



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE  
STATE OF CALIFORNIA

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Order Instituting Rulemaking on the )  
Commission's Own Motion into Combined Heat )  
and Power Pursuant to Assembly Bill 1613. )

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Rulemaking R.08-06-024  
(Filed June 26, 2008)

**APPLICATION OF PACIFIC GAS AND ELECTRIC COMPANY (U 39-E), SOUTHERN CALIFORNIA EDISON COMPANY (U 388-E), SOUTHERN CALIFORNIA GAS COMPANY (U 904-G), AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902-M) FOR REHEARING OF DECISION 09-12-042**

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Dated: **January 20, 2010**

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COMPANY (U 904-G), AND SAN DIEGO GAS & ELETRIC COMPANY (U 902-M) FOR  
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Pursuant to Public Utilities Code Section 1731 and Rule 16.1 of the California Public Utilities Commission’s (“Commission” or “CPUC”) Rules of Practice and Procedure, Pacific Gas and Electric Company (“PG&E”), San Diego Gas & Electric Company (“SDG&E”), Southern California Gas Company (“SoCalGas”) and Southern California Edison Company (“SCE”) (collectively, the “Joint Utilities”) file this Application for Rehearing of Decision (“D.”) 09-12-042 (the “Decision”), which was mailed on December 21, 2009. The Joint Utilities are concurrently filing a Motion and Request for Stay of the Decision. The Joint Utilities hereby reserve the federal claims raised in this Application for Rehearing for decision by a federal court in accordance with *England v. Louisiana State Bd. of Medical Examiners*, 375 U.S. 411 (1964).

**I.**

**INTRODUCTION AND SUMMARY OF THE REHEARING APPLICATION**

The Decision adopts policies and procedures for purchasing excess electricity under Assembly Bill (“AB”) 1613 that violate both federal and state law. The Joint Utilities seek rehearing of the Decision on three grounds. First, the CPUC committed clear legal error by exceeding its limited authority to set the wholesale price for energy in violation of the

Supremacy Clause of the United States Constitution and the Federal Power Act (“FPA”). Second, the CPUC committed legal error by failing to maintain “ratepayer indifference” as required by AB 1613. Third, the Decision violates state law by failing to allocate the above-market costs of energy and capacity to all customers who benefit from the AB 1613 program. These errors are discussed in more detail below. The Joint Utilities are not opposed to policies that further efficient CHP and GHG reductions. However, the Commission must correct the serious legal errors in the Decision.

### **Federal Preemption of Wholesale Power Pricing**

The Decision improperly concludes that the CPUC has jurisdiction to set the wholesale price for energy and capacity so long as the wholesale sales transaction arguably furthers environmental goals. The Decision states that “[s]ince AB 1613 seeks to incorporate more efficient CHP systems that would provide environmental benefits into a utility’s procurement portfolio, it would be within the Commission’s authority to implement all aspects of AB 1613, including the price offered by the electric utility.”<sup>1</sup> This conclusion is erroneous as a matter of law. It is contrary to the FPA and longstanding case law establishing that the Federal Energy Regulatory Commission (“FERC”) has exclusive authority to set the rates for the wholesale sale of electricity in interstate commerce. Although the CPUC can direct the procurement activities of the investor-owned utilities subject to its jurisdiction, it cannot set the price for power sales made pursuant to AB 1613 or otherwise intrude on FERC’s exclusive jurisdiction over wholesale power markets.

Mischaracterizing the AB 1613 program as an “energy efficiency” or environmental program does not change this fact. The Decision establishes a mandatory purchase program for energy and capacity – at a CPUC-determined price – designed to encourage a particular form of electrical generation. Although the CPUC has the authority under current precedent to require

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<sup>1</sup> Decision, Conclusion of Law No. 2, pp. 77-78.

load-serving entities (“LSEs”) to purchase power from certain types of generators,<sup>2</sup> it does not have the authority to set the price for such sales of energy and capacity.

### **Ratepayer Indifference Is Not Maintained**

In addition to the violating federal law, the Decision violates state law by failing to maintain “ratepayer indifference” as required by AB 1613. AB 1613 requires the Commission to ensure that “ratepayers not utilizing combined heat and power systems are held indifferent to the existence of [the AB 1613] tariff.”<sup>3</sup> The Decision correctly concludes that “customer indifference is achieved when ratepayers not utilizing the CHP systems are no worse off, nor any better off, as a result of power purchased pursuant to AB 1613.”<sup>4</sup> The Decision fails to adhere to its own standard. CHP under this program will be providing “as-available” power only. However, the Decision rejects pricing based on the market for “as-available” power or the utility’s avoided cost. Instead, the Decision adopts a price based on the cost of building and operating a Combined Cycle Gas Turbine (“CCGT”), which is a resource that can be controlled and dispatched by the utility. In doing so, the Decision disregards the lesser value of “as-available” CHP that will be developed under the AB 1613 program and ignores that ratepayers can – and regularly do – purchase “as-available” CHP power identical to that sold under the AB 1613 program at a much lower price.

