

Decision 11-03-011 March 10, 2011

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company
for Approval of Three Power Purchase
Agreements With Existing Qualifying Facilities
and Associated Cost Recovery. (U39E)

Application 10-10-004
(Filed October 8, 2010)

**DECISION APPROVING THREE POWER PURCHASE AGREEMENTS
WITH EXISTING QUALIFYING FACILITIES**

This decision approves three power purchase agreements between Pacific Gas and Electric Company (PG&E) and three existing qualifying facilities, and cost recovery associated with those agreements, contingent on the “Qualifying Facility and Contained Heat and Power Program Settlement Agreement” becoming effective. This proceeding is closed.

1. Background

By this application, Pacific Gas and Electric Company (PG&E) requests Commission approval of three power purchase agreements (PPAs) between PG&E and three existing 48 megawatt (MW) cogeneration qualifying facilities (QFs): Kern Front Limited, Double C Limited, and High Sierra Limited (sellers).¹

¹ The corporate names of the selling parties to the existing QF contracts are Kern County Cogen, LLC, Double C-2 Cogen, LLC, and Sierra Cogen, LLC, respectively. The sellers have changed the corporate names and entities for purposes of the power purchase agreements that are the subject of this application.

Each of these QFs currently sells energy and 47 MW of firm capacity to PG&E under must-take, Standard Offer No. 2 firm capacity contracts that are currently set to expire on May 27, 2014, May 9, 2011, and March 26, 2011, respectively.

The Kern Front project was initially offered in response to PG&E's 2008 Long Term Request for Offers. Kern Front offered to convert its must-take contract into a utility-scheduled power purchase agreement. While PG&E, with its Procurement Review Group, was reviewing the offer, Double C and High Sierra similarly offered to convert their must-take contracts into utility-scheduled power purchase agreements.

During or shortly after this period, PG&E, together with the California Cogeneration Council, Independent Energy Producers Association, Cogeneration Association of California/Energy Producers and Users Coalition, The Utility Reform Network, Division of Ratepayer Advocates, Southern California Edison Company and San Diego Gas & Electric Company entered into negotiations to resolve numerous outstanding QF-related disputes. That effort culminated in a comprehensive "Qualifying Facility and Combined Heat and Power Program Settlement Agreement" (QF/CHP Settlement), which the Commission approved in Decision (D.) 10-12-035.

PG&E filed this application in anticipation of the Commission's approval of the QF/CHP Settlement, asserting that the power purchase contracts are just and reasonable, in large part, because they are consistent with the QF/CHP Settlement. Alliance for Retail Energy Markets (AREM) filed a protest opposing the application, including the proposed cost recovery provisions, as premature because the QF/CHP Settlement had not been adopted by the Commission. The

California Independent System Operator (CAISO) filed a response supporting the application.

On December 3, 2010, the assigned commissioner issued a scoping memo and ruling which identified the issues to be determined and set a schedule for addressing those issues. In particular, the scoping memo determined that the matter should be submitted upon the filing of concurrent opening and reply briefs without the need for evidentiary hearing, set a schedule in anticipation that the Commission would issue a decision on the QF/CHP Settlement on December 16, 2010, and provided an opportunity for parties to file a motion for extension of time or other procedural relief upon a showing that the Commission decision approving the QF/CHP Settlement, if any, substantially deviated from the then-pending proposed decision. The Commission approved the QF/CHP Settlement in D.10-12-035 on December 16, 2010, whereupon no motions seeking an extension of time or other procedural relief were filed.

By unopposed motion filed January 10, 2011, and granted by informal ruling of the Administrative Law Judge (ALJ) on February 3, 2011, CAMS Juniper (California), LLC, Double C Limited, High Sierra Limited, and Kern Front Limited jointly moved for party status.

PG&E, AReM and, jointly, CAMS Juniper (California), LLC, Double C Limited, High Sierra Limited, and Kern Front Limited filed concurrent opening briefs on January 10, 2011, AReM filed its concurrent reply brief on January 20, 2011, and PG&E filed its concurrent reply brief on January 24, 2011, upon which the proceeding was submitted.

