

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

I.D. #11745
RESOLUTION E-4537
December 20, 2012

R E S O L U T I O N

Resolution E-4537. Southern California Edison Company (SCE) requests approval of a Transition Power Purchase Agreement (PPA) with Watson Cogeneration Company, an affiliate.

PROPOSED OUTCOME: This Resolution approves without modification the Transition PPA between Southern California Edison Company and Watson Cogeneration Company, an affiliate, pursuant to the terms of the Qualifying Facility and Combined Heat and Power Program Settlement Agreement.

ESTIMATED COST: SCE approximates the total payments to Watson from January 2013 to the end of the Transition Period under the Transition PPA to be \$319 million. During this period Firm Capacity payments are expected to be \$14.9 million less than those that would have occurred under a continuation of the Legacy PPA.

By Advice Letter 2763-E Filed on August 3, 2012.

SUMMARY

Southern California Edison Company's ("SCE's") Transition Power Purchase Agreement ("Transition PPA") with Watson Cogeneration Company ("Watson" or "Seller"), an affiliate, complies with the requirements imposed on Transition PPAs by the Qualifying Facility and Combined Heat and Power Program Settlement ("Settlement") and is approved without modification.

On August 3, 2012, SCE filed Advice Letter ("AL") 2763-E requesting Commission approval of a Transition PPA with Watson effective upon CPUC approval until the completion of the Settlement Transition Period, July 1, 2015.

Watson, a California general partnership and affiliate to SCE,¹ owns an existing natural gas-fired combined cycle topping-cycle cogeneration facility (“Facility”) in Carson, California. The facility has four gas turbines, two steam turbines, and a maximum operating capacity of 416.6 MW. SCE executed an initial contract based on a QF Standard Offer Contract with Watson’s predecessor, ARCO Petroleum Products Company, for 385 MW contract nameplate capacity on December 19, 1984. The contract was amended in 1985, 1986, 1988, 1998, and 1999. An extension agreement pursuant to D.07-09-040 was executed June 25, 2008 and was scheduled to expire at a time established by CPUC or upon mutual agreement. This 2008 extension serves as the existing PPA, referred to as a “Legacy PPA” under the Settlement.

Section 11.2.1 of the Term Sheet of the QF/CHP Settlement, which was adopted by the Commission in Decision (“D.”) 10-12-035, establishes a procedure to prevent the interruption of power delivery by allowing Legacy PPAs executed pursuant to D.07-09-040 to remain in effect until Seller commences deliveries under a new or amended (“Subsequent”) PPA. Negotiating parties shall use all reasonable efforts to meet conditions to enter into a Subsequent PPA by March 22, 2012. Absent the pendency of regulatory approvals that would prevent the entrance into a Subsequent PPA, extensions of Legacy PPAs terminate March 22, 2012. In the case of a dispute between Buyer and Seller, the Director of the Energy Division may authorize Seller requests for further extensions to Legacy PPAs based on good cause, but “requests shall not be unreasonably repetitive or designed primarily to delay terminations of the extension of the Legacy CHP PPA.”

Watson requested to enter a Transition PPA² with SCE, taking into consideration the Facility’s 416 MW generating capacity, six units, thermal operational

¹ Three general partners own Watson: Products Cogeneration Company, Carson Cogeneration Company, and Camino Energy Company. Camino is a wholly-owned subsidiary of Edison Mission Group, which is a wholly-owned subsidiary of Edison International, a public utility holding company.

² Per the Settlement Term Sheet Glossary of Defined Terms, a Transition PPA is “A short-term PPA between a CHP currently selling to an IOU under a Legacy PPA or extension thereof that begins on the expiration of the Legacy PPA and ends at the conclusion of the Transition Period, the form of which is attached to this Settlement as Exhibit 4.”

requirements, and desire to include Additional Dispatchable Capacity (“ADC”) in supplement to Firm Capacity per Settlement Term Sheet Section 3.4.1.2. Negotiations began January 13, 2012. SCE and Watson disputed the procedure of how negotiations for ADC related to the entry into a Transition PPA. Watson posited that ADC would be included in negotiations of the Transition PPA. SCE posited that the Seller under a Legacy PPA would first enter a Transition PPA and later negotiate about ADC. Watson requested an extension of time of an unspecified length to commence the term of the Transition PPA from the Energy Division Director. SCE supported an extension, but to no later than June 1, 2012. The extension request was granted by the Energy Division Director on March 20, 2012 effective through June 1, 2012.

In the draft of the Transition PPA, Watson requested terms for ADC at an unspecified price and modifications to the Major Overhaul Allowance (Section 1.05(b)) and Forecasting Penalty (Exhibit I, Section 3(b)) terms.

On May 17, 2012 Watson wrote the Energy Division Director and asserted that the Transition PPA was “inapplicable” to Watson’s unique position that allowed it to offer ADC and that a Subsequent Agreement must include ADC. On May 24, 2012 SCE responded, arguing that the Transition PPA “is precisely applicable” to Watson’s situation. SCE asserted that Watson could execute and at a subsequent time, amend the Transition PPA to provide for ADC. The Energy Division Director agreed with SCE and denied Watson’s requests for further extensions unless they executed a Transition PPA or Subsequent PPA by June 1, 2012 (the deadline was later extended to June 8).