Beyond this, the Decision also includes purported “societal benefits” in the administratively-set price for power to be purchased under the AB 1613 program.<sup>5</sup> The Decision does not attempt to quantify these purported benefits and instead presents the circular reasoning that the price adopted necessarily reflects the value of the benefits because the value of the benefits is included in the price. Accordingly, there is no support in the record quantifying these purported “societal benefits.” Because the Decision adopts a price for power that exceeds what

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<sup>2</sup> The current authority of the states to implement certain public policy choices through the regulation of public utility purchases is not immutable. If FERC finds that a state’s policy choices impermissibly impact wholesale electricity markets, it can invoke federal preemption.

<sup>3</sup> Cal. Public Utilities Code § 2841(b)(4).

<sup>4</sup> Decision, p. 16.

<sup>5</sup> *Id.* The Decision specifically references purported Greenhouse Gas (GHG) and “locational” benefits.

ratepayers would otherwise pay and includes unquantified “societal benefits,” the Decision violates the ratepayer indifference standard mandated by state law.

### **Costs Are Not Allocated To All Benefiting Customers**

Lastly, the Decision violates state law because it fails to allocate the above-market costs of energy and capacity to all customers who benefit from the AB 1613 program. Rather, the Decision elects to allocate only those costs associated with GHG compliance and the “locational bonus” to Direct Access (“DA”) and Community Choice Aggregation (“CCA”) customers. There is no limitation in the AB 1613 statute authorizing only the allocation of GHG or locational bonus costs, and if the Decision imposes above-market costs for energy and capacity on the Joint Utilities’ ratepayers, those costs must be imposed on all customers benefiting from the AB 1613 program, including DA and CCA customers. The Decision commits legal error by failing to adhere to this statutory requirement.

For these reasons, the Joint Utilities request that the Commission grant rehearing and reconsideration of D.09-12-042 to correct its serious legal errors.

## **II.**

### **THE DECISION UNLAWFULLY SETS THE PRICE FOR WHOLESALE POWER**

#### **A. The CPUC Is Federally Preempted from Setting the Price for Wholesale Sales of Electricity in Interstate Commerce.**

Only FERC may set rates for wholesale power sales by public utilities.<sup>6</sup> Part II of the FPA, codified at 16 U.S.C. §§ 824-824m, delegates to FERC ““exclusive authority to regulate the . . . sale at wholesale of electric energy in interstate commerce.””<sup>7</sup> In cases dealing with FERC’s

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<sup>6</sup> See, e.g., *Barton Village Inc.*, 100 FERC ¶ 61,244 at P 12 (2002) (footnote omitted) (“Under the Federal Power Act . . . the Commission has exclusive jurisdiction over . . . wholesale power sales rates . . . [t]hus, we have no legal obligation to review, much less rely upon, the findings by the [state].”); *Midwest Indep. Transmission Sys. Op., Inc.*, 111 FERC ¶ 61,448 at P 41 (2005) (“We disagree . . . that state commissions can serve as co-regulators with regard to wholesale energy markets”).

<sup>7</sup> *Transmission Agency of N. Cal. v. Sierra Pac. Power Co.*, 295 F.3d 918, 928 (9th Cir. 2002) (quoting *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982)).

regulatory authority over transactions and services, courts have held that FERC’s regulation of wholesale power sales and interstate transmission pursuant to FPA Section 201(b) is plenary and preempts State regulation in these areas.<sup>8</sup> The “scope of this authority is not amenable to case-by-case analysis, but rather represents a bright-line rule.”<sup>9</sup> The sole exception to this rule is that states do have authority to establish an avoided-cost price when utilities purchase power from qualifying facilities (“QFs”) pursuant to PURPA.<sup>10</sup> These rules were stated plainly by FERC as follows:

In the case of QFs, the Commission [FERC] has authority under PURPA to regulate how rates for QF sales at wholesale will be determined. Although states may set the ultimate per unit (kW and/or kWh) charges for QF sales at wholesale, they may do so only in accordance with this Commission’s regulations. In the case of facilities that are not QFs, but where the capacity and energy is sold by public utilities at wholesale in interstate commerce, the Commission has exclusive authority to set the rates.

