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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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**Order Instituting Rulemaking to Integrate
and Refine Procurement Policies and
Consider Long-Term Procurement Plans.**

Rulemaking 13-12-010
(Filed December 19, 2013)

**COMMENTS OF THE CALIFORNIA COGENERATION COUNCIL
TO THE ADMINISTRATIVE LAW JUDGE'S RULING
SEEKING COMMENTS ON CHP ISSUES**

Introduction

The California Cogeneration Council ("CCC") respectfully submits these comments on the Administrative Law Judge's Ruling Seeking Comment on CHP Issues (the "Ruling"). As noted by the Administrative Law Judge ("ALJ"), there are outstanding issues that were deferred to the Long-Term Procurement Plans ("LTTP") proceeding from Decision ("D.") 10-12-035, as modified by D. 11-10-016, in which the California Public Utilities Commission ("Commission") adopted a combined heat and power program ("CHP Program") based upon the Qualifying Facility and Combined Heat and Power Settlement Agreement (the "Settlement Agreement"). The majority of the questions go to issues addressing what is to occur under the CHP Program in the Second Program Period.

In order to address and to put the questions set forth in the Ruling into context, the CCC begins these comments by reviewing the results to date in the Initial Program Period under the CHP Program. This will provide the framework for the CCC answers to the questions posed by the ALJ.

It is critical for the Commission to keep the CHP Program goals and objectives in mind in deciding how to proceed in the Second Program Period. The goals and objectives stated in the Settlement Agreement are as follows:

Section 1.1.1. “Develop a State combined heat and power (CHP) program (CHP Program)”.

Section 1.1.2. “Create a smooth transition from the existing QF CHP PURPA Program to a State-administered CHP Program”.

Section 1.1.3. “Settle all CHP/QF litigation referenced in Section 14”.

Thus far, only the goals and objectives set forth in Section 1.1.3 have been fully achieved and the Commission should strive to structure the Second Program Period to ensure that the goals and objectives in Sections 1.1.1 and 1.1.2 are fully achieved by the end of the Second Program Period. While the framework of the CHP Program was developed in the Settlement Agreement and the Initial Program Period is well underway, as set forth in more detail below, the CHP Program is not on track to realize its goals. Specifically, for a significant portion of existing and efficient CHP facilities under Legacy or Transition power purchase agreements (“PPAs”) the transition has not been smooth or has not occurred at all. Likewise, to date, virtually no new CHP has been developed under the CHP Program.

Careful resolution of the issues deferred to the LTPP proceeding is thus critical if the goals and objectives set forth in Section 1 of the Settlement Agreement are to be met. Only if the CHP Program provides viable options for existing efficient and new CHP facilities will the State have a chance of meeting the 6,500 or 4,000 MW goals established by the Governor and CARB, respectively. This will require adjustments or changes in the Second Program Period. Without such adjustments or changes, rather than moving forward to meet these CHP goals, the State will lose ground with regard to CHP.

The CCC appreciates the focus the Ruling brings to the CHP issues that were identified in the Settlement Agreement for resolution in the LTPP process. Given that the Transition PPAs terminate on July 1, 2015 and the Initial Program Period ends on November 23, 2015, it is critical that the CHP issues be addressed in the current LTPP. After parties have had an opportunity to review responses to the Ruling, the Commission should direct that the parties determine whether settlement discussions are likely to lead to resolution of the issues raised in the comments or a more formal process, such as testimony and hearings will be needed. In either

case, a procedure to provide a common data set to the parties will be needed to allow for a meaningful assessment of the CHP Program to date, and informed participation and decision making on goals and targets for the Second Program Period.