Watson proposed another draft of the Transition PPA with the modifications to Section 1.05(b) and Exhibit I, Section 3(b), but without terms for ADC. SCE was willing to accommodate these changes to the Standard Form Transition PPA if the QF could demonstrate that changes were necessary to accommodate unique operational characteristics of the facility. In addition, SCE inserted changes regarding CPUC and Federal Energy Regulatory Commission (“FERC”) approvals, as the Transition PPA is a transaction between affiliated companies. SCE rejected Watson’s other proposed contract changes. SCE and Watson finalized and executed the Transition PPA with the three modifications on June 5, 2012. The Legacy PPA remains in effect until the requisite CPUC and FERC approvals of the Transition PPA.

Detailed analyses regarding the modifications to the Standard Form Transition PPA and propriety of the affiliate transaction are, respectively, included in the Transition PPA Matters and Independent Evaluator Review sections below.

BACKGROUND

On December 16, 2010, the Commission adopted the Qualifying Facility and Combined Heat and Power Program Settlement Agreement with the issuance of D.10-12-035. The Settlement resolves a number of longstanding issues regarding the contractual obligations and procurement options for facilities operating under legacy and new qualifying facility (“QF”) contracts.

The QF/CHP Settlement establishes Megawatt (“MW”) procurement targets and greenhouse gas (“GHG”) emissions reduction targets the investor-owned utilities are required to meet by entering into contracts with eligible CHP facilities, as defined in the Settlement. Pursuant to D.10-12-035, the three large electric investor owned utilities (“IOUs”) must procure a minimum of 3,000 MW of CHP and reduce 4.8 million metric tonnes (“MMT”) of GHG emissions consistent with the California Air Resources Board (“CARB”) Scoping Plan.

Among other things, D.10-12-035 updates methodologies and formulas for calculating the Short Run Avoided Cost (“SRAC”) energy price for QFs to be used in the Standard Offer Contracts for QFs with a Power Rating that is Less than or Equal to 20 MW (the “QF Standard Offer Contract”), Transition PPAs, amendments to existing QF PPAs, and Optional As-Available PPAs. The SRAC methodology under the QF/CHP Settlement includes:

- (1) By January 1, 2015, transitioning SRAC pricing from a formula that is based in part on administratively-determined heat rates to a formula that solely uses market heat rates;
- (2) IOU-specific time-of-use (“TOU”) factors to be applied to energy prices to encourage energy deliveries during the times when the energy is most needed by customers;
- (3) A locational adjustment based on California Independent System Operator (“CAISO”) nodal prices; and,
- (4) Pricing options based on whether a cap-and-trade program or other form of greenhouse gas (“GHG”) regulation is developed in California or nationally.

One of the three stated goals and objectives of the Settlement (Section 1.1.2) was to create a smooth transition from the existing QF CHP PURPA Program to a State-Administered CHP Program. Section 2.1 of the Term Sheet defines a Transition period, beginning on the Settlement Effective Date, November 23, 2011, and ending on July 1, 2015. During the Transition Period, existing CHP Facilities will obtain a new PPA per Section 4, sell into the wholesale market, shut down, or cease to export to the grid.

NOTICE

Notice of AL 2763-E was made by publication in the Commission's Daily Calendar. Southern California Edison (SCE) states that a copy of the Advice Letter was mailed and distributed in accordance with Section 3.14 of General Order 96-B.

PROTESTS

Advice Letter 2763-E was not protested. AL 2763-E received a timely response from Watson Cogeneration Company on August 23, 2012.

Watson supported the approval of the Transition PPA and clarified that they remain in arms-length negotiations with SCE concerning an amendment to the Transition PPA to incorporate Additional Dispatchable Capacity. As a result, until an amendment is completed, Watson is only obligated to deliver Firm Contract Capacity as is defined in Section 1.02 of the Transition PPA.

DISCUSSION

On August 3, 2012, SCE filed Advice Letter ("AL") 2763-E requesting Commission approval of a Transition PPA with Watson that will replace an existing Legacy PPA. The Transition PPA will become effective upon requisite CPUC and FERC approvals, and the Transition PPA will end at the election of the Seller but no later than July 1, 2015.

Specifically, SCE requests that the Commission issue a final resolution that contains:

1. Approval of the Agreement in its entirety; and
2. Any other and further relief as the Commission finds just and reasonable.

Energy Division evaluated the Proposed PPA based on the following criteria:

- Consistency with D.10-12-035, which approved the QF/CHP Program Settlement, including:
 - Consistency with Transition PPA Matters
 - Consistency with Legacy PPA Matters for All Existing QFs
 - Consistency with MW Accounting Methodology
 - Consistency with GHG Accounting Methodology
 - Consistency with Cost Recovery Requirements
- Need for procurement
- Cost reasonableness
- Project viability
- Consistency with the Emissions Performance Standard
- Consistency with D.02-08-071, which requires Procurement Review Group (PRG) participation

In considering these factors, Energy Division also considers the analysis and recommendations of an Independent Evaluator (IE), if available.³ In this case an IE oversaw all negotiations and communications between SCE and Watson.⁴

Consistency with D.10-12-035 which approved the QF/CHP Program Settlement:

On December 16, 2010, the Commission adopted the QF/CHP Program Settlement with the issuance of D.10-12-035. The Settlement resolves a number of longstanding issues regarding the contractual obligations and procurement options for facilities operating under legacy and new QF contracts. Among other things, it establishes methodologies and formulas for calculating SRAC to be used in the new QF Standard Offer Contract. Furthermore, the Settlement allows for bilaterally negotiated contracts with QFs to determine energy and capacity payments mutually agreeable by relevant parties and subject to CPUC approval. Finally, the Settlement establishes a MW and GHG target for the IOUs. The IOUs

³ Per Term Sheet 4.3.2: Use of an IE shall be required for any negotiations between an IOU and its affiliate and may be used, at the election of either the buyer or the Seller, in other negotiations.

