below, that takes into account the participation of third parties as provided by the Commission's Rules, the clear public benefit of the Amendment should result in limited intervention by third parties and few issues for CPUC staff

review. If intervention is limited or non-existent, PG&E requests the procedural schedule to be shortened accordingly.

**B. Request for Confidential Treatment**

In support of this Application, PG&E provides the following Confidential Appendices:

- **Confidential Appendix A** – Amendment Summary and Analysis evaluating the benefits of the Amendment
- **Confidential Appendix B** – Amendment

Concurrent with the filing of this Application, PG&E has filed a separate *Motion for Leave to File Confidential Material Under Seal* to protect from public disclosure confidential market sensitive information, as defined by R.05-06-040, and other proprietary business information contained in certain appendices to this Application. The contract price amendment, other proprietary contract terms, and information about the value of the transaction to PG&E are presented in Appendix A, “Amendment Summary and Analysis.” The confidential Amendment is provided as Appendix B. In accordance with D.08-04-023, PG&E requests the Commission to preserve the continued confidentiality of the Amendment to the PPA, and all other contractual information not required to be made public by D.06-06-066.<sup>17</sup>

**VI. COMPLIANCE WITH THE COMMISSION’S RULES OF PRACTICE AND PROCEDURE**

**A. Contents of Application (Rule 2.1)**

**1. Requested Relief**

PG&E requests the Commission to find that the terms of the Amendment are reasonable and that PG&E’s execution of the Amendment is reasonable; to approve the Amendment in its entirety, including payments to be made thereunder by PG&E; and to authorize PG&E to recover

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<sup>17</sup> The *Motion for Leave to File Confidential Material Under Seal* is based upon D.08 -04-023 and the August 22, 2006 Administrative Law Judge’s Ruling Clarifying Interim Procedures for Complying with D.06 -06-066 to demonstrate the confidentiality of the material and to invoke the protection of confidential utility information provided under either the terms of the IOU Matrix, Appendix 1 of D. 06-06-066 and Appendix C of D.08 -04-023, or General Order 66-C.

costs incurred pursuant to the Amended PPA through a debit to its ERRA, subject only to the Commission's review of the reasonableness of PG&E's administration of the Amended PPA.

PG&E requests the Commission to approve the Amendment as soon as practicable, but in any event no later than during the month of February of 2013, which is approximately five months from the date on which this Application is being filed.

## **2. Statutory Authority**

PG&E makes this request and seeks the above-stated relief pursuant to the following sections of the Public Utilities Code: Section 451 for a finding that PG&E's electricity procurement costs under the Amended PPA are just and reasonable; Section 454 for authorization to recover costs of the Amended PPA in rates; Section 454.5 for upfront approval of the Amended PPA as acceptable and eligible for rate recovery; Section 701 which confers plenary authority on the Commission to regulate every public utility within California; Section 728 under which the Commission may set just and reasonable rates; and Section 729 which authorizes the Commission to establish new rates based upon an investigation.

## **3. Legal Name and Principal Place of Business (Rule 2.1(a))**

The Applicant's legal name is Pacific Gas and Electric Company. PG&E's principal place of business is 77 Beale Street, San Francisco, California. Its post office address is P. O. Box 7442, San Francisco, CA 94120-7422. PG&E is a corporation organized under the laws of the State of California.

## **4. Correspondence and Communication Regarding This Application (Rule 2.1(b))**

Correspondence regarding this Application should be directed to the following PG&E representatives in this matter:

Evelyn C. Lee  
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**5. Category of the Proceeding**

The Application should be categorized as a rate-setting proceeding.

**6. Need for Hearing**

The Commission should approve the Amendment without hearings, based on the information presented by PG&E in this Application.

**7. Issues To Be Considered**

The following issues should be considered in this proceeding:

- (a) Whether the Amendment proposed in this Application is reasonable and in the best interest of PG&E’s customers and thus should be approved by the Commission,
- (b) Whether PG&E’s execution of the Amendment is reasonable, and
- (c) Whether PG&E should be authorized to recover costs incurred pursuant to the Amended PPA in ERRA and to recover any stranded costs consistent with D.08-09-012.

**8. Proposed Schedule**

PG&E proposes the following schedule for Commission approval:

<b>ACTIVITY</b>	<b>PROPOSED SCHEDULE</b>
Application Filed	September 25, 2012
Application Noticed	September 28, 2012
Responses Filed	October 29, 2012
PG&E’s Reply to Responses	November 9, 2012
Pre-Hearing Conference	November 19, 2012
Scoping Memo	November 26, 2012
Concurrent Opening Briefs Filed	December 11, 2012
Reply Briefs Filed	December 21, 2012
ALJ Proposed Decision Filed	January 29, 2012
Final Decision	February 28, 2013

**B. Organization and Qualification to Transact Business (Rule 2.2)**

PG&E is, and since October 10, 1905 has been, an operating public utility corporation organized under California law. It is engaged principally in the business of furnishing electric and gas services in California. A certified copy of PG&E’s Restated Articles of Incorporation,



effective April 12, 2004, is on record before the Commission in connection with PG&E's Application 04-05-005, filed with the Commission on May 3, 2004. These articles are incorporated herein by reference pursuant to Rule 2.2 of the Commission's Rules.

**C. Authority to Increase Rates (Rule 3.2)**

PG&E does not propose to modify its electric rates in this Application. PPA procurement costs will be forecasted and included in the ERRA subject to true-up and recovery through the ERRA rate. ERRA costs are not defined as rates for purposes of Public Utilities Code, Section 454.

**VII. REQUESTED RELIEF**

PG&E respectfully requests the Commission to issue an order that:

1. Finds that the terms of the Amendment, including the price of delivered energy, are reasonable;
2. Finds PG&E's execution of the Amendment to be reasonable;
3. Approves the Amendment in its entirety, including payments to be made by PG&E pursuant to the Amended PPA, subject only to the Commission's review of the prudence of PG&E's administration of the Amended PPA;
4. Makes the following conclusions of law in support of cost recovery for the Amended PPA:
  - (a) It is reasonable for PG&E to recover its costs under the Amended PPA through its Energy Resource Recovery Account and
  - (b) Any stranded costs that may arise from the Amended PPA are subject to the provisions of D.04-12-048 which authorize recovery of stranded procurement costs over the life of the contract. The implementation of the D.04-12-048 stranded cost recovery mechanism is addressed in D.08-09-012.

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5. Grants PG&E such other relief as the Commission finds to be just and reasonable.

DATED: September 26, 2012

Respectfully submitted,

EVELYN C. LEE  
CHARLES R. MIDDLEKAUFF

By:                                 /S/ Evelyn C. Lee                                  
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## VERIFICATION

I, Roy M. Kuga, declare:

I am an officer of Pacific Gas and Electric Company, a corporation, and am authorized, pursuant to Code of Civil Procedure § 446, ¶ 2, to make this Verification for and on behalf of said Corporation, and I make this Verification for that reason. I have read the foregoing Application, and I am informed and believe that the matters therein concerning Pacific Gas and Electric Company are true.

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

Executed on September 25, 2012, at San Francisco, California.

*/S/ Roy M. Kuga*

**ROY M. KUGA**

Vice President - Energy Supply Management

# **Appendix A**

**CONFIDENTIAL**

## **Amendment Summary and Analysis**

**Appendix B**

**CONFIDENTIAL**

**First Amendment to  
Starwood Power-Midway  
Power Purchase and Sale Agreement**