The Initial Program Period

The majority of the MWs procured thus far in the Initial Program Period by the investor-owned utilities (“IOUs”) are not from CHP MWs. In fact, approximately 1087 MWs or 42%¹ are from utility prescheduled facilities (“UPFs”), many of which will convert from qualifying facility (“QF”) CHP operations to exempt wholesale generator (“EWG”) operations with a minimal or no thermal application. Allowing for the conversions to UPFs was clearly contemplated under the Settlement Agreement. Another approximately 340.5 MWs or 13.4%² of the MWs procured in the Initial Program Period were awarded to RA-only PPAs. The Commission has ruled that going forward RA-only contracts are not to be a part of the CHP Program.

To be clear, the CCC fully supports UPF conversions and the accompanying greenhouse gas (“GHG”) savings. Additional conversions will occur in the Second Program Period and UPF conversions are valuable to the State in meeting its GHG goals. Likewise, the shutdown and repower of inefficient CHP facilities and facilities that are known as “Public Utility Regulatory Policies Act (“PURPA”) machines”³ are beneficial to the State. However, the conversion or shutdown of inefficient CHP was never intended to be the focus of the CHP Program. There is no question that the parties to the Settlement Agreement contemplated that efficient existing and new CHP would be able to obtain contracts under the CHP Program. This was fundamental to the CHP participants’ agreement to support the IOUs’ application to the Federal Energy Regulatory Commission to terminate the IOUs’ obligation to purchase under PURPA. CHP participants to the Settlement Agreement were assured by the IOUs that there would be a place in the utility portfolio for CHP to allow existing efficient facilities to continue to operate and to

¹ CAC-CCC September 2014 data compilation based on CHP semi-annual reports, advice letters, resolutions and Commission decisions.

² *Id.*

³ “PURPA machines” are facilities that were built primarily to sell power to the IOUs under PURPA rather than to provide useful thermal energy to host facilities.

allow for the development of new efficient CHP facilities. Many of these CHP facilities must be operated as base-load generation to meet the thermal requirements of host facilities and cannot offer the IOUs dispatchable products. The primary reason for the CHP Program and CHP-only requests for offers (“RFOs”) was that other IOU solicitations did not provide a viable place for sales of the products produced by CHP facilities, especially those that must operate as base-load facilities to meet thermal requirements.

The simply reality is that while there have been significant successes associated with the CHP Program, for the most part, the IOUs are not signing contracts that allow for the continued or new operation of efficient base-load CHP facilities. The State is at risk of losing CHP, not advancing this efficient use of resources. This is troublesome for two reasons. One, in setting the 4.8 MMT GHG reduction target for the CHP Program and the MW target for the Initial Program Period, the parties to the Settlement Agreement accounted for the fact that the existing fleet of CHP facilities operating in the State were contributing and would continue to contribute 1.95 MMT of GHG savings.⁴ In other words, the 4.8 GHG reduction target was incremental to the existing reductions in GHG emissions from existing CHP. To the extent the existing efficient CHP is not retained, the State loses the benefits which CHP is contributing today to GHG reductions. Two, the Initial Program Period 3,000 MW target was set to provide a viable opportunity for existing CHP to obtain contracts after the expiration of the Transition PPAs or Legacy PPAs. The CHP parties did not contemplate that the majority of the MW target would be met through non-CHP products to the exclusion of MWs from CHP facilities. This result contravenes the express purpose of the State CHP Program, set forth in Section 1.2.1.3 of the Settlement Agreement, which provides:

The purpose of the State CHP Program is to encourage the continued operation of the State’s Existing CHP Facilities, and the development, installation, and interconnection of new, clean and efficient CHP Facilities, in order to increase the diversity, reliability, and environmental

⁴ The 1.95 MMT are the GHG savings attributable to existing CHP as set forth in 6.2.1 of the Settlement Agreement.

benefits of the energy resources available to the State's electricity consumers.⁵