⁴ Report of the Independent Evaluator, Transition Power Purchase Agreement Between Southern California Edison Company and Watson Cogeneration Company (August 2012), p. 12.

must procure 3,000 MW of CHP and 4.8 MMT of greenhouse gas emission reductions in proportion to the load of the IOU and non-IOU Load Serving Entities. The QF/CHP Settlement became effective on November 23, 2011. The Settlement Term Sheet establishes criteria for contracts with Facilities including:

Consistency with Settlement Requirements for Transition PPA Matters

Per Section 3.1 of the Settlement Term Sheet, a CHP Facility currently selling to an IOU under a Legacy PPA or an extension thereof that is expiring during the Transition Period is eligible to sign a Transition PPA with the same IOU-Buyer.

Pursuant to the QF/CHP Settlement, SCE is permitted to enter a Transition power purchase agreement ("Transition PPA") with Watson Cogeneration Company ("Seller") because the Watson facility is currently selling to SCE under an extension of a Legacy PPA.

Per Section 3.1.2 of the Settlement Term Sheet the Transition PPA begins upon expiration of the Legacy PPA or extensions of the Legacy PPA and ends at the election of the Seller but no later than July 1, 2015.

As SCE and Watson are affiliated companies, the Transition PPA is subject to approvals by both the CPUC pursuant to the Affiliate Transaction Rules and FERC as required by Section 205 of the Federal Power Act. The term of the Transition PPA commences upon its approval by both Commissions.

Since the Transition PPA is a transaction between affiliates, the Transition PPA commences upon CPUC and FERC approvals, and ends at the election of the Seller but no later than July 1, 2015.

Per Section 3.1.3 of the Settlement Term Sheet, the capacity and energy that the CHP Facility may sell to the IOU are limited to an amount consistent with the QF's historical deliveries under its Legacy PPA, but energy delivery may be lower upon election of the Seller.

The amount of energy and capacity Watson delivers to SCE are limited to the facility's historical deliveries under the Legacy PPA executed pursuant to D.07-09-040. Firm Contract Capacity for the term of the Transition PPA is less than the Firm Contract Capacity from the Legacy PPA. No As-Available Contract Capacity is offered under the Transition PPA. Energy deliveries are capped such that they must not exceed historical deliveries under the Legacy PPA. SCE set this cap at the maximum annual energy deliveries to SCE during the previous four years, which occurred in 2008 for Watson. Watson's estimate for deliveries for the remainder of the Transition Period is less than this maximum. Historical

and expected deliveries and contract capacities are shown in Table 1 in the Appendix.

Under the Transition PPA, Seller's energy and capacity deliveries to SCE are limited such that they do not exceed historical deliveries under the Legacy PPA.

The Transition PPA is a modification of the QF Standard Offer Contract ("SOC") modified for the Transition Period. The Standard Form Transition PPA was attached to the QF/CHP Settlement Agreement Term Sheet as Exhibit 4. Section 3.4 of the Term Sheet outlines the modifications to the SOC for the Transition PPA.

The Transition PPA contains the terms of the Standard Form PPA with three exceptions. Watson requested changes regarding 1) major overhaul allowance and 2) the threshold for forecast error penalties. SCE requested changes regarding 3) CPUC and FERC regulatory approvals.

First, Section 1.05(b) is modified to allow Watson to use up to a total of 750 hours for Major Overhaul Allowance⁵ at different periods during the term of the PPA. This modifies the Standard Form Transition PPA Section 1.05(b), which allowed Seller to i) request one Major Overhaul Allowance of up to 750 total hours, and ii) schedule no more than one Major Overhaul⁶; provided, however, that the Maintenance Debit Value⁷ for such Major Overhaul may not exceed 750 hours. The modification allows Seller to distribute its 750 allowed Major Overhaul hours to each of its generating units. SCE notes that the Standard Form Transition PPA was developed assuming a single generating unit and allowing for a single major overhaul of a duration less than or equal to 750 hours. Watson requested this change as a result of the Facility's six generation units and its thermal host's continuous requirements for steam.

⁵ Major Overhaul Allowance: "A value indicating a Term-Year maximum allowance with which Seller can request credit for a Major Overhaul." Transition PPA, Exhibit A.

⁶ Major Overhaul: "A time period during which Seller plans to remove the Generating Facility from Operation in order to dismantle the Generating Facility's equipment for inspections, repairs or replacement, with the goal that such equipment will be reassembled and made available for Operation." Transition PPA, Exhibit A.

⁷ Maintenance Debit Value: "A value indicating how much allowance is used when Seller requests credit for a Maintenance Outage or Major Overhaul." Transition PPA, Exhibit A.

SCE modified Section 1.05(b) of the Transition PPA at the request of Seller to allow Seller's Major Overhaul Allowance of up to 750 hours to be divided among multiple generation units to accommodate the unique operational characteristics of the Watson Facility and thermal host.