2. Scope of Issues

The assigned Commissioner's December 3, 2010, scoping memo and ruling identified the following issues to be determined in the proceeding:

1. Are the power purchase agreements just and reasonable?
In deciding this overarching issue, we will consider the following factors:
 - a. Will the power purchase agreements reduce customer costs by providing better market value?
 - b. Will the power purchase agreements provide operational benefits?
 - c. Will the power purchase agreements result in reduced greenhouse gas (GHG) emissions?
 - d. Will procurement under the power purchase agreements satisfy the Emissions Performance Standard adopted by D.07-01-039?
 - e. Will procurement under the power purchase agreements serve to meet PG&E's MW targets and GHG emissions reductions under the QF/CHP Settlement? This issue encompasses consideration of whether procurement under the power purchase agreements should count toward the MW and GHG emissions reduction targets.
 - f. Will procurement under the power purchase agreements serve the Commission's policy preference for the utilities to maintain their current level of QF capacity, as provided in D.07-12-052? This issue encompasses consideration of whether procurement under the power purchase agreements should count toward PG&E's obligation to maintain its current level of QF capacity.
2. Should PG&E be authorized to recover the costs of the power purchase agreements through the Electric Revenue Recovery Account (ERRA) and allocate stranded costs consistent with Section 13.1 of the QF/CHP Settlement Term Sheet? This issue encompasses consideration of whether PG&E's cost allocation proposal is consistent with the QF/CHP Settlement.

3. The Power Purchase Agreements are Just and Reasonable

3.1. Power Purchase Agreement Description

The power purchase agreements provide that PG&E provides the fuel for the facilities and decides when the facilities should be scheduled, based on availability schedules provided by the sellers. The power purchase agreements also limit scheduling so that the facilities are not operated as baseload facilities under Pub. Util. Code §§ 8340-8341. PG&E receives all of the energy from the facilities when they are scheduled, as well as the Resource Adequacy value associated with the facilities. PG&E acts as the CAISO Scheduling Coordinator for the facilities.

The power purchase agreements include several provisions that are not included in the existing QF contracts. For example, under the power purchase agreements, the sellers must comply with North American Electric Reliability Corporation and Western Electricity Coordinating Council requirements, as well as CAISO metering and scheduled maintenance outage requirements and restrictions. PG&E is permitted to conduct annual capacity tests to ensure that the facilities can operate and provide capacity as required under the power purchase agreements. If a facility does not pass its test, its capacity and corresponding contract payments can be adjusted. The power purchase agreements also include default and termination provisions, collateral requirements, limitations on liability, insurance provisions, record and audit requirements, and dispute resolution provisions as are typical for current power purchase agreements.

The sellers guarantee a certain capacity availability for the summer months and a lower capacity availability for non-summer months. Availability is

determined based on a formula in the power purchase agreements and impacts the payments received by the sellers. The sellers are paid monthly fixed payments, as well as variable energy and operations and maintenance payments when the facilities are scheduled by PG&E. The power purchase agreements also address governmental charges and GHG compliance costs.

The term of the power purchase agreements is nine years and commences after Commission approval of the power purchase agreements, Commission approval of the QF/CHP Settlement, and approval by the Federal Energy Regulatory Commission (FERC) of PG&E's, Southern California Edison Company's and San Diego Gas & Electric Company's joint application for a waiver of their obligations under the Public Utility Regulatory Policies Act of 1978, as specified in the QF/CHP Settlement. To the extent that the power purchase agreements become effective before the existing QF contracts expire, the power purchase agreements will replace the existing QF contracts.

3.2. Market Value

Under the QF/CHP Settlement, existing combined heat and power (CHP) QFs with an expiring standard offer contract may convert it to a transitional, must-take, Transition Power Purchase Agreement (Transition PPA) that will expire by no later than July 1, 2015. In addition, the QF/CHP Settlement establishes MW targets that the utilities must meet through CHP resources. The QF/CHP Settlement establishes the CHP procurement processes, which include the utilities' conduct of requests for offers exclusively for CHP resources as well as the ability to enter into bilaterally negotiated power purchase agreements with CHP resources. Eligible CHP facilities include qualifying cogeneration facilities, as well as any CHP facility that meets the federal definition of a qualifying cogeneration facility under 18 Code of Federal

Regulations (CFR) § 292.205 as of September 20, 2007 and converts to a “utility prescheduled facility,” even if the facility no longer meets the federal definition of a qualifying cogeneration facility.²

Under the power purchase agreements proposed in this application, the sellers will convert to utility prescheduled facilities, allowing PG&E to schedule the resources only when it is economic to do so. As a result of this scheduling flexibility, the power purchase agreements will provide approximately \$12 million greater market value than the contracts that the sellers could receive in the event that they obtained must-take contracts under the QF/CHP Settlement.

