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# California Approves Controversial Carlsbad Power Plant

*By Nancy Saracino, Richard Lehfelddt, Frank R. Lindh, and Jack Stoddard\**

*The authors of this article discuss a recent decision by the California Public Utilities Commission to conditionally approve a down-sized, 500 MW power contract between the controversial NRG Carlsbad Energy Center and San Diego Gas & Electric Company.*

In late May, the California Public Utilities Commission (“CPUC”) voted to conditionally approve a down-sized, 500 MW power contract between the controversial NRG Carlsbad Energy Center and San Diego Gas & Electric Company (“SDG&E”). Four Commissioners voted in favor, with one dissenting.

The original dispute concerned whether California should approve a proposed 600 MW gas-fired power plant, or to instead try and meet its reliability need with new “preferred resources,” such as renewable energy, energy efficiency, and demand response. Opponents were also critical of the fact that the Carlsbad contract was the result of bilateral negotiations between SDG&E and NRG and was not part of a competitive solicitation process.

The Commission’s approval marks the end of months of uncertainty for the Carlsbad project. It remained unclear up until the vote whether the Commission would reject the project, as proposed by the presiding Administrative Law Judge, approve the project at a reduced size, as proposed in Commission President Michael Picker’s alternate proposed decision, or defer judgment until SDG&E could determine whether the Carlsbad capacity was needed in light of a recent SDG&E request for offers, which is expected to result in procurement of preferred resources.

Ultimately, the CPUC adopted President Picker’s alternate decision and found that the Carlsbad project is needed in order to meet reliability needs created by the shutdown of the San Onofre Nuclear Generating Station (“SONGS”) and the retirement of older coastal power plants reliant on once-through-cooling technology, which is being phased out in California.

Parties supporting approval of the project included the California Independent System Operator (“CAISO”) and the City of Carlsbad. The project was opposed by environmental groups, including the Sierra Club, and consumer advocates. SDG&E itself came to question the need for the project. SDG&E surprised stakeholders when it argued, in public comments filed at the end of April, that the Commission should defer making a decision on the project until after it could assess the results of its 2014 request for offers and the long term impact of policy initiatives related to direct

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access, renewable procurement, and distributed generation.

### **BACKGROUND: AGING POWER PLANTS FROM “THE GREATEST GENERATION”**

Most of California’s major power plants are located along or near the coast, where the population is concentrated. Many of these plants have operated for decades, and they are nearing the end of their useful lives. But other factors, not just normal aging and wear-and-tear, are pushing these plants into retirement.

Three years ago, the massive SONGs power plant, with a capacity of over 2,200 megawatts, was taken off line due to a major equipment failure that proved fatal to the plant’s continued operation. Its majority owner, Southern California Edison Company, announced in June 2013 that the plant would be permanently shuttered and decommissioned.

In addition, numerous major fossil-fueled power plants along the California coast are slated for closure in the coming years. The timing of their closure is being driven by a state policy that requires power plant owners to retrofit or retire units that rely on ocean, bay and river waters for cooling, a technology referred to as “once through cooling.”

Between the shuttering of SONGs and the anticipated retirement of once through cooling facilities, California faces the loss of thousands of megawatts of electrical generating plants.

The transition in power supply and uncertainty regarding reliability that California is currently grappling with is a portent of what other U.S. regions may face in the coming years as aging fleets of coal-fired power plants are retired and taken off line.

California’s choices are further complicated by its renewable power mandates, a more recent energy storage target, and the state’s policy commitment to the “loading order.” With respect to renewable power, California is targeting 33 percent renewables by 2020, and Governor Jerry Brown is pushing to increase that to 50 percent by 2030. The “loading order,” a 12 year old policy adopted by California’s energy agencies, requires California utilities to meet resource needs first by increasing energy efficiency and demand response, followed by renewable and distributed generation resources, and then with clean fossil-fueled generation. Adding to the challenge, California also has a longstanding moratorium on new nuclear plants (which was upheld by the U.S. Supreme Court in 1983). In addition, California has since 2007 prohibited its utilities from entering into new contracts for base-load power from coal generation.

### **NRG’S PROPOSAL: THE CARLSBAD ENERGY CENTER**

NRG owns the Encina Power Station, a 965 MW natural-gas-fired power plant that has been in operation since 1954. As a replacement, NRG proposed to build the Carlsbad Energy Center, a modern, 632 MW simple cycle natural gas-fired facility, adjacent to the old Encina plant.

NRG entered into a 20-year “power purchase and tolling agreement” with San Diego Gas & Electric Company for nearly the full capacity of the proposed new

Carlsbad facility (600 MW). The agreement was contingent upon SDG&E's receiving authorization from the CPUC to consummate the agreement and to recover the cost of the commitment in its retail electric rates. SDG&E filed its application at the CPUC in July 2014.<sup>1</sup>

On March 6, 2015, the presiding administrative law judge ("ALJ") issued a Proposed Decision, recommending that SDG&E's request for approval of the Carlsbad agreement be denied. Consistent with the recommendations of ratepayer advocates and environmental groups (including the Sierra Club), the ALJ found that SDG&E should first attempt to replace the Encina facility by procuring, through a request-for-offers solicitation process, a variety of small-scale "preferred resources" (renewable energy, demand response, energy storage, etc.) in locations throughout the San Diego load area.