There are several explanations for the Initial Program Period results to date. First, the IOUs never wanted the CHP products, especially from base-load facilities. Second, because existing CHP does not count toward GHG reductions (as per the GHG Accounting Methodology in Section 7 of the Settlement Agreement), there was no immediate or visible incentive for the IOUs to enter into new contracts with existing facilities that would operate as CHP facilities. Third, as was predicted by the parties to the Settlement Agreement, new CHP might have a difficult time in a bid evaluation against existing efficient CHP and conversions. Under the Settlement Agreement, the contract term for new facilities is limited to 12 years and recovery of capital costs in such a short period would make pricing offers from new CHP uncompetitive. Fourth, in Independent Evaluator ("IE") Reports of the results from the second RFO solicitations, the IEs recommend that the IOUs emphasize procurement of GHG-rich offers in order to meet the Program's GHG target by 2020⁶. This has skewed the bid evaluation during the First Program Period away from an emphasis on retaining existing CHP and meeting the MW targets.

Although still in the Initial Program Period, the IOUs are now emphasizing GHG reductions in bid evaluations. However, the problem remains that preventing the loss of the significant GHG reductions from existing CHP does not appear to be treated, in a bid evaluation, as comparable to the incremental GHG reductions from UPFs or CHP facilities that have made operational changes such that their overall output has been reduced. Thus, it is not likely that existing efficient facilities will be any more successful in subsequent auctions unless certain changes are made for the Second Program Period, as discussed below.

⁵ Settlement Agreement Term Sheet, § 1.2.1.3.

⁶ Independent Evaluator's Report-SDG&E's 2013 RFO for Combined Heat and Power Contracts, Van Horn Consulting, May 18 2014, at 17. Southern California Edison Company 2013 Combined Heat and Power Request for Offers, Independent Evaluators Report Bid Evaluation and Selection Process and Purchase Power Agreement with Elk Hills Power, LLC, June 2014, at 50.

The Second Program Period

There are several adjustments or changes that will be needed in the Second Program Period to provide for a viable CHP Program. A few of these that do not fit neatly into the questions posed by the ALJ are:

- (1) There needs to be a CHP facility target either within the GHG target for the Second Program Period or as a separate MW target as part of the Second Program Period to ensure that the GHG goals are not met through UPF conversions and shutdowns to the exclusion of efficient existing and new CHP facilities. Efficient CHP facilities contribute to GHG savings but GHG savings alone cannot drive the selection criteria. The results in the Initial Program Period amply demonstrate that other non-CHP products will fare better than CHP products. There are numerous reasons that the State supports CHP beyond the potential GHG reductions enjoyed from CHP facilities, such as the contributions from CHP facilities to grid stability, reliability and resiliency. In addition, a viable CHP Program is needed to support important sectors of the State's economy, including the institutions, industrial plants, and manufacturing operations that depend on CHP to maintain competitive operations in the State.
- (2) Contrary to the current accounting in Section 7 of the Settlement Agreement, existing projects under QF Legacy contracts or Transition contracts that are procured by the IOUs should count toward meeting the CHP Program GHG reduction goals. In other words, the CHP Program needs to value preventing the loss of existing GHG reductions as highly as achieving incremental emission reductions.
- (3) Contract terms for new CHP facilities need to be at least 20 years to allow financing and to avoid front loading of capital cost recovery. The Commission has certainly endorsed this need in its RPS programs which routinely provide for PPAs of 20 or more years.

Answers to Specific Questions for Comment:

- 1. Should the Commission increase, decrease, or leave constant the utilities' obligation to procure 4.8 million metric tons of GHG emissions reductions by December 31, 2020, the end of the Second Program Period? If a change is necessary, what should the new target be?**

As of September 2014, the total GHG reductions procured in the Initial Program Period is 2.14 MMT⁷ toward the 4.8 MMT⁸. This value may increase based on results of the IOUS' third RFOs. While there has been significant progress toward the GHG goal, as discussed above, for the most part the goal is not being met from CHP products or facilities. Moreover, this tally does not yet consider the existing GHG reductions which may be lost if existing efficient CHP facilities cease to operate.