Second, Exhibit I, Section 3(b) is modified to allow Watson an average Forecast error for all hours of the month of less than or equal to 3% of the average Day-Ahead Forecast without being penalized for a Mean Absolute Error ("MAE") Failure⁸. This modifies a clause within Section 3(b) which deems that an MAE Failure would occur if the average Forecast error for all hours of the month is greater than 3 MW.

This modification prevents the application of a penalty if Watson's actual generation varies from the forecast by more than 3 MW. Watson requested the change as a result of its large generating capacity and asserted that the 3 MW was appropriate for smaller facilities within the IOU portfolios. SCE cites the QF Semi-Annual Reports and asserts that since 90% of QFs under contract with the IOUs are less than 50 MW in size, the permitted 3 MW error provides a forecast error tolerance of approximately 6% of capacity. Assuming a Day-Ahead Forecast of 282 MW (the initial level of Firm Contract Capacity in Section 1.02), 3 MW error represents a 1% error tolerance. In effect the 3 MW limit holds Watson to a forecast error tolerance of six times the stringency as smaller QFs within the IOUs' portfolio. Watson proposed a 3% forecasting error tolerance, which is in line with the 3% tolerance for scheduling and delivery in Exhibit K to the Standard Form Transition PPA. Watson further asserted that allowing this level of tolerance would benefit all parties by reducing administrative burdens from scheduling deviations. SCE concurred with the proposed modification, asserting that to adhere to the pre-approved terms of the Standard Form Transition PPA would disadvantage Watson.

SCE modified Exhibit I, Section 3(b) of the Transition PPA at the request of Seller to allow Seller's average Forecast error to be 3% of the average Day-Ahead Forecast, increasing the tolerance for forecast error to accommodate the large generation capacity of the Watson Facility and to reduce administrative burden.

⁸ In the Standard Form Transition PPA, "MAE Failure" occurs if the mean absolute error (the difference between forecast and actual energy deliveries for all hours in a month, divided by the total forecasted deliveries in a month) is greater than 15% or if the average Forecast error for all hours of the month is greater than 3 MW. Transition PPA, Exhibit I.

Third, Section 1.01, Section 2.01(j), Section 2.02(e), Section 2.04, Section 9.01(b), and Exhibit A are modified to address CPUC and FERC regulatory approvals required because the PPA is transaction between affiliated companies. The modifications clarify precedential conditions and party obligations in acquiring CPUC and FERC approvals.

SCE modified the Transition PPA to condition approval of the agreement between its affiliate Watson upon the requisite CPUC and FERC approvals.

The modifications to the QF/CHP Settlement's Standard Form Transition PPA regarding a major overhaul allowance, the threshold for forecast error penalties, and effectiveness contingent upon CPUC and FERC regulatory approvals are consistent with the QF/CHP Settlement requirements imposed on Transition PPAs. The modifications under the Transition PPA are reasonable given the unique circumstances of the Facility and are not inconsistent with the QF/CHP Program goals.

Consistency with Legacy PPA Matters for All Existing QFs

Section 11.2.1 of the Settlement Term Sheet establishes a procedure to prevent the interruption of power delivery by allowing Legacy PPAs executed pursuant to D.07-09-040 to remain in effect until Seller commences deliveries under a new or amended ("Subsequent PPA") pursuant to D.10-12-035. As detailed in the Summary and Protests sections of this resolution, SCE and Watson entered into negotiations regarding the Transition PPA and disagreed upon the inclusion of terms for Additional Dispatchable Capacity. The Legacy PPA was further extended by the Energy Division Director until June 8, 2012, pending negotiations about terms for ADC. Buyer and Seller executed the Transition PPA on June 5, 2012 without ADC. Both SCE and Watson have reported that arms-length negotiations regarding an amendment to the Transition PPA including ADC are ongoing. Such negotiations are subject to the provisions of "Sale of Additional Dispatchable Capacity beyond the Transition PPA Capacity Product" as set forth in Section 3.4.1.2 of the Term Sheet.

Until an Amendment to the Transition PPA is reached, Seller is obligated to deliver the Firm Contract Capacity defined in Section 1.02 of the Transition PPA. The QF/CHP Settlement Term Sheet Section 3.4.1.2 guides the terms of any amendment to the Transition PPA regarding Additional Dispatchable Capacity.

Consistency with Settlement MW Accounting Methodology

Per Term Sheet Section 5.1.3, the IOUs are directed to enter into PPAs to meet the MW and GHG Emissions Reduction Targets consistent with the CHP Procurement Processes in Section 4. Transition PPAs are not listed as a Procurement Process in Section 4. Therefore it does not count toward SCE's MW Target. This is appropriately reflected in the Advice Letter.

Pursuant to the QF/CHP Settlement, Seller's contract capacity under the Transition PPA does not count toward SCE's MW procurement target because Transition PPAs are not an eligible procurement process.

Consistency with Settlement Greenhouse Gas Accounting Methodology

Per Term Sheet Section 5.1.3, the IOUs are directed to enter into PPAs to meet the MW and GHG Emissions Reduction Targets consistent with the CHP Procurement Processes in Section 4. Transition PPAs are not listed as a Procurement Process in Section 4. Therefore it does not count toward SCE's GHG Target. This is appropriately reflected in the Advice Letter.

Pursuant to the QF/CHP Settlement, any change in Seller's operations under the Transition PPA does not count toward SCE's GHG Emissions Reduction Target because Transition PPAs are not an eligible procurement process.

