

Decision 11-01-010 January 13, 2011

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)

DECISION REGARDING PAY AS YOU SAVE PILOT

1. Summary

This decision assesses whether the Commission should establish a "Pay as You Save" (PAYS)¹ Pilot Program as part of its efforts to promote Combined Heat and Power plants in California. The Commission determines that due to lack of interest and other complexities with implementing such a financing program, it will not establish a PAYS pilot at this time, in this proceeding. Furthermore, other actions the Commission has taken to provide financing assistance to combined heat and power facilities reduce the need for a PAYS pilot. Should interest increase for a PAYS pilot or new facts arise regarding implementation of such a program, parties may file a petition to modify this decision and request the Commission reexamine the issue.

2. Background

The Commission opened this rulemaking in June 2008 to implement the provisions of Assembly Bill (AB) 1613. (Stats. 2007, ch. 713.) AB 1613 established

¹ It has come to our attention that Pay As You Save and the acronym PAYS are trademarked by the U.S. Patent and Trademark Office.

the Waste Heat and Carbon Emissions Reduction Act which relates to the utilization of excess waste heat through combined heat and power (CHP) technologies.² The legislation expresses the intent to support and facilitate both consumer and utility-owned CHP systems and imposes certain requirements on the Commission, the California Energy Commission (CEC), the State Air Resources Board and electrical corporations.

Among other things, AB 1613 directs the Commission to establish a PAYS pilot program for each electrical corporation to finance all the upfront costs for the purchase and installation of CHP systems by eligible customers. (Pub. Util. Code § 2842.4.)³ An “eligible customer” for purposes of § 2842.4 is defined as either a nonprofit organization exempt from taxation pursuant to Section 501 of the Internal Revenue Code (26 U.S.C., § 501(a)) or a federal, state or local government facility.⁴

In the scoping memo of November 4, 2008, the Commission set forth four main issues to be addressed in this rulemaking. The first three issues, pertaining to the policies and procedures for purchase of electricity from eligible CHP systems, were addressed in Decision (D.) 09-12-042. On May 11, 2010, the Administrative Law Judge (ALJ) issued a ruling requesting parties to provide comments on the fourth issue, namely policies and procedures for a PAYS pilot

² CHP (sometimes referred to as cogeneration) is the production of two kinds of energy – electricity and heat – from a single source of fuel.

³ Unless otherwise specified, all statutory references are to the Public Utilities Code.

⁴ Section 2842.4 was amended by AB 2791 (Stats. 2008, ch. 253) to include a federal, state or local government facility within the definition of “eligible customer” for purposes of the pay-as-you-save pilot program.

program. Comments in response to the May 2010 ruling were filed by Mountain Utilities, Pacific Gas and Electric Company (PG&E), PacifiCorp, Sierra Pacific Power Company, Southern California Edison Company (SCE), and jointly by San Diego Gas & Electric Company and Southern California Gas Company (SDG&E/SoCalGas). Reply comments were filed by SCE.

3. PAYS Pilot

In enacting AB 1613, the Legislature stated its intent to increase the efficiency of the state's use of natural gas by capturing unused waste heat and to support and facilitate both customer and utility-owned CHP systems. According to the statute, a PAYS pilot program should enable an eligible customer, namely a qualifying non-profit organization or government facility, to finance all of the upfront costs of a CHP system by repaying those costs over time through on-bill financing at the difference between what an eligible customer would have paid for electricity without a CHP system and the lower electricity bill that results from having CHP for a period of up to 10 years. (Section 2842.4(c).) The statute also mandates that "all costs of the [PAYS] program or financing mechanisms shall be borne solely by the combined heat and power generators that use the program or financing mechanism, and the Commission shall ensure that the costs of the program are not shifted to the other customers or classes of customer of the electric corporation." (Section 2842.4(e).)

In the original scoping memo in this proceeding, the Commission stated its intent to hold a workshop to address the following:

- (1) Will the pay-as-you-save pilot program mean that the electrical corporations are functioning as lending institutions? If so, would the program be subject to state and federal lending laws?

- (2) Can the on-bill financing program for energy efficiency programs serve as a model for the pay-as-you-save pilot program?
- (3) Should electrical corporations that are unable to finance CHP projects be required to participate in the pilot program?

In a May 11, 2010 ruling, the Commission sought to refresh the record on the topic of a PAYS pilot. Parties were asked to comment on the questions specified in the scoping memo as well as current interest in development and implementation of a PAYS pilot, the potential pool of eligible customers for such a pilot, what other financing options might exist for eligible customers purchasing CHP facilities, and whether a workshop is necessary to consider issues surrounding a PAYS pilot.

Six parties responded to the ruling, all utilities. There were no comments from non-profit entities or potential government customers on the ruling. The utilities generally responded that they are not aware of any current interest in a PAYS pilot. PG&E notes that as a preliminary matter, market research should be conducted to identify potential customer interest in a PAYS pilot. PG&E also explains that if the Commission's Self-Generation Incentive Program (SGIP) is modified to provide incentives to CHP projects, SGIP could be a source of financing for projects up to 5 megawatts (MW). SCE questions whether a PAYS pilot would provide any significant advantages over the financing options that currently exist in the credit market.