In comments filed later in March, SDG&E and NRG, as well as the CAISO, opposed the ALJ's Proposed Decision, and urged the CPUC to approve the Carlsbad facility.

On April 6, 2015, CPUC President Michael Picker issued his "Alternate Decision," recommending approval of a 500 MW contract, rather than the proposed 600 MW contract. California rules allow a commissioner that disagrees with an ALJ's proposed decision to issue an "Alternate" decision. The full CPUC may then approve either the "Alternate" decision, the original ALJ's Proposed Decision, or reject both proposals. The Carlsbad item was originally up for consideration on May 7, but was held for further consideration after SDG&E itself questioned the need for the project and suggested waiting for the results of its 2014 request for offers.

On May 21, the Commission approved the Picker Alternate Decision. The decision finds that the Carlsbad contract is needed to ensure reliability in light of the retirement of SONGs and the pending retirement of the older coastal once-through-cooling projects. In support of reducing the contract from 600 MW to 500 MW, the CPUC concluded that approving the full 600 MW of the original proposed contract could preclude SDG&E from procuring the minimum required amount of 200 MW of preferred resources. The Commission further indicated, however, that it was reluctant to rely solely on preferred resources to meet a reliability need in light of the fact that the amount and viability of such resources are still speculative. In addition, the Commission noted that Carlsbad would provide additional benefits, including integration of renewable resources and locational reliability benefits.

### **DEJA VU ALL OVER AGAIN?**

To observers of large energy infrastructure proposals before the CPUC, the controversy over NRG's Carlsbad Energy Center is reminiscent of other recent projects, including the CPUC's 2014 approval of SDG&E's contract with the Pio Pico Energy Center, SDG&E's 2006 proposal to construct the Sunrise Power Link, a 117-mile-long transmission line from the Imperial Valley into SDG&E's service

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<sup>1</sup> Application No. 14-07-009.

territory in San Diego, and PG&E's proposed contract with the Oakley Power Project.

As was the case with Carlsbad, SDG&E's contract with Pio Pico met with substantial opposition from environmental and consumer groups. Opponents criticized the Pio Pico project as a "one-off" procurement that did not comply with SDG&E's approved procurement framework. In addition, they argued that the project was not needed and that any identified need should be met with preferred resources. Ultimately the ALJ sided with SDG&E and concluded that the project was needed, and complied with relevant procurement orders. Project opponents petitioned the California Supreme Court for review of the CPUC's approval but the court denied the petition. Importantly, unlike the Carlsbad Energy Center, the Pio Pico contract was selected through a competitive procurement process.

In the case of the Sunrise Power Link, SDG&E applied for a certificate of public convenience and necessity to construct and operate the project and recover associated costs. Opponents protested SDG&E's application arguing that SDG&E failed consider cheaper, cleaner alternatives.

In October 2008, the ALJ in the Sunrise case issued a proposed decision, recommending that the requested authorization be denied, based on reasoning similar to that used by the ALJ in the recent Carlsbad decision, i.e., that SDG&E should address the reliability needs by acquiring preferred generating resources within the San Diego load area, rather than undertaking a large infrastructure project.

Thereafter, then-CPUC President Michael Peevey responded by issuing an Alternate Decision, recommending approval of the Sunrise project without restrictive conditions. The CAISO, among others, supported the Peevey Alternate, on the ground that the Sunrise project was the best solution for reliability in the San Diego area.

In December 2008, a majority of Commissioners voted to adopt the Peevey Alternate, granting SDG&E authorization to proceed with the Sunrise project. SDG&E then proceeded with construction, and in June 2012 the Sunrise project was completed and placed into service, at a cost of approximately \$1.9 billion.

The last example is the CPUC's 2012 decision approving Pacific Gas & Electric Company's contract with the 556 MW Oakley Power Project. The CPUC approved the Oakley contract despite significant opposition from environmental and consumer groups that argued the plant was not needed. In 2014, a California Court of Appeal vacated the CPUC decision, finding that the record did not include substantial evidence that the plant was needed. PG&E has since abandoned the project.

## **PRESIDENT PICKER MAKES HIS PRESENCE FELT**

Commissioner Michael Picker was named president of the California PUC by Governor Jerry Brown, effective January 2015. The Carlsbad case was the first major new energy infrastructure project to arise during President Picker's tenure as CPUC president. The Carlsbad decision indicates that, like his predecessor Michael Peevey, President Picker is likely to err on the side of ensuring system reliability, even where

the need for a project is questioned by the purchasing utility itself.

Despite the Commission's approval, it is highly likely that one or more of the parties that opposed approval of the Carlsbad project have applied for rehearing. The Sierra Club has already stated that it intends to do so. Parties seeking rehearing were required to do so by June 23, 2015. Assuming that the Commission denies rehearing, parties could then seek appellate review. Based on recent similar cases, including Pio Pico, it is unlikely that the Carlsbad decision will be overturned. Nonetheless, project developers should pay close attention to future proceedings, as they will establish a framework for how the CPUC will begin to address the competing interests in the plethora of resource decisions that it will face in the years ahead.