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That is, the primary result of sections 201 et seq. of the FPA was to give to the Commission (originally the Federal Power Commission, and now, its successor, this Commission [FERC]) the authority that was denied to the states – the authority to regulate the sale of electric energy at wholesale in interstate commerce. Jurisdiction over public utility rates for sales at wholesale in interstate commerce is thus beyond the reach of state authority and is instead subject to exclusive Commission authority. Prior to the enactment of PURPA, states were preempted from setting public utility wholesale rates in interstate commerce. Likewise, subsequent to the enactment of PURPA, states had no greater ability to set public utility wholesale rates in interstate commerce.<sup>11</sup>

Here, the Decision encroaches on FERC’s jurisdiction in violation of the FPA because it requires the investor-owned utilities (“IOUs”) to purchase wholesale power from certain eligible

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<sup>8</sup> See, e.g., *FPC v. Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964); *Public Util. Dist. No. 1 of Gray’s Harbor County Washington v. IDACORP, Inc.*, 379 F.3d 641, 646-47 (9th Cir. 2004).

<sup>9</sup> *Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 850 (9th Cir. 2003).

<sup>10</sup> 16 USC §824a-3 et.seq.

<sup>11</sup> *Connecticut Light and Power Co.*, 70 FERC ¶ 61,012, 61,027 and 61,030 (1995) (finding that a municipal rate statute “cannot be applied to require particular rates for sales from facilities that are not QFs but are sales by public utilities at wholesale in interstate commerce because the rates for such sales are subject to exclusive Commission jurisdiction”) (footnotes omitted).

facilities at a set price, regardless of whether those facilities have obtained QF status, and regardless of whether the price exceeds the utility's avoided cost. In fact, the CPUC specifically disavows that the state's PURPA authority has any role in the statute being implemented, stating that AB 1613 does not make any reference to PURPA requirements.<sup>12</sup> The CPUC has no authority to set prices outside of PURPA. What the State only has authority to do, and only under PURPA, is to set prices for QFs at the IOU's avoided cost.<sup>13</sup> In light of this legal framework over prices, any Commission order that sets the price for wholesale power must comply with PURPA.<sup>14</sup>

The case of *Midwest Power Systems, Inc.*<sup>15</sup> addresses whether the state has authority to mandate the purchase of electricity from alternative providers at a set price and is directly on point. There, FERC found that orders of the Iowa Utilities Board implementing an Iowa alternative energy statute were preempted in part by federal law. The Iowa Board had ordered Iowa electric utilities to enter into long-term contracts for the purchase of power from alternative facilities, which might or might not be QFs, at a specified six-cent rate. FERC found that:

[T]he Iowa statute and the implementing orders of the Iowa Board are consistent with federal law to the extent that they require electric utilities located in Iowa to purchase from certain types of generating facilities. Nevertheless, the orders of the Iowa Board are preempted to the extent that they require rates to QFs in excess of the purchasing utilities' avoided cost, and to the extent that they set rates for the wholesale sales of electric energy by public utilities.<sup>16</sup>

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<sup>12</sup> Decision, p. 7.

<sup>13</sup> *Southern California Edison Co.*, 70 FERC ¶ 61,215, *reconsideration denied*, 71 FERC ¶ 61,269 (1995) ("PURPA does not permit either [FERC], or the States in their implementation of PURPA, to require a purchase rate that exceeds [the utility purchaser's] avoided cost."); *Connecticut Light and Power Co.*, 70 FERC ¶ 61,012, *rehearing denied* 71 FERC ¶ 61,035 (1995) (same).

<sup>14</sup> Some entities that sell wholesale power, such as state and federal instrumentalities, are not subject to FERC jurisdiction as to their wholesale power sales.

<sup>15</sup> 78 FERC ¶ 61,067 (1997).

<sup>16</sup> *Id.* at 61,246 (emphasis added).

The Iowa Utilities Board's arguments to FERC were nearly identical to those made by the Commission here, as the Board there claimed that it merely was regulating purchases and could do so for environmental purposes.<sup>17</sup>

FERC explained that the Iowa alternative facilities that sold energy at wholesale in interstate commerce did not have to be QFs, but could be exempt wholesale generators (under the Energy Policy Act of 1992), in which case FERC would evaluate their rates on a cost-of-service or market basis. FERC stated that “[u]nder the FPA, [FERC] cannot delegate this wholesale ratemaking authority to the states.”<sup>18</sup>

As FERC determined in *Midwest Power Systems, Inc.*, the CPUC encroaches on FERC's jurisdiction in violation of the FPA to the extent the CPUC requires the IOUs to purchase wholesale power from eligible program facilities irrespective of whether they are QFs. To the extent that the Commission seeks to set the price for power sold by eligible facilities, those facilities must obtain QF status, and the Commission must set the price at the IOU's avoided cost.<sup>19</sup> The other lawful alternative is to allow the FERC-jurisdictional market to govern prices for power purchased pursuant to the AB 1613 program.