Many MWs of existing QF CHP are still on Legacy or Transition contracts. While it is not known how these facilities compare to the existing double benchmark and thus the commensurate GHG emissions reductions (as the data is not available to make the calculations), the IOUs should be incentivized to secure the GHG savings from efficient CHP, and not just from CHP that shuts down or that changes operations to become non-CHP UPF facilities.

At a minimum, the GHG target should remain at 4.8 MMT. For a number of reasons, however, the 4.8 MMT number should be increased. First, the 4.8 MMT CARB goal was for incremental reductions to the 1.95 MMT of GHG reductions that were already being contributed from the existing CHP fleet. Thus, the Commission should add the 1.95 MMT of reductions from existing efficient CHP to the incremental 4.8 MMT goal, for a total CHP goal of 6.75 MMT. Concurrently, the Commission should change the accounting under the Settlement Agreement to count the retention of emission reductions from existing efficient CHP on the same basis as incremental GHG reductions.

⁷ CAC-CCC September 2014 data compilation based on CHP semi-annual reports, advice letters, resolutions and Commission decisions.

⁸ This value would be reduced by 505,792 MMT if the ACE/Phoenix project is not developed. This demonstrates the vulnerability of the CHP Program number to additions or deletions of projects.

The GHG emissions reductions to be counted in Second Program Period should include the following:

- Existing efficient CHP (both topping and bottoming cycle) (**requires change to accounting**);
- UPF conversions;
- Facility shutdowns where thermal load goes away;
- New CHP; and
- Physical change: repowered, expansion, fuel change.

The Commission will need to revise the accounting under Section 7 of the Settlement Agreement to ensure that outcomes consistent with the purpose of the CHP Program are incentivized. Specifically, although UPFs and shutdowns should be valued, they should not be valued to the exclusion of retaining the existing reductions from existing efficient CHP.

2. What procurement processes and strategies should the Commission direct the utilities to employ in order to meet the MW and/or GHG targets established for the Second Program Period?

All of the potential resources set forth in Section 4 of the Settlement Agreement should continue to apply. In terms of the procurement process, the Commission should establish a separate MW target set-aside in the Second Program Period that may comprise only PPAs procuring power from efficient existing and new or repowered CHP facilities. The results in the Initial Program Period discussed above amply demonstrate that without the implementation of such a set-aside, CHP facilities, which were intended to be the focus of the CHP Program, may continue to be left without viable contracting opportunities within the CHP Program.

As far as the calculation of GHG emissions, reductions to be counted in the Second Program Period should include the list set forth in the answer to question number 1, above.

As discussed above, the Commission will need to revise the accounting standards in Section 7 of the Settlement Agreement to ensure that the right incentives are in play; i.e., UPFs and shutdowns should be valued, but not to the exclusion of efficient existing and new CHP.

3. How many competitive RFOs should the Commission require the utilities to hold in the Second Program Period?

The CCC recommends that each IOU should be required to hold at least two CHP-only RFOs during the Second Program Period, with a focus on acquiring existing efficient and new CHP. Once the Commission has determined the GHG and MW targets for the Second Program Period, the Commission will be positioned to determine if more than two CHP RFOs are needed in the Second Program Period, as well as the necessary timing and size requirements for each RFO. The results through the end of the Initial Program Period may also call for further adjustments, as MWs not procured are moved into the Second Program Period. The Commission should also keep in mind that SDG&E already has a 51 MW target for the Second Program Period.

Given the problem with Legacy and Transition PPA holders not getting contracts in the Initial Program Period, the IOUs should hold the first RFO early in the Second Program Period to allow for a smooth transition for these contract holders into the State CHP Program.

4. Should the Commission modify the way GHG emissions reduction benefits are calculated for Settlement counting purposes, including how it calculates the double benchmark?

The Commission should retain a double benchmark for the Second Program Period. Whether the benchmark should be changed and whether there should be a single benchmark for the entire State versus regional benchmarks will need to be explored as part of either settlement discussions encouraged by the ALJ, or more formally within the LTPP proceeding, if required.