Consistency with Cost Recovery Requirements

Ordering Paragraph 5 of D.10-12-035 orders the three large electric IOUs to recover the net capacity costs from CHP Program contracts on a non-bypassable basis from all bundled service, Direct Access ("DA") and Community Choice Aggregator ("CCA"), and Departing Load Customers ("DLC"), except for CHP DLC. With this authorization, the Settlement supersedes to the extent necessary D.06-07-029 and D.08-09-012, which, established and modified the Cost Allocation Mechanism, respectively. Section 13.1.2.2 of the Settlement Term Sheet requires that the IOU recover CHP contract costs, net of the value of energy and ancillary services provided to the IOU. Non-IOU load-serving entities ("LSEs") receive ("Resource Adequacy") RA credits in proportion to the allocation of the net capacity costs that they pay.

On January 17, 2012 the Commission made effective SCE AL 2645-E as of November 23, 2011, which authorized SCE to revise its New System Generation Balancing Account to recover the net capacity costs of CHP contracts as it was

directed by D.10-12-035. AL 2645-E determines the net capacity costs as the result of a debit and credit, where:⁹

- Debits include: 1. Capacity and energy costs, including QF/CHP Program contracts that are eligible for net capacity cost recovery
- Credits include: 4. Energy revenues for QF/CHP Program contracts that are eligible for net capacity cost recovery

Section 13.1.2.2 of the Settlement Term Sheet states: “In exchange for paying a share of the net costs of the CHP Program, the LSEs serving DA and CCA customers will receive a pro-rata share of the RA credits procured via the CHP Program.” In addition to standardized Power Product, the terms of the Transition PPA require the sale of Related Products which include “Resource Adequacy Benefits.”

Resource adequacy benefits are to be allocated according to the share of the net capacity costs paid by load-serving entities serving direct access and community choice aggregation customers as prescribed in Section 13.1.2.2 of the QF/CHP Settlement Term Sheet.

Need for procurement

SCE’s total MW procurement goal for the CHP Program is 1,402 MW, with 630 MW allocated to Target A. SCE’s 2020 GHG Emissions Reduction Target is 1.96 MMT. As of the October 8, 2012 CHP Semi-Annual Report, SCE has executed contracts contributing 847 MW and 0.09 MT toward these goals.

The Transition PPA does not count toward the MW or GHG Targets set forth in the Settlement, as it is not an eligible procurement process. Therefore the execution of the Transition PPA with Watson does not affect the need to procure additional CHP resources required to achieve the MW and GHG Targets.

The execution of the Watson Transition PPA does not contribute to SCE’s need to procure additional CHP resources to meet the remaining MW and GHG Targets.

Cost reasonableness

The Settlement defines pricing for the Transition PPAs in Term Sheet Section 3.2. Article One, Section 1.06 of the Transition PPA outlines the Power Product

⁹ SCE Advice Letter 2645-E. <http://www.sce.com/NR/sc3/tm2/pdf/2645-E.pdf>

Prices. Per Term Sheet Section 3.2.1, capacity prices shall be paid as established in D.07-09-040. The Firm Capacity and As-Available Capacity Prices are consistent with the methodology adopted in D.07-09-040.

Table 2. Capacity Prices (\$/kW-year) established by D.07-09-040

Year	Firm Capacity	As-Available Capacity
2012	\$91.97	\$43.09
2013	\$91.97	\$45.00
2014	\$91.97	\$46.97
2015	\$91.97	\$48.98

Per Term Sheet Section 3.2.2, energy pricing will be Short Run Avoided Cost (SRAC) as defined in Section 10 of the Term Sheet, "SRAC Energy Pricing Structure." Exhibit D, Section 2 of the Transition PPA outlines the calculation of the monthly energy payment:

Time-of-Day ("TOD") Period Energy Payment = the sum from the first hour of the applicable TOD Period to the last hour of the applicable TOD Period,

$$\frac{[(\text{TOD Period Energy Price} - \text{Location Adjustment}) * \text{Allowed Payment Energy} + \text{Location Adjustment} * \text{Metered Accounts}]}{\text{Metered Accounts}}$$

The TOD Period Energy Price (EP) and Hourly Location Adjustment Price (LA) refer to Sections of Exhibit S of the Transition PPA, which is an adapted form of Section 10 of the Term Sheet.

The pricing terms of the Transition PPA are determined by Commission-approved capacity pricing per D.07-09-040 and energy pricing per the SRAC Energy Pricing Structure as defined within the Settlement.

Comparison to Existing Power Purchase Agreement

The Legacy PPA between SCE and Watson is based on an amended QF Standard Offer Contract executed in 1984. In 2007 and 2008, SCE and Watson signed letter agreements to set pricing terms for capacity and energy, respectively. Capacity payments were set to \$91.97/kW-year for 340 MW of firm capacity and eliminated bonus payments. Energy payments were set in accordance with the Market Index Formula ("MIF") per D.07-09-040. In 2011, during the proceedings of the QF/CHP Settlement, SCE and Watson signed the Extension of the Legacy PPA and determined that MIF-based energy payments would continue to be in effect until December 31, 2011. Beginning on January 1, 2012, per Section 10.2 of

the Settlement Term Sheet, energy payments would be based on SRAC as calculated within the Settlement.