The Decision rejects both of these lawful options and instead sets a price for wholesale power in violation of the FPA. Here, the Decision does not set a rate for QFs pursuant to its authority under PURPA. To the contrary, the Decision goes to great lengths to clarify that AB 1613 is not a PURPA program, eligible facilities need not obtain QF status, and the price adopted is not the utility's avoided cost.<sup>20</sup> Thus, the CPUC is in fact setting a price for wholesale power sold in interstate commerce. And as FERC found in *Midwest Power Systems, Inc.*, AB 1613 and the implementing order of the CPUC are preempted because they set rates for the wholesale sales of electric energy by public utilities.

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<sup>17</sup> Protest of the Iowa Utilities Board at p. 6, FERC Dkt. No. EL95-51 (Nov. 13, 1996).

<sup>18</sup> *Id.* at 61,247.

<sup>19</sup> See *supra* note 6.

<sup>20</sup> Decision, pp. 55-56; p.16 (“While one could argue that indifference would be achieved by setting price equal to an electrical corporation's avoided cost or the market price, we do not believe that such a narrow application would be the appropriate measure in this instance.”). As discussed in more detail in Section III of this Application for Rehearing, the price adopted by the Commission far exceeds utility avoided cost.

**B. The Decision’s Mischaracterization Of The AB 1613 Program Does Not Shield It From A Preemption Challenge**

The Decision claims that the IOUs wrongfully assert that the CPUC is limited in its ability to set prices under AB 1613 and the IOUs mischaracterize the program established by the Decision.<sup>21</sup> To the contrary, the IOUs have accurately characterized the AB 1613 program as a sale for resale of electric energy at wholesale in interstate commerce and it is the Decision that is attempting to characterize AB 1613 as something other than a mandatory purchase obligation at a mandated price for energy and capacity that will be resold at retail. The Decision describes the AB 1613 program as “an incentive structure to encourage the adoption of energy efficiency measures with beneficial environmental attributes.”<sup>22</sup> The AB 1613 program, however, is not an energy efficiency program. Installing CHP systems does not simply reduce energy use; CHP systems are power generators that serve on-site electricity needs. If CHP is energy efficiency, then by the same logic, the repowering of conventional generation facilities should also be considered energy efficiency as it too is designed to serve electricity needs.

Irrespective of how the CPUC characterizes the AB 1613 program, the Decision requires the mandatory purchase of excess energy and capacity<sup>23</sup> delivered into the grid,<sup>24</sup> at a mandated price,<sup>25</sup> in an effort to encourage a preferred form of electrical generation.<sup>26</sup> The Decision’s mischaracterization of the AB 1613 program does not change the fact that the energy sold under the proposed AB 1613 program is wholesale power subject to the exclusive jurisdiction of the FERC under the FPA. Under current FERC and court FPA precedent, the CPUC can require electrical corporations to purchase from certain types of generating facilities to further the State’s

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<sup>21</sup> Decision, p. 7.

<sup>22</sup> Decision, p. 9.

<sup>23</sup> Public Utilities Code 2841(b)(2) provides that “[t]he tariff shall provide for payment for every kilowatthour delivered to the electrical grid” by the CHP system.

<sup>24</sup> Electric energy is deemed to be sold in interstate commerce if it is transmitted in interstate commerce or is commingled with electric energy that is transmitted in interstate commerce. *FPC v. Florida Power & Light Co.*, 404 U.S. 453 (1972).

<sup>25</sup> Decision, pp., 34-39.

<sup>26</sup> Decision, p. 5 (stating that one of the CPUC’s guiding principles is to “[p]rovide sufficient payment to stimulate untapped markets and build new projects, but not overpay”).

social and environmental goals, but it cannot set the price for such purchases except as allowed under PURPA. Accordingly, the relevant question for purposes of an FPA analysis is whether the Commission is setting the price for “a sale of electric energy to any person for resale.”<sup>27</sup> As the IOUs will resell power to their retail customers, the Decision encroaches upon FERC’s plenary authority to regulate prices in the wholesale electricity market.