The responding utilities with fewer customers in California, namely Mountain Utilities, PacifiCorp and Sierra Pacific, unanimously urge that any program not apply in their service territories. Mountain Utilities states it is not aware of any potential for CHP in the Kirkwood community that it serves, and it contends it has extremely limited resources to finance CHP projects. PacifiCorp

states that only one CHP system currently exists in its territory, and the pool of potential eligible customers is extremely limited. Sierra Pacific opposes the adoption of a PAYS pilot in its territory, noting that it is unlikely any CHP systems will ever be developed in its unique service territory in the Lake Tahoe area.

With regard to the question of whether state and federal lending laws would apply to the utilities administering a PAYS pilot, both SCE and SDG&E/SoCalGas contend that if the utility uses ratepayer funds to finance CHP systems, it would most likely be considered a lending institution. According to both SCE and SDG&E/SoCalGas, this question previously arose during implementation of on-bill financing for energy efficiency programs in D.05-09-043. They report that in that proceeding, the California Department of Corporations (DOC) issued Release No. 60-FS which found the utilities would not be considered to be engaged in the business of financial lender or broker under certain narrow circumstances. To remain exempt from lending regulations, the DOC laid out specific requirements for lenders, the borrowers and the loans themselves. One of those requirements is that the loans have to impose no costs on the borrowers, i.e., they are provided free of interest, fees, late payment penalties and other charges. As SCE points out, the PAYS program described in AB 1613 precludes this no cost scenario because “all costs of the [PAYS] program or financing mechanisms shall be borne solely by the combined heat and power generators that use the program...” (2842.4(e).) SCE suggests that application of lending laws to the utility programs might be avoided if a third party finances the purchase and installation of a CHP system and the utility merely facilitates on-bill repayment of third party loans.

The utilities also responded to the question of whether on-bill financing for energy efficiency programs can serve as a model for a PAYS pilot.

SDG&E/SoCalGas contend that the energy efficiency on-bill financing program could serve as a model for a PAYS pilot, however several key issues would need to be addressed including on-going administrative costs, creditworthiness standards, and treatment of loan defaults. Both PG&E and SCE allege that energy efficiency on-bill financing is not an appropriate model for a PAYS pilot. According to SCE, the financing costs for CHP facilities are \$1.2 to \$1.5 million per MW, and a CHP facility could need financing up to \$30 million. This dwarfs the financing provided through energy efficiency on-bill financing efforts which have a maximum financing cap of \$250,000. In addition, CHP systems can take up to two years to construct, creating a significant lag time between when the money is loaned to a customer and when the project operations begin, creating the energy savings that are used for loan repayment. This exposes the utilities and ratepayers to project finance risks, and raises the costs of the program, which cannot be absorbed by non-participating customers according to AB 1613. PG&E points out that a PAYS pilot would have no up-front funding source, whereas energy efficiency financing is paid out of energy efficiency funds collected from ratepayers. Similar to SCE's concerns, PG&E notes that non-participating customers and the utilities would be at risk for the principal lent to the nonprofit customers to finance their CHP systems.

Based on the comments provided, we conclude that at this time, in this proceeding, we will not pursue development of a PAYS pilot for several reasons. First, it is unclear if there is customer interest for a PAYS financing program at present or if a PAYS pilot would provide more favorable financing than what potential customers could find in the market or through other incentive

programs.⁵ No eligible customers or their representatives responded to the ruling where we attempted to ascertain current interest. Moreover, we find that Mountain Utilities, PacifiCorp and Sierra Pacific provide valid reasons that a PAYS pilot is not feasible or suited to the unique circumstances of their service territories.

Second, it appears a PAYS pilot may not fall within DOC lending law exemptions for utility programs. Information provided by SCE and SDG&E/SoCalGas suggests that because a PAYS pilot could involve financing for projects far greater than the \$250,000 cap for energy efficiency financing and would require participating customers to bear all costs for the pilot, it would not fall within the requirements set forth by DOC that allow lending law exemptions for utility on-bill financing. This is an area that will require greater review and analysis before the Commission could establish a PAYS pilot. Since demand for on-bill financing for CHP systems is unclear, we will not explore this question at this time. Should parties desire the Commission to reconsider a PAYS pilot in the future, they should address the DOC criteria for lending law exemptions set forth in Release No. 60-FS and provide analysis of how a PAYS pilot might work within that framework.

Third, we agree with the utilities that in order to establish a PAYS pilot, there are several issues areas that require further consideration. Specifically, PG&E, SDG&E/SoCalGas, and SCE maintain that more information is needed on applicability of federal and state lending laws, the appropriate interest rate for

⁵ Available financing options include California Energy Commission loan programs and energy efficiency financing. (See <http://www.energy.ca.gov/efficiency/financing/index.html#eligibility>.)

loans, how utility lenders would deal with loan defaults, loan security, credit requirements, and cost recovery. SCE questions whether in the event of a default, it would take ownership of a CHP system. PG&E is concerned with the risks imposed on non-participating customers by a PAYS pilot. Likewise, SCE contends that since the nonprofit organizations and government facilities purchasing and installing CHP systems must bear all costs of the PAYS pilot, the utilities must perform a careful analysis of all likely costs of the pilot to ensure that other customers remain unaffected. We agree that all of these issues will require greater consideration by the Commission before a PAYS pilot can be established.