There will also need to be specific modifications to the GHG accounting as discussed in the CCC reply to question number 2. What is clear from the results in the First Program Period to date is that the objective of maintaining efficient existing CHP is not being met. Thus, the accounting will need to be aligned to meet that objective. Otherwise, there will not be a smooth transition from the existing QF CHP PURPA Program to the State CHP Program.

5. By what procedural method should a utility be permitted to make a showing during the Second Program Period that it is unable to meet its MW and/or GHG emissions reduction targets? How should the Commission evaluate whether a utility is justified in failing to meet its targets?

Both SCE and SDG&E have thus far fallen short of their procurement targets (specifically Target B) for the Initial Program Period. As set forth above, all three IOUs chose products that were not the CHP product that was to be the focus of a viable CHP program; mainly, procurement of a CHP product that was not competitive in all source and other solicitations. Simply put, under Section 4.2.12 of the Settlement Agreement, the IOUs were to give a preference to CHP products⁹ and they have not done so. Thus, in the Second Program Period, the IOUs should be required to make a specific showing if CHP products are not winning in the RFOs, and the justification cannot be that the other products offered were cheaper or offered greater GHG reductions. It is clear that State public policy strongly supports CHP and the existence of CHP as distributed generation makes a valuable contribution to the system, including local area reliability and stability, reduced transmission capacity costs and reduced overall market prices. While the CHP product may not be the cheapest product available to the IOUs, CHP provides value commensurate with the price for the CHP product.

The specific driver for the CHP-only RFOs was that the CHP product would be more expensive or offer less GHG savings as compared to non-CHP products; however,

⁹ Specifically, Section 4.2.12 states: “In IOU evaluations of final offers from CHP bidders, the IOUs will give preference to Pro Forma offers with no options, relative to non-Pro Forma offers, to the extent that such Pro Forma offers are competitive with the non-Pro Forma offers.” The Pro Forma offers were for CHP facilities bidding based upon the Pro-Forma PPA for CHP facilities that were greater than 20 MWs.

the CHP Program was to provide a viable option for CHP products to be procured. To be clear, the CCC is not advocating that all existing efficient CHP facilities be given a contract under the CHP Program regardless of price. Rather, it is advocating that existing efficient CHP facilities be evaluated with like existing efficient CHP facilities, so they do not lose in the bid evaluation process to non-CHP facilities such as UPFs that no longer operate as qualifying CHP facilities.

In the settlement discussions encouraged in the Ruling, or more formal proceedings in the LTPP, if required, participants should consider possible pricing protocols to protect both the CHP facilities and the ratepayer. For example, the IOUs could be required to justify the savings for ratepayers if they select less than the target amount of MWs in an RFO. In addition, Transition and Legacy PPA holders might be required to be price takers, subject to, for example, a second price auction, so that the prices paid may not exceed the highest priced CHP product chosen by the IOUs. If the CHP facility was not selected on its bid price (i.e., its price was too high), it would be offered a contract at the second price. If the CHP facility rejected the second price, it would not be entitled to a PPA in the CHP Program. As to the highest priced CHP product to be chosen, some standard deviation from the mean for bids from existing efficient gas-fired topping-cycle CHP facilities could be used. This would capture the lower priced offers for the benefit of ratepayers while ensuring that the higher priced products from existing efficient gas-fired topping-cycle CHP facilities were not rejected in the RFO process.

In sum, the pricing mechanisms for purchasing from existing efficient CHP need to be constructively explored in the suggested settlement discussions or LTPP proceeding, if required; the IOUs should not be allowed to justify not meeting CHP Program targets based upon the pricing of CHP products as compared to other non-CHP products.

The Commission should note that although the Settlement Agreement provides for the appointment of a CHP Auditor, the CHP parties have not asked that this step be taken. Since there is no penalty under the Settlement Agreement if the IOUs do not meet

the MW and GHG targets, and particularly if the CHP products are not procured in the CHP Program, the benefit of the audit is dubious.