Given that the wholesale sales transactions mandated by the Decision cannot legitimately be characterized as energy efficiency, the recognition by FERC in *California Independent System Operator Corporation*<sup>28</sup> that energy efficiency programs should be within the states’ jurisdiction is not relevant. The same is true of the Decision’s reliance on *New York v. FERC*, (2002) 535 U.S. 1, which simply reaffirms that Congress preserved the states’ jurisdiction over retail sales services. As this program does not involve retail sales services, the *New York* decision is also not relevant to this discussion.<sup>29</sup>

### **C. The CPUC’s Authority Over Procurement Practices Does Not Shield The Decision From A Preemption Challenge**

The Decision asserts jurisdiction over the program’s pricing on the grounds that it may regulate electrical corporations’ procurement practices.<sup>30</sup> The CPUC’s authority, however, does not include the authority to set prices for mandatory wholesale power purchase programs such as AB 1613. As discussed above, *Midwest Power Systems, Inc.*<sup>31</sup> addresses the question of whether the CPUC has the authority to mandate the purchase of electricity from alternative providers. FERC found that the Iowa Utilities Board had the authority to “require electric utilities located in Iowa to purchase from certain types of generating facilities” but did not have the authority to “set

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<sup>27</sup> 16 U.S.C. § 824(d).

<sup>28</sup> 119 FERC ¶ 61,076 (2007).

<sup>29</sup> In arguing that the AB 1613 program is an energy efficiency program, the Decision states that CHP systems will have to meet certain requirements and be subject to a statewide cap of 500 MW. Decision, p. 11. This appears to be a typographical error as the statewide cap was rejected in the final version of the Decision.

<sup>30</sup> Decision, p. 11.

<sup>31</sup> 78 FERC ¶ 61,067 (1997).

rates for the wholesale sales of electric energy by public utilities.”<sup>32</sup> FERC stated that “[u]nder the FPA, [FERC] cannot delegate this wholesale ratemaking authority to the states.”<sup>33</sup>

Accordingly, although the CPUC can, under current precedent, require electrical corporations to purchase from certain types of generating facilities to further the State’s social and environmental goals, the Commission cannot set the price at which such purchases will be made except pursuant to its authority under PURPA. The State simply does not have the authority to set the price of wholesale power in any other manner.

The Decision fails to provide any legal authority supporting its position that it has the authority to set the price for power for the AB 1613 program. References to D.07-01-039 and *Ameren Energy Marketing Company*, 96 FERC ¶ 61,306 (2001), only support the Commission’s authority to regulate the reasonableness of a utility’s procurement decisions.<sup>34</sup> Those citations are not legal authority for the Commission’s assertion of jurisdiction to set the price for AB 1613 power because only FERC may set rates for wholesale power sales by public utilities.

**D. The Decision’s Purported Focus of Regulation Does Not Shield It From A Preemption Challenge**

The Decision’s assertion that the CPUC is regulating electrical corporations and “not regulating wholesale generators or marketers” is irrelevant to the question of whether the Commission is setting the price for a wholesale power sale in interstate commerce. It is true that the Decision does not set a price at which a generator must sell its power to the utilities and thereby does not “regulate” sellers. The Decision is also correct that the CPUC is regulating the electrical corporations by requiring them to purchase electric energy from certain sellers at a price set by the CPUC. The requirement to purchase at a price established by the CPUC,

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<sup>32</sup> *Id.* at 61,246.

<sup>33</sup> *Id.* at 61,247.

<sup>34</sup> In D.07-01-039, the CPUC stated its authority over the planning and resource decisions of California public utilities but did not have to consider its authority to set any type of price for wholesale power sales. Similarly, *Ameren Energy Marketing Company* states only that state commissions have the authority to address “whether a purchaser has prudently chosen from among available supply options” but does not grant any authority for state commissions to set the price for wholesale power sales. 96 FERC at 62,189.

however, does in fact set a price for wholesale power sales in violation of the FPA. In *Midwest Power Systems, Inc.* the Iowa Utilities Board was also not directly regulating the sellers in ordering Iowa electric utilities to enter into renewable energy contracts at a specified price. FERC, however, found that the actions of the Board to set a wholesale power price violated the FPA because the Board was setting a price for wholesale power.<sup>35</sup> The FPA defines a wholesale sale as “a sale of electric energy to any person for resale.”<sup>36</sup>

A sale of energy and capacity by an eligible CHP facility to an electrical corporation is a sale for resale of electric energy at wholesale in interstate commerce because the Joint Utilities resell such power to their retail customers. Accordingly, even though the CPUC may not be directly regulating wholesale generators in its activities to implement AB 1613, the Commission will be encroaching upon FERC’s regulation of the wholesale electricity market and violating the FPA.

The Decision provides no lawful justification for setting a price for wholesale power at anything other than avoided cost under the authority granted to states under PURPA. Although section 201(b) of the FPA preserves the State’s authority over retail sales, this mandatory power purchase program does not involve retail sales. Although the Commission may have the authority to determine the composition of utility portfolios, the proposed program goes beyond prescribing the composition of a utility’s portfolio – it unlawfully sets a price for wholesale power sales.<sup>37</sup>

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<sup>35</sup> 78 FERC ¶ 61,067, 61,246 (1997).

<sup>36</sup> 16 U.S.C. § 824(d).

