BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into Combined Heat and Power Pursuant to Assembly Bill 1613	Rulemaking 08-06-024 (Filed June 26, 2008)

COMMENTS OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) AND SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) ON THE JULY 31 ENERGY DIVISION STAFF PROPOSAL

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I. INTRODUCTION

Pursuant to Administrative Law Judge ("ALJ") Yip-Kikugawa's *Ruling Incorporating Energy Division Final Staff Proposal Into The Record And Providing For Comments Thereon* ("Ruling") issued August 4, 2009, San Diego Gas and Electric ("SDG&E") and Southern California Gas Company ("SoCalGas") herein provide comments on the Energy Division Final Staff Proposal ("Staff Proposal").

II. QUESTIONS FOR FURTHER COMMENT

A. Pricing

1. Discuss Pricing Option 1 – Proxy Market Price Based on the Costs of a New Combined Cycle Gas Turbine (CCGT).

a. Ratepayer Indifference Requirement of Public Utilities Code § 2841(b)(4)

Public Utilities (PU) Code § 2841(b)(4) states that ratepayers not utilizing Combined Heat and Power ("CHP") systems should be "held indifferent to the existence of this tariff," a ratepayer indifference requirement similar to Federal Energy Regulatory Commission ("FERC") ratepayer indifference standard under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). The California Public Utilities Commission ("CPUC" or "Commission") should consider only options to implement pricing under the AB 1613 program that are compatible with "utility avoided cost." The first Energy Division Staff ("Staff") pricing option appears to establish a clear standard for the avoided cost of the CHP facility in a CCGT. Small CHP facilities will have a baseload or mid-merit grid export profile, so that its export profile is closest to that of a CCGT. However, the characteristics of small CHP (less than 20 MW) do not match precisely those of a CCGT in that a CCGT is able to provide firm capacity and ancillary services. SDG&E and SoCalGas' key reservation with regard to whether Staff's Option 1 meets the test of ratepayer indifference is whether paying a firm price for as-available capacity is consistent with ratepayer indifference. In D.07-09-040, the Commission found that as-available capacity was worth less than 40 percent of firm capacity.

In addition, there are other measures of the costs of a CCGT such as the California Energy Commission ("CEC") report on Comparative Costs of California Central Station Electricity Generation Technologies that is currently used by the California Independent System Operator ("CAISO") as the cost of a CCGT.[1] SDG&E and SoCalGas do not object to the Staff's proposed CCGT cost based on data developed, but would note the wide disparity between the costs used in the Staff Proposal ($191/kW-yr) and the costs used by the CAISO ($133/kW-yr).

b. Advantages and Disadvantages

The advantages of this approach include the following:

- Seems to satisfy the ratepayer indifference criteria if the as-available versus firm capacity differences are corrected. See above.
- Is consistent with the Buyer taking responsibility for the Greenhouse Gas ("GHG") costs that is Energy Division's preference. With a fixed heat rate, the energy payment is based on variable operating costs of a CCGT without the GHG costs included (unlike an energy payment based on market prices).

[1] CAISO, *Market Issues & Performance*, 2008 Annual Report, 2.31.

- To the extent the CHP facility is more efficient than a CCGT, the GHG savings benefits will flow to the CHP facility, providing incentive for more efficient CHP units to be installed.

- The use of the TOU factors encourages on-peak delivery of electricity to the grid by the CHP facility.

- The use of a monthly gas price is consistent with what the operator of the CHP facility will pay, so there is no serious mismatch of payments with costs as in Option 2.

The disadvantages of this approach include the following:

- A CHP facility does not exactly match a CCGT in that a CCGT can provide firm capacity, while CHP only provides as-available capacity.

- A CHP facility does not exactly match a CCGT in that a CCGT can provide ancillary services.

SDG&E and SoCalGas can see no major disadvantages to this approach if the input values are measured correctly. In addition, if fixed price contracts are offered, the fuel cost portion of the contract should be based on natural gas futures prices at the time of the execution of the contract to ensure non-participating ratepayer indifference.