The Transition PPA sets forth a capacity performance requirement of 60% availability to earn any part of the Firm Capacity Payment and 95% availability in order to earn the full Payment. According to the Independent Evaluator, 95% availability represents an increase from 80% availability under the Legacy PPA. In addition, the Transition PPA has decreased Seller's amount of Firm Capacity available from 340 MW to 282 MW, and decreasing according to the season of delivery (See Table 1 in Appendix). This will decrease Buyer's total capacity payments to Seller, most significantly from June through September due to the high Capacity Payment Allocation Factors during the summer months.¹⁰ As-Available Capacity is not permitted under the PPA.

SCE's estimates that in comparison to historical capacity payments from 2009 to 2011, the execution of the Transition PPA will decrease Firm Contract Capacity Costs to Seller. Adjusting historical payments to 2012 dollars, SCE calculates a decrease of \$14.9 million in total capacity payments for the time period from January 2013 to the end of the Transition Period (See Table 3 in Appendix).

With the execution of the Transition PPA, energy pricing for the facility will continue to be based on monthly SRAC updates that will be calculated per Section 10 of the Term Sheet. SCE assumes that Watson's energy deliveries will occur without triggering the penalty provisions that are included in the Transition PPA. Therefore, SCE's total energy payments to Watson that would have occurred under the continuation of the Legacy PPA are equivalent to those under the Transition PPA.

SCE provided an approximation of the total energy payments to Watson for the time period between January 2013 and the end of the Transition Period.¹¹ This calculation is based on the annual energy production by, and energy payments to

¹⁰ Capacity Payment Allocation Factors are used to allocate the capacity payment according to the Season and TOD Time Periods, as tabulated in Appendix D to the Standard Form Transition PPA.

¹¹ Note that this calculation is meant to be illustrative of the total magnitude of energy payments since payments in 2011 were based on the Market Index Formula and not Short Run Avoided Cost, which became effective for the Legacy PPA on January 1, 2012.

Watson for the historical years 2009 to 2011.¹² Adjusting this information to 2012 dollars, SCE calculated the average of monthly energy prices (\$/kWh) paid for historical deliveries. SCE then scaled the average of historical monthly deliveries (kWh) to account for the amount of deliveries expected during the Transition PPA. The products of these monthly energy payments (\$) are inflated by 2.0% annually. For the 30 months between January 2013 and June 2015, SCE approximates the total energy payments to be \$258 million (see Table 3 in the Appendix).

Under the Transition PPA Seller is required to perform at a higher level of availability. In addition, Watson will provide less Firm Capacity to SCE, which will decrease total payments that would have otherwise occurred under the Legacy PPA by at least \$14.9 million between January 2013 and the end of the Transition Period.

Project Viability

Watson owns an existing qualifying facility and has operated under a power purchase agreement with SCE since 1984. As an existing QF, the project faces minimal project development risk. The Transition PPA is effective upon the Commission's approval of the Transition PPA and approval of the Affiliate Transaction as required by the Federal Energy Regulatory Commission.

Watson is an existing CHP facility and therefore is a viable project.

Consistency with the Emissions Performance Standard

California Public Utilities Code Sections 8340 and 8341 require that the Commission consider emissions costs associated with new long-term (five years or greater) power contracts procured on behalf of California ratepayers. D.07-01-039 adopted an interim Emissions Performance Standard ("EPS") that establishes an emission rate for obligated facilities to levels no greater than the greenhouse gas emissions of a combined-cycle gas turbine power plant.

Pursuant to Sections 4.10.4.1 of the CHP Program Settlement Term Sheet, PPAs greater than five years that are submitted to the CPUC in a Tier 2 or Tier 3 advice letter must be compliant with the EPS.

¹² Energy Resource Recovery Account Reasonableness Filings, Production by and Payment to Affiliate PURPA Projects, Watson, filed April 1, 2010, April 1, 2011, and April 1, 2012.

The EPS applies to all energy contracts that are at least five years in duration for baseload generation, which is defined as a power plant that is designed and intended to provide electricity at an annualized plant capacity factor greater than 60 percent.

The term of the Watson Transition PPA begins upon CPUC and FERC approvals and ends no later than July 1, 2015. The term of the PPA is less than five years and therefore the EPS does not apply to this procurement.

The Transition PPA is not subject to the EPS under D.07-01-039 as the term of the PPA is less than five years.

Consistent with D.02-08-071, SCE's Procurement Review Group ("PRG") was notified of the Transition PPA.

SCE's PRG consists of representatives from: the Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN), California Department of Water Resources-California Energy Resources Scheduling (CDWR/CERS), Coalition of California Utility Employees (CUE), the Independent Evaluator, and the Commission's Energy and Legal Divisions.

Negotiations on the Transition PPA between Seller and SCE began in January 2012 and were completed in June 2012. SCE noticed the Transition PPA to its PRG on July 26, 2012.

SCE has complied with the Commission's rules for involving the PRG.

Independent Evaluator Review

SCE retained Barry Sheingold of Merrimack Energy Group, Inc. as the Independent Evaluator (IE)¹³ for the negotiations of the Transition PPA with Watson, pursuant to Section 4.3.2 of the Settlement Term Sheet. Previously in D.06-12-029, the Commission prohibited resource procurement from an affiliate without prior approval from the Commission.¹⁴ Pursuant to this Decision, SCE's

¹³ Pursuant to Settlement Term Sheet Sections 4.2.5.7-8, SCE retained Merrimack as the IE for the CHP RFO to ensure consistency of Settlement implementation.