<sup>37</sup> FERC discussed the distinction between its authority to regulate wholesale power sales and the states’ authority to direct procurement in *Order on Petitions for Enforcement Action Pursuant to Section 210(h) of PURPA*, 70 FERC ¶ 61,215, 61,676 (1995). There, FERC stated:

“Finally, in acting today, we acknowledge California’s ability under its authorities over the electric utilities subject to its jurisdiction to favor particular generation technologies over others. We respect the fact that resource planning and resource decisions are the prerogative of state commissions and that states may wish to diversify their generation mix to meet environmental goals in a variety of ways. Our decision today does not, for example, preclude the possibility that, in setting an avoided cost rate, a state may account for environmental costs of all fuel sources included in an all source determination of avoided cost. Also, under state authority, a state may choose to require a utility to construct generation capacity of a preferred technology or to purchase power

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For the reasons stated, the Joint Utilities urge the Commission to correct the legal error in the Decision and to implement pricing consistent with federal law.

### III.

#### **THE DECISION VIOLATES THE RATEPAYER INDIFFERENCE STANDARD MANDATED BY AB 1613**

In addition to the violating federal law, the Decision commits legal error by failing to maintain “ratepayer indifference” as required by AB 1613. AB 1613 requires the Commission to ensure that “ratepayers not utilizing combined heat and power systems are held indifferent to the existence of [the AB 1613] tariff.”<sup>38</sup> The Decision correctly concludes that “customer indifference is achieved when ratepayers not utilizing the CHP systems are no worse off, nor any better off, as a result of power purchased pursuant to AB 1613.”<sup>39</sup> The Decision fails to adhere to this standard, however, and rejects pricing based on the market for “as-available” power or the utility’s avoided cost. The Decision also increases the price ratepayers must pay for AB 1613 power by including value for purported “societal benefits” which are not quantified. As discussed in more detail below, because the Decision adopts a price for power that exceeds what ratepayers would otherwise pay and includes compensation for unquantified “societal benefits,” the Decision violates the ratepayer indifference standard mandated by AB 1613.

#### **A. The Decision Violates The Ratepayer Indifference Standard By Adopting Pricing Which Exceeds Utility Avoided Cost**

By definition, “avoided cost” should be the measure of ratepayer indifference. That is, if ratepayers are simply paying the price they would have otherwise paid “but for” the AB 1613

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from the supplier of a particular type of resource. The recovery of costs of utility-constructed generation would be regulated by the state. The rates for wholesale sales would be regulated by this Commission on a cost-of-service or market-based rate basis, as appropriate.” (Emphasis added.)

<sup>38</sup> Cal. Public Utilities Code § 2841(b)(4).

<sup>39</sup> Decision, p. 16.

purchase, they are indifferent to the existence of the AB 1613 tariff. The CPUC has adopted pricing which it has deemed to be the utility's avoided cost in the context of its QF program.<sup>40</sup> The avoided cost pricing adopted by the CPUC in the QF Decision (D.07-09-040) is notable in three respects: First, the pricing established is applicable to "as-available" CHP generators like the ones eligible for AB 1613. Second, the pricing established in the QF Decision is different – and lower – than the pricing adopted by the CPUC in the current Decision. And third, the pricing established in the QF Decision clearly and unquestionably distinguishes between "firm" resources and "as-available" resources. The CPUC stated:

First, firm, unit-contingent capacity is more valuable than as-available capacity because, it is much more predictable and, therefore, much more reliable. Thus, firm power and as-available power cannot be priced identically. Historically, as-available QF power has been priced based on the real economic carrying charge of a combustion-turbine (CT) power plant. We will continue that practice as described herein because as-available QF power, as a block, does allow an IOU to avoid the procurement of additional capacity albeit without the same precision as that associated with a block of firm power. Second, the firm, unit-contingent power product from our prospective QF Program will allow an IOU to more precisely avoid the procurement of additional capacity.<sup>41</sup>

Without any meaningful explanation, the Decision rejects pricing based on the market for "as-available" resources or the CPUC-adopted utility avoided cost for as-available QF power. Instead, the Decision adopts a price based on the cost of building and operating a Combined Cycle Gas Turbine ("CCGT"), which is a highly valued and fully dispatchable resource. The Decision does not explain why "as-available" energy and capacity delivered from eligible CHP under the AB 1613 program should be priced differently from identical "as-available" CHP

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<sup>40</sup> SCE continues to maintain that the currently-adopted methodology for calculating avoided cost does not accurately represent SCE's true avoided cost. Specifically, the Commission's current method for determining avoided cost utilizes an outdated and unsupported administrative heat rate rather than utilizing 100% market pricing data. D.07-09-040, as modified by D.08-07-048, anticipates that the calculation of the utility's avoided cost of energy will transition to Market Redesign and Technology Upgrade (MRTU) pricing within 6 to 12 months after MRTU implementation. Because that methodology has not yet been developed or reviewed, SCE cannot comment on whether it would be an appropriate calculation of SCE's avoided cost, but SCE anticipates that a market-based pricing methodology will better reflect the measure of ratepayer indifference.