Another factor in our decision to not pursue a PAYS pilot at this time is our current review of SGIP eligibility in response to Senate Bill (SB) 412. In our Distributed Generation Rulemaking (R.) 10-05-004, we are considering modifying SGIP to provide up front incentives to CHP systems that meet certain criteria. SB 412 allows the Commission, in consultation with the California Air Resources Board, to determine eligible technologies for SGIP based on the requirement that they achieve reductions of greenhouse gas emissions. The Commission released a Staff Proposal on September 30, 2010 that proposed a variety of changes to the SGIP with regard to CHP systems.⁶ These proposed SGIP modifications will be considered by the Commission in R.10-05-004 in the near future. In addition, in D.09-12-042, we have adopted two standard contracts for purchase of excess electricity from eligible CHP systems by an electrical corporation under AB 1613. One contract is available to CHP systems up to 20 MW and a simplified contract

⁶ See *"ALJ's Ruling Requesting Comment on Staff Proposal Regarding Modifications to the SGIP,"* R.10-05-004, September 30, 2010.

is available to CHP systems that export no more than 5 MW. Together, modification to SGIP and the standard contracts available to CHP systems reduce the need for the PAYS pilot envisioned in AB 1613.

Nevertheless, we clarify that should interest arise for a PAYS pilot, and should other new facts and circumstances warrant reconsideration of today's decision, parties may petition to modify this order and provide information on those new facts or circumstances. Any such petition should address the following issues:

- Demand for a PAYS pilot;
- Forms of CHP financing available as alternatives to a PAYS pilot;
- Application of state and federal lending laws to the electrical corporations providing the financing for PAYS, particularly DOC criteria for lending law exemptions in Release No. 60-FS; and
- PAYS pilot characteristics, including:
 - Risks to utilities and non-participating customers
 - Interest rate for participants
 - Procedures for loan defaults
 - Loan security
 - Credit requirements
 - Program costs and cost recovery.

4. Comments on Proposed Decision

The proposed decision of the assigned Commissioner in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed by SCE on December 30, 2010. No reply comments were filed. No changes were made in response to comments.

5. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Amy Yip-Kikugawa is the assigned ALJ in this proceeding.

Findings of Fact

1. AB 1613 directs the Commission to establish a PAYS pilot program to finance all the upfront costs for purchase and installation of CHP systems by eligible customers, namely nonprofit organizations and government facilities.

2. Section 2842.4(e) mandates that all costs of a PAYS program shall be borne solely by the CHP generators that use the program and program costs shall not be shifted to other customer classes.

3. DOC Release No. 60-FS provides narrow exemptions for utilities to provide project financing without being considered finance lenders or brokers.

4. CHP facilities could involve costs of \$1.2 to \$1.5 million per MW, compared to financing provided through utility energy efficiency programs, which is capped at a maximum of \$250,000.

5. A PAYS pilot would have no up-front funding, and non-participating customers and utilities would be at risk for the principal lent to eligible customers to finance their CHP systems.

6. There is limited potential for CHP in the California communities served by Mountain Utilities, PacifiCorp and Sierra Pacific, and those utilities have limited resources to finance CHP projects.

7. In R.10-05-004, the Commission is considering modifying SGIP to provide incentives to CHP systems that meet certain criteria.

Conclusions of Law

1. The Commission should not pursue development of a PAYS pilot at this time because the level of customer interest in such a program is unclear and

because it appears difficult to institute a program that imposes no costs on non-participating customers and still falls within the requirements set forth by the DOC to allow utilities exemptions from lending laws.

2. If the Commission were to consider a PAYS pilot in the future, it needs to carefully examine the DOC criteria for lending law exemptions and how to ensure that nonparticipating customers remain unaffected by the costs of a PAYS pilot, as required by the statute.

3. Potential modifications to SGIP under consideration in R.10-05-004 and standard contracts available to CHP systems reduce the need for a PAYS pilot at this time.

4. Any petition asking the Commission to consider development of a PAYS pilot should address any new facts or circumstances warranting consideration of a PAYS pilot, and the issues set forth in Section 3 of this decision.

O R D E R

IT IS ORDERED that:

1. At this time, the Commission will not pursue development of a Pay As You Save Pilot Program to provide on-bill financing for combined heat and power facilities in Rulemaking 08-06-024.

2. Any petitions to modify this decision and request Commission consideration of a Pay As You Save Pilot Program should address the items set forth in Section 3 of this decision.

3. Rulemaking 08-06-024 is closed.

This order is effective today.

Dated January 13, 2011, at San Francisco, California.

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
NANCY E. RYAN
Commissioners