Also, checkpoints should be included in the timeline of the Second Program Period to allow for adjustments/refinements in the procurement process if the goals of the CHP Program are not being met. This is necessary to mitigate unintended consequences that might arise in the Second Program Period.

6. Should the Transition Period be extended so that the end of the Transition Period coincides with the end of the Initial Program Period?

Based on the results of the Initial Program Period, it is clear that the Transition Period and associated contracts need to be extended. Assuming that the selection criteria are modified in the Second Program Period to ensure that existing efficient CHP facilities under Transition contracts have a viable opportunity to obtain new contracts, for winning bidders, the extension should be in place until the associated contracts become effective. For losing bidders, the extension should remain in place for six months following announcement of the results of the Second Program Period RFOs, assuming there are two in the Second Program Period. Transition contracts should also be available to Legacy contract holders who are unable to obtain a new contract prior to the expiration of the Legacy contract. Without these accommodations, existing efficient CHP facilities under Transition and Legacy contracts may have no option but to shut down, to the detriment of both the State and the businesses that have long depended upon the operations of the associated CHP facilities.

The CCC is not advocating that the Transition Period continue indefinitely through the Second Program Period. A valid concern regarding extension of the Transition Period would be that such an accommodation might incentivize a Transition PPA holder to stay on the Transition PPA as long as possible. To avoid this, the Commission can direct that Transition PPA holders who are given extensions must either bid into each RFO in the Second Program Period or declare their intent not to seek a contract in the CHP Program. In the latter case, the Transition PPA should expire within six months of the notice of intent not to bid.

The Commission should also keep in mind that in 2015 the avoided cost energy prices in the Transition Contracts will transition to full market pricing. In addition, the firm capacity price in the Transition PPAs, \$92 per kW-year, has not been changed or updated for almost a decade (this value was first proposed in 2005 in the SRAC litigation and was approved in 2007 in D. 07-09-040, at pages 97-100). This value is now below-market for long-term firm capacity. Thus, there is no economic harm to ratepayers from an extension of the Transition PPAs for these firm capacity resources.

7. Should the Commission establish special targets or rules to promote CHP resources that face barriers to development and that have significant potential to reduce GHG emissions (e.g. bottoming cycle CHP, or renewably-fueled CHP resources)?

Based upon the results to date in the Initial Program Period, the answer to this question is complicated. While the CCC does not think that the Commission should be favoring one technology over another in a competitive process, it is clear that procurement of certain products has dominated the Initial Program Period. Thus, without CHP Program changes, these same products will dominate the Second Program Period. Unfortunately, as set forth above, these are not CHP products. Since, for the most part, efficient operating CHP has not been successful in obtaining contracts in the Initial Program Period, the CCC thus supports special targets or rules for the Second Program. This would mean specific targets and rules to capture gas-fired, efficient, topping cycle CHP facilities.

As far as bottoming-cycle CHP facilities and renewable CHP facilities, the CCC would support separate targets aimed at capturing these facilities provided that (i) they are not permitted to dominate the Second Program Period, and (ii) such targets are distinct from the targets for gas-fired, topping-cycle CHP facilities. Under the current GHG accounting, these types of facilities are assigned a higher value than gas-fired topping-cycle CHP facilities; as such, arguably, a specific incentive is already in place and no more is needed. This is particularly true for renewably-fueled CHP, which also can pursue the option to be counted toward the State's Renewable Portfolio Standard.

Again, what is needed are special targets and rules supporting existing efficient and new CHP facilities.

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Respectfully submitted,

/s/ Jerry R. Bloom

Jerry R. Bloom

Winston & Strawn LLP

333 S. Grand Avenue

Los Angeles, California 90071

Telephone: (213) 615-1756

Email: jbloom@winston.com

Attorney for California Cogeneration Council