<sup>41</sup> D.07-09-040, p. 92.

power delivered under the QF program. Nor does the Decision explain its departure from recognized Commission decisions which establish that as-available capacity is less valuable than firm capacity.<sup>42</sup> Although the Decision states that the AB 1613 CHP units are “likely to operate as a firm resource” to satisfy their thermal and electrical host, these facilities have no contractual obligation to deliver energy and capacity to the utility at any particular time. Thus, they are not “firm” resources that the utility can depend upon and therefore offer less value to ratepayers. Because the Decision disregards established Commission precedent concerning the lesser value of “as-available” CHP and ignores the fact that ratepayers can – and regularly do – purchase “as-available” CHP power identical to that which will be sold under AB 1613, but at a lower price, the Decision violates the ratepayer indifference mandate in AB 1613.

**B. The Decision Violates The Ratepayer Indifference Standard By Adopting Pricing Which Includes Compensation for Unquantified “Societal Benefits”**

The only rationale in the Decision for why utility avoided cost is not an appropriate measure of ratepayer indifference is that avoided cost is “too narrow” and does not include purported “societal benefits” of GHG reductions and “locational” value. The Decision does not attempt to quantify these purported benefits and instead presents the circular reasoning that the price adopted necessarily reflects the value of the benefits because the value of the benefits is included in the price. This reasoning makes no sense, and cannot support the price adopted for AB 1613 power. For example, the Decision states that the costs for GHG compliance reasonably approximate the value of the GHG reduction benefits obtained. However, if a generator elects to run less efficiently, its GHG compliance costs will be higher, but the GHG reduction benefits to non-participating customers will be lower. Thus, contrary to the Decision, there is often an inverse correlation between GHG cost and GHG reduction benefit.

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<sup>42</sup> The Proposed Decision did account for the lesser value of as-available capacity, and only required payment of 40 percent of the fixed cost component of the 2008 MPR as an adjustment for the lesser value of as-available capacity. The final Decision deleted this aspect of the pricing calculation.

Likewise, support in the Decision for a ten percent location “bonus” to the payment is non-existent. The Decision seeks to reward projects which locate in areas that will reduce grid congestion, and therefore applies an arbitrary ten percent bonus to projects that locate in areas with local capacity requirements. However, there is no analysis whatsoever in the Decision that ten percent of the adopted price for energy and capacity (or any other number) reasonably approximates the value of power delivered at a particular time and place. In fact, adopting a fixed percentage is unreasonable on its face, because it implies that the delivery system costs that a CHP facility could avoid are proportionally related to the cost of a CCGT generating facility. No such relationship exists. Further, the notion that a CHP facility’s ability to relieve delivery constraints can be represented by a fixed value of 10% over the life of the contract is equally flawed. Congestion on the electrical system could be more or less depending on many factors that will most certainly change over time. California Independent System Operator MRTU locational prices include a congestion component. As these prices reflect, the congestion element can vary dramatically by hour and location, and the incidence of congestion occurs sporadically.<sup>43</sup> There is no support in the record for the location bonus adopted in the Decision, and as such, the Decision does not ensure ratepayer indifference as required by AB 1613.

Because the Decision adopts a price for power that exceeds what ratepayers would otherwise pay and includes unquantified “societal benefits,” the Decision violates the ratepayer indifference standard mandated by AB 1613.

#### IV.

#### **THE DECISION VIOLATES STATE LAW BY FAILING TO ALLOCATE ALL ABOVE-MARKET COSTS OF THE PROGRAM TO ALL BENEFITING CUSTOMERS**

State law requires the Commission to allocate all costs and benefits of the program to all benefiting customers.<sup>44</sup> The Decision violates this mandate by only allocating the costs