2. Discuss Pricing Option 2 – Applicable Retail Commodity Tariff Rate

c. Ratepayer Indifference Requirement of Public Utilities Code § 2841(b)(4)

PU Code § 2841(b)(4) states that ratepayers not utilizing CHP systems should be "held indifferent to the existence of this tariff." The proposed applicable retail commodity tariff pricing would assure indifference to the participating ratepayer, but not to non-participating ratepayers. If the average price is less than the marginal price the utility pays for power, non-participating ratepayers are better off. Conversely, if the average price is greater than the marginal price, non-participating ratepayers are worse off. This option could be consistent with ratepayer indifference by coincidence, but it is more likely than not to violate non-participating customer indifference.

d. Advantages and Disadvantages

The advantages to this approach:

- Would be simple and understandable by the customer installing the CHP facility
- Would have less volatility in electric price since the applicable retail commodity tariff generally changes only once per year
- The use of the TOU factors encourages on-peak delivery of electricity to the grid by the CHP facility

The disadvantages of this approach include the following:

- Does not satisfy the ratepayer indifference criteria. See above.
- Would be inconsistent with the Buyer taking responsibility for the GHG costs in that any utility-paid GHG costs for other generation would be contained in the applicable retail commodity tariff.
- A stable electric price could create a serious mismatch of payments with costs since gas prices change monthly. In some months, the CHP facility may receive windfalls if natural gas prices are low and in other months the CHP facility may be squeezed if high gas prices occur.
- The applicable retail commodity tariff is adjusted for deviations of actual electric prices compared to electricity price forecasts for the prior year. Balancing accounts that result may skew electricity prices in any one year. Windfalls may occur in some years and significant price squeezes may occur in other years.
- For SDG&E, the cost allocation used in developing the applicable retail commodity tariff was set by settlement among parties. The proposed use of applicable retail commodity tariff is a new application that the settlement parties did not contemplate.

SDG&E and SoCalGas see major problems in using the applicable retail commodity tariff. The lack of match with costs could create severe operational problems for the CHP facility and/or could lead to less electricity grid reliability if the CHP units are operating in windfall periods and shutting down in shortfall periods.

3. 10 Percent Location Bonus – Appropriateness and Determination

The "generation location bonus" of 10 percent in the Staff Proposal is arbitrary. There is no one-to-one relationship between congestion and the cost of operating a CCGT, nor between local reliability and the variable costs of a CCGT. For SDG&E, CHP in its service area is more valuable than CHP located elsewhere in the CAISO-controlled grid given its need for local resources. SDG&E would be much more amenable to accepting as-available small CHP power at a firm capacity price if, in addition, the value of being located in its service area was included in the package.

SDG&E and SoCalGas would recommend that the pricing in the Staff's Proposed Pricing – Option 1 be assumed to include the locational bonus to get closer to the ratepayer indifference standard. In addition, there should be a discount off the Staff's Proposed Pricing, Option 1, for small, as-available power not providing locational value.

Locational value should be provided only for small CHP located in areas with local resource adequacy requirements when contracting with the local utility.

B. Contract Terms and Conditions

In general, SDG&E and SoCalGas agree with the Staff Proposal's contract terms and conditions. SDG&E and SoCalGas are not aware of any important terms and conditions that parties disagree upon that were not addressed in the Staff Proposal.

However, SDG&E and SoCalGas disagree with Staff's recommendations on Qualifying Facility Status, Credit and Collateral, and Green Attributes and provide comments below.

1. Qualifying Facility Status

Staff recommends that all references and terms related to Qualifying Facilities in this contract be deleted in their entirety. As pointed out in previous comments, the IOUs maintain that the Federal Power Act ("FPA") grants exclusive jurisdiction to FERC to regulate wholesale sales of electricity of electricity in interstate commerce. One exception to the FPA's exclusive grant of authority to FERC over wholesale rates is the state's authority to adopt a program and pricing pursuant to its authority under PURPA. Therefore, although the CPUC may not issue an order establishing wholesale rates for power purchased from entities not subject to PURPA, the CPUC does have authority, under PURPA, to set prices for Qualifying Facilities at the utility's avoided cost, which does not vary for different types of Qualifying Facilities. SDG&E and SoCalGas believe that, if the CPUC determines the price set in the standard contract, the Generating Facility must be a Qualifying Facility.

2. Credit and Collateral

SDG&E and SoCalGas disagree with Staff's recommendation to reduce the amounts for Performance Assurance and Development Security. The recent credit crisis that engulfed the banking industry is a strong reminder of the importance to have strong credit risk management. It is prudent and necessary to have sufficient collateral to protect both ratepayers and IOUs against CHP parties defaulting. Therefore, the amounts for Performance Assurance and Development Security should reflect the creditworthiness of the CHP parties as well as the credit risk associated with entering into long term contracts with CHP parties. The reduced security amount recommended by in the Staff Proposal provides only a fraction of the minimum required collateral and will be insufficient to mitigate credit risk. In the event of CHP parties defaulting, collateral amount should cover legal fees and potentially higher energy replacement costs, to hold ratepayers and IOUs indifferent to energy generated by CHP or conventional generation. For reasons mentioned above, SDG&E and SoCalGas recommend adopting the existing credit and collateral requirements as stated in Exhibit D of the Standard Form Contract in the May 15, 2009 Working Group Report.