¹⁴ D.06-12-029 at Appendix A-3, p. 5, Rule III.B.1
<http://docs.cpuc.ca.gov/published//Graphics/63089.PDF>

Compliance Plan required the use of an IE for the solicitation of new or repowered generation sources where an affiliate participates.¹⁵

FERC is required to approve affiliate contracts pursuant to Section 205 of the Federal Power Act.¹⁶ The IE cites that in 1991, FERC required that a sale of wholesale electric power for resale at market based rates between a seller and an affiliated regulated entity must demonstrate that the rates and other terms and conditions of the power sales contract are not unduly preferential to the affiliate. In later cases, FERC enunciated four guidelines in evaluating whether an affiliate has received undue preference during a competitive procurement solicitation: a) Transparency of the solicitation process; b) Precise definition of products sought through the solicitation; c) Standard and equal application evaluation criteria; d) Independent oversight by third party.

The IE identifies that the underlying concern of the CPUC and FERC rules regarding affiliate transactions is to “ensure that affiliates are treated in a non-preferential manner so that prices ultimately paid by captive retail customers are not unduly high as a consequence.” To this end, the IE monitored the transaction to ensure that SCE did not treat Watson in a preferential manner, to oversee that Watson was treated fairly, and to ensure SCE acted reasonably in accordance with the Settlement. The IE’s activities are summarized in a public report attached to AL 2763-E. The IE reports that:

- i) Watson is contracted under a Legacy PPA that grants eligibility for the Transition PPA and Watson is entitled to the provision of project specific information into the Transition PPA.
- ii) Watson requested modifications of the Standard Form Transition PPA because the standard terms were inconsistent with and inappropriate for the characteristics of the Facility. First, the Major Overhaul term was inconsistent with its thermal host’s operational requirements and the Facility’s six generating units. Second, the Forecasting Penalty term was inappropriate given the generating capacity of the Facility. Despite initially not accepting any of Watson’s proposed changes SCE accepted these two

¹⁵ 2011 Affiliate Transaction Rules Compliance Plan. SCE AL 2600-E, (June 30, 2011), p. 16, Rule III.B.1, <http://www.sce.com/NR/sc3/tm2/pdf/2600-E.pdf>.

¹⁶ Report of the Independent Evaluator Transition Power Purchase Agreement between Southern California Edison and Watson Cogeneration Company (August 2012), p. 3.

terms. SCE stated that its policy with respect to Transition PPAs “is that it would only make changes for which there are strong justifications due to unique project circumstances.”¹⁷ Additionally, SCE indicated that it would “not entertain renegotiating general contractual matters, especially those that would affect the overall allocation of risks.”¹⁸

- iii) SCE modified the Transition PPA to condition approval on CPUC and FERC approvals since the Transition PPA is a transaction between affiliated companies.
- iv) SCE’s internal Risk Management Committee reviewed and refined the modified provisions of the Transition PPA to protect SCE’s interests. In addition, SCE’s affiliate compliance officer ensured that the PPA was consistent with its Affiliate Transaction Rules Compliance Plan.

The IE also notes that SCE would only accept modifications to the Standard Form Transition PPA where modifications were 1) were requested by the counterparty; 2) were requested due to project-specific circumstances and were reasonable under the circumstances; and 3) did not constitute modification of general contractual provisions which had been the subject of the intensive negotiations among the CHP Settling Parties.¹⁹ The Independent Evaluator concludes that SCE treated Watson in a non-preferential manner, and that the results of the negotiations were reasonable and not unduly preferential for Watson.²⁰ The IE therefore recommends Commission approval of the Transition PPA. This recommendation is consistent with the analysis above that outlines how the transactions and Transition PPA are consistent with the QF/CHP Settlement.

The Independent Evaluator concludes that SCE’s negotiations with Watson were compliant with the CPUC’s Affiliate Transaction Rules and finds that the Transition PPA merits Commission approval.

¹⁷ Ibid, p.18.

¹⁸ Ibid, p.19.

¹⁹ Ibid.

²⁰ Ibid, p. 3.

SCE modified the Standard Form Transition PPA to accommodate the Facility's unique operational characteristics and in recognition of Seller's affiliate status. The resulting Transition PPA is consistent with the requirements of the QF/CHP Settlement and the CPUC's Affiliate Transaction Rules.

COMMENTS

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from today.

FINDINGS AND CONCLUSIONS

1. Southern California Edison Company filed Advice Letter ("AL") 2763-E on August 3, 2012, in which is requested Commission approval of a Transition power purchase agreement ("Transition PPA") with the Watson Cogeneration Company that has been modified from the Standard Form Transition PPA approved by the Commission in Decision ("D.") 10-12-035. AL 2763-E received a response in support of the advice letter from Watson Cogeneration Company on August 23, 2012 clarifying that they continue arms-length negotiations regarding Additional Dispatchable Capacity with SCE.
2. Pursuant to the Qualifying Facility and Combined Heat and Power Program Settlement ("QF/CHP Settlement"), which was adopted by the Commission in D.10-12-035, SCE is permitted to enter into a Transition PPA with Watson Cogeneration Company ("Seller") because the Watson facility is currently selling to SCE under an extension of a Legacy PPA.
3. Since the Transition PPA is a transaction between affiliates, the Transition PPA commences upon CPUC and FERC approvals, and ends at the election of the Seller but no later than July 1, 2015.
4. Under the Transition PPA, Seller's energy and capacity deliveries to SCE are limited such that they do not exceed historical deliveries under the Legacy PPA.
5. SCE modified Section 1.05(b) of the Standard Form Transition PPA at the request of Seller to allow Seller's Major Overhaul Allowance of up to 750 hours to be divided among multiple generation units to accommodate the unique operational characteristics of the Watson Facility and thermal host.