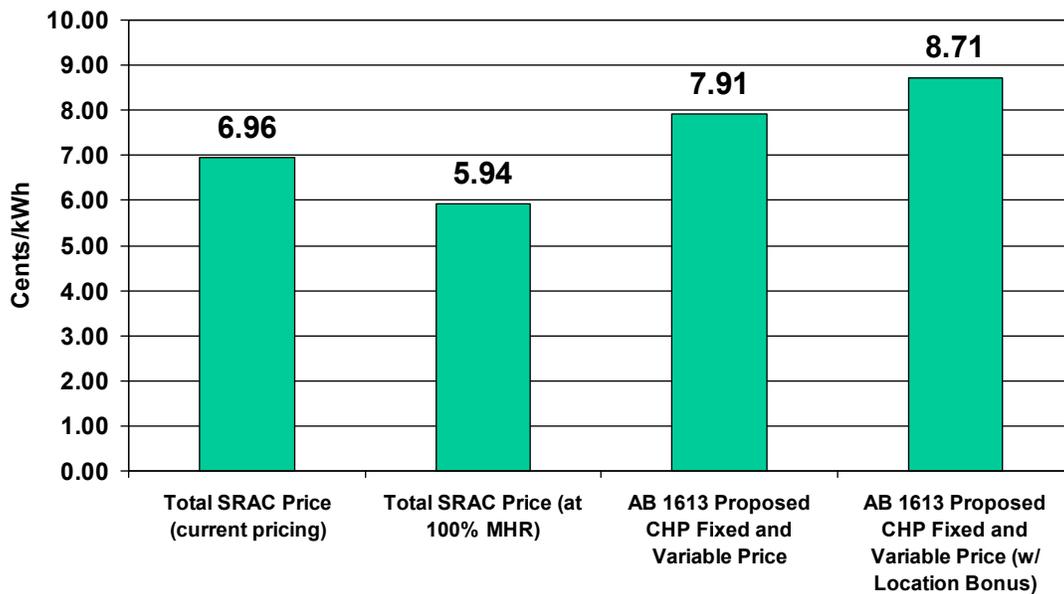
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<sup>43</sup> In its comments, SCE highlighted that the MRTU nodal price does precisely account for the value of power delivered at a particular time and place, but the Decision rejected MRTU day-ahead pricing.

<sup>44</sup> Cal. Public Utilities Code § 2841(e)

associated with the “societal benefits” to Direct Access (“DA”) and Community Choice Aggregation (“CCA”) customers. In so doing, the Decision fails to allocate all above-market costs of energy and capacity purchased under the AB 1613 program to all benefiting customers. As the graph below illustrates, the all-in price for energy and capacity adopted in the Decision is estimated to be approximately .95 cents/kWh more than the current pricing for as-available QFs, and almost two cents/kWh more than pricing based on a 100% market heat rate.<sup>45</sup>

**Illustrative Levelized Price Comparison<sup>46</sup>**



There is no limitation in AB 1613 to allocate only GHG or locational bonus costs. To the extent the CPUC seeks to impose above-market costs for energy and capacity on the Joint Utilities’ ratepayers, those are in fact costs “associated with any tariff or contract entered into by an electrical corporation pursuant to [AB 1613]”<sup>47</sup> and must be imposed on all customers

<sup>45</sup> As noted in footnote 36, D.07-09-040, as modified by D.08-07-048, anticipates that the calculation of the utility’s avoided cost of energy will transition to MRTU pricing within 6 to 12 months after MRTU implementation. MRTU was implemented in April 2009.

<sup>46</sup> This price comparison is intended to be illustrative, and utilizes the following sources of public data: The “Total SRAC Price (current)” uses the current market index formula adopted in D.07-09-040 and a market heat rate assumed to be the 2008 MPR heat rate of 6,924, plus payment for as-available capacity. The “Total SRAC Price (at 100% MHR)” uses 100% market heat rate assumed to be the 2008 MPR heat rate of 6,924, plus payment for as-available capacity. The “AB 1613 Proposed CHP Fixed and Variable Price” uses 100% of the fixed component of the 2008 MPR (*i.e.*, the fixed price component provided in the contract) and MPR gas price forecast data. The period measured is 2010 to 2019.

<sup>47</sup> Cal. Public Utilities Code §2841(e).

benefiting from AB 1613, including DA and CCA customers. The Decision commits legal error by failing to follow this mandate.

V.

**CONCLUSION**

For all of the foregoing reasons, the Commission should grant rehearing of the Decision.

Respectfully submitted,

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January 20, 2010

**CERTIFICATE OF SERVICE**

I hereby certify that, pursuant to the Commission's Rules of Practice and Procedure, I have this day served a true copy of **APPLICATION OF PACIFIC GAS AND ELECTRIC COMPANY (U 39-E), SOUTHERN CALIFORNIA EDISON COMPANY (U 388-E), SOUTHERN CALIFORNIA GAS COMPANY (U 904-G), AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902-M) FOR REHEARING OF DECISION 09-12-042** on all parties identified on the attached service list(s). Service was effected by one or more means indicated below:

Transmitting the copies via e-mail to all parties who have provided an e-mail address. First class mail will be used if electronic service cannot be effectuated.

Executed this **20th day of January, 2010**, at Rosemead, California.

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