3. Green Attributes

a. Relationship to Pricing

Staff recommends a term in this contract that establishes that all actual costs associated with GHG compliance incurred by the Seller be paid by Buyer. SDG&E and SoCalGas support the Buyer paying for the costs but should only be required to pay for them once. If the compliance costs are already included in the price paid to the Seller as is the case for Staff's Pricing Option 2, then the Buyer should not be required to reimburse Seller for actual costs associated with GHG compliance.

b. Section 3.02

Staff's suggested language relating to green attributes (Section 3.02) does not adequately address GHG attributes and compliance costs. Section 3.02 should be modified to require payment for only that portion of electricity generated that is actually exported to the grid. The following assumes that the Commission will pursue Staff's Pricing Proposal – Option 1, where the electricity exported to the grid is assumed to have a 6,924 Btu/kilowatt-hour ("kWh") heat rate. Option 1 would only pay once for GHG costs at a level comparable to a CCGT. Total GHG costs of the Seller would be split between the Buyer and Seller based on the assumed heat rate. That is, the Buyer would only be responsible for the GHG associated with the megawatt-hours ("MWhs") exported to the grid at a 6,924 Btu/kWh heat rate as a percent of total GHG. If 20 percent of the facility GHG is associated with electricity exports, the GHG taxes, charges or fees would be split in the same proportion. This approach provides incentive for efficiency in that the Buyer will pay a larger percentage of the GHG costs the more efficient the CHP facility.

The following are additional provisions should be included in the contracts to address the California Air Resources Board's potential GHG regulatory structure assuming that the Commission pursues Staff's Pricing Proposal – Option 1.

- **Allocation of allowances or auction revenue rights to Seller.**

  If Seller has the right to obtain allowances or credits or receives auction revenue rights attributed to the Generating Unit to offset the GHG Charges for the Generating Unit, then Seller shall utilize such allowances or credits to mitigate any GHG Charge before any allocation of GHG costs to parties.

- **Greenhouse Gas Cap and Trade Mechanism**

  If a Greenhouse Gas "cap and trade mechanism" is adopted to control the emissions of GHG, where a Governmental Authority establishes a cap on the amount of GHG that can be emitted and market participants, including generators, are required to purchase emission allowances or credits representing the right to emit GHG in an aggregate amount equal to the cap, then the Buyer shall be responsible for acquiring the emission allowances or credits attributable to the Buyer's share of Seller's GHG emissions and delivering the allowances or credits to the Buyer.

C. Total Program Capacity Size

a. The Energy Division Staff propose a 500 MW statewide limit on export capacity allocated proportionally between utilities based on 2008 peak demand.

SDG&E and SoCalGas fully support CHP that has the characteristics described in AB1613 – efficient and sized to fit the on-site thermal load. A cap, however, is a prudent idea given the substantial variation in the amount of electricity sold to the utility depending on the on-site electricity needs of the utility customer installing the CHP unit. In an open-ended program, without kWh limits, a smaller utility like SDG&E might be forced to take power that is not needed in off-peak periods when renewables like wind and geothermal have substantial deliveries. These problems can exist in aggregate or can exist on segments of the distribution system depending on the status of other distributed generation in the same area. SDG&E and SoCalGas agree with the Energy Division Staff on its proposed cap size for the near term.

b. Venue for Revisiting Capacity Goal

The Energy Division Staff's cap size should be reviewed in the Commission's CHP OIR in the context of an overall CHP program for addressing reductions in Greenhouse Gases that looks at the market potential for small export CHP. The cap can then be adjusted over time in the Long-term Procurement Plan ("LTPP") proceeding as the impacts of the RPS and direct access on resource planning become clearer and as experience is gained with sales patterns of new small CHP projects developed as a result of AB 1613 tariffs.

III.
CONCLUSION

SDG&E and SoCalGas appreciate the opportunity to comment of the Staff Proposal and look forward to working with the Staff and other parties to implement AB 1613 for CHP systems under 20 MW.

Respectfully submitted,

/s/ Steven D. Patrick

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August 24, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing **COMMENTS OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) AND SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) ON THE JULY 31 ENERGY DIVISION STAFF PROPOSAL** on all known interested parties of record in **R.08-06-024** via email to those whose email address is listed in the official service list and via first-class mail to those whose email address is not available.

Copies were also sent via Federal Express to Commissioner Michael Peevey and Administrative Law Judge Yip-Kikugawa.

Dated at Los Angeles, California, this 24th day of August, 2009.

/s/ Marivel Munoz
Marivel Munoz

CALIFORNIA PUBLIC UTILITIES COMMISSION
Service Lists Proceeding: R0806024 - Last changed: August 10, 2009

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