6. SCE modified Exhibit I, Section 3(b) of the Standard Form Transition PPA at the Request of Seller to allow Seller's average Forecast error to be 3% of the average Day-Ahead Forecast, increasing the tolerance for forecast error to accommodate the large generation capacity of the Watson Facility and to reduce administrative burden.
7. SCE modified the Transition PPA to condition approval of the agreement between its affiliate Watson upon the requisite CPUC and FERC approvals.
8. The modifications to the QF/CHP Settlement's Standard Form Transition PPA regarding a major overhaul allowance, the threshold for forecast error penalties, and effectiveness contingent upon CPUC and FERC regulatory approvals are consistent with the QF/CHP Settlement requirements imposed on Transition PPAs. The modifications under the Transition PPA are reasonable given the unique circumstances of the Facility and are not inconsistent with the QF/CHP Program goals.
9. Until an Amendment to the Transition PPA is reached Seller is obligated to deliver the Firm Contract Capacity defined in Section 1.02. The QF/CHP Settlement Term Sheet Section 3.4.1.2 guides the terms of any amendment to the Transition PPA regarding Additional Dispatchable Capacity.
10. Pursuant to the QF/CHP Settlement, Seller's contract capacity under the Transition PPA does not count toward SCE's MW procurement target because Transition PPAs are not an eligible procurement process.
11. Pursuant to the QF/CHP Settlement, any change in Seller's operations under the Transition PPA does not count toward SCE's GHG Emissions Reduction Target because Transition PPAs are not an eligible procurement process.
12. Resource adequacy benefits are to be allocated according to the share of the net capacity costs paid by load-serving entities serving direct access and community choice aggregation customers as prescribed in Section 13.1.2.2 of the QF/CHP Settlement Term Sheet.
13. The execution of the Watson Transition PPA does not contribute to SCE's need to procure additional CHP resources to meet the remaining MW and GHG Targets.
14. The pricing terms of the Transition PPA are determined by Commission-approved capacity pricing per D.07-09-040 and energy pricing per the SRAC Energy Pricing Structure as defined within the Settlement.

15. Under the Transition PPA Seller is required to perform at a higher level of availability. In addition, Watson will provide less Firm Capacity to SCE, which will decrease total payments that would have otherwise occurred under the Legacy PPA by at least \$14.9 million between January 2013 and the end of the Transition Period.
16. Watson is an existing CHP facility and therefore is a viable project.
17. The Transition PPA is not subject to the EPS under D.07-01-039 as the term of the PPA is less than five years.
18. SCE has complied with the Commission's rules for involving the PRG.
19. The Independent Evaluator concludes that SCE's negotiations with Watson were compliant with the CPUC's Affiliate Transaction Rules and finds that the Transition PPA merits Commission approval.
20. SCE modified the Standard Form Transition PPA to accommodate the Facility's unique operational characteristics and in recognition of Seller's affiliate status. The resulting Transition PPA is consistent with the requirements of the QF/CHP Settlement and the CPUC's Affiliate Transaction Rules.

THEREFORE IT IS ORDERED THAT:

1. The request of the Southern California Edison (SCE) in Advice Letter 2763-E for Commission approval of the Transition PPA with Watson Cogeneration Company, an affiliate, in its entirety, including modifications to the Standard Form Transition PPA, is approved.
2. SCE is authorized to recover the costs associated with the Transition PPA through the cost recovery mechanisms set forth in D.10-12-035 (as modified by D.11-07-010), Section 13.1.2.2 of the QF/CHP Settlement, and SCE's Advice Letter 2645-E.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on December 20, 2012; the following Commissioners voting favorably thereon:

Paul Clanon
Executive Director

APPENDIX

DRAFT

Table 1: Summary of Capacity and Energy Terms of PPAs between SCE and Watson

PPA Name	Effective Date	Firm Contract Capacity (MW)		As-Available Contract Capacity (MW)	Annual Energy Deliveries (MWh)	
		Non-Summer (October-May)	Summer (June-September)		Actual or [Expected]	Cap
Fifth Amendment to PPA (8/25/1999)	1/2000					2,451,000 * 1.02^year
Extension PPA or "Legacy PPA"	6/17/2008	340	340		2,350,767.600	
Transition PPA	CPUC & FERC Approvals to 12/31/2013	282	277	0	[2,262,100]	2,350,767.600
	1/1/2014 to 7/1/2015	279	274	0		
	CPUC & FERC Approvals to 7/1/2015	≤ 340	≤ 340	≤ 0		

Table 3: Capacity and Energy Payments Estimated between January 2013 and July 1, 2015 (2012 Real \$)

Payment Type	Extension PPA or "Legacy PPA"	Transition PPA	Delta (Transition - Legacy)
Firm Capacity	\$75,546,505	\$60,629,325	-\$14,917,179
Energy	\$258,677,057	\$258,677,057	0
TOTAL	\$344,223,562	\$319,306,383	-\$14,917,179