3.3. Operational Benefits

The power purchase agreements give PG&E the right to schedule the facilities to operate when the energy is needed and when it is economic to do so. In addition, the power purchase agreements require the sellers to notify PG&E of available capacity and changes to it, so that PG&E is able to more accurately forecast and schedule the facilities’ output. The Commission noted these benefits of converting an existing QF to a utility-dispatchable facility in its recent decision approving the QF/CHP Settlement. (D.10-12-035 at 45-46.)

The power purchase agreements also require the sellers to comply with all applicable CAISO tariff requirements, including interconnection, scheduling outages, and metering, consistent with the Commission’s policy to better integrate QF resources into the CAISO tariffs and deliverability standards. (See, e.g., D.07-09-040 at 210-211.)

² D.10-12-035, Appendix A, Term Sheet §§ 3.1, 4.2.2, and 4.8.

3.4. GHG Emissions

Because the power purchase agreements give PG&E the right to schedule the facilities, PG&E can schedule the facilities only when the system heat rate is greater than the power purchase agreements' guaranteed heat rate. This will reduce both the facility GHG emissions and overall system emissions, as the replacement electricity will be less GHG-intensive. This is consistent with Commission policy encouraging the utilities to consider GHG emissions and costs when making procurement and scheduling decisions (see, e.g., D.07-12-052 at 243-245) and its recognition, in the Commission's recent decision approving the QF/CHP Settlement, of the benefits of converting an existing QF to a utility-dispatchable facility to reduce GHG emissions (D.10-12-035 at 46.)

3.5. Emissions Performance Standard Requirements

Under the Emissions Performance Standard adopted by the Commission in D.07-01-039, long-term (five years or greater) contracts for generating facilities designed and intended to provide electricity at an annualized capacity factor of 60% must provide for a maximum carbon dioxide emissions rate of no more than 1,100 pounds per megawatt-hour. The power purchase agreements comply with this requirement because they provide that PG&E will not schedule the facilities such that the annualized capacity factor of the facilities would be equal to or greater than 60 percent.

3.6. Consistency with QF/CHP Settlement and PG&E's MW and GHG Emissions Reduction Targets

Section 4.8.1.2 of the QF/CHP Settlement provides that new power purchase agreements with utility prescheduled facilities count toward the MW targets if the existing QF power purchase agreement expires before the end of the transition period. Section 7.3.1.3 provides that CHP conversion to a utility

prescheduled facility counts as a GHG credit. As the power purchase agreements are with utility prescheduled facilities, they count toward PG&E's MW and GHG emissions reduction targets.

3.7. Consistency with Policy Preference to Maintain Current Level of QF Capacity

In D.07-12-052, as modified by D.08-09-045, the Commission indicated its policy preference for utilities to maintain their current level of QF capacity through new or renewed contracts, subject to the limitations of the Public Utilities Regulatory Policy Act of 1978 (PURPA).³ One of the expressed purposes of the QF/CHP Settlement, which D.10-12-035 affirmed as consistent with state and Commission policy and law, is to encourage the continued operation of the state's existing CHP facilities. Consistent with QF/CHP Settlement, although going forward the facilities might not operate as QFs as defined by PURPA, the power purchase agreements allow for the continued operation of three existing CHP QF facilities that have provided reliable energy and capacity to PG&E since the 1980s. This is consistent with the Commission's policy preference that the utilities maintain currently existing QF capacity in their resource mix.

4. Cost Recovery

Section 13.1.2 of the QF/CHP Settlement provides that the Commission shall select one of two specified methods for allocation of CHP procurement costs to all electric service providers and community choice aggregators. In approving the QF/CHP Settlement, D.10-12-035 approved the allocation method set forth in Section 13.1.2.2 of the settlement, which provides that net capacity

³ The United States Congress passed PURPA in 1978, as codified in the United States Codes (U.S.C.) at 16 U.S.C. Section 824a-3, and 18 CFR Sections 292.301 *et seq.*

costs and all resource adequacy benefits associated with power purchase agreements entered into pursuant to the settlement shall be proportionately allocated annually to all bundled, electric service provider, community choice aggregator and departing load customers (as defined in Section 17 of the settlement) on a non-bypassable basis.

Section 13.2.1 of the QF/CHP Settlement provides that the utilities shall recover the cost of all payments made pursuant to power purchase agreements entered into pursuant to the settlement in their respective Energy Resources Recovery Accounts, subject only to their reasonable administration.

PG&E should proportionately allocate annually the power purchase agreements' net capacity costs and all resource adequacy benefits associated with them to all bundled, electric service provider, community choice aggregator and departing load customers on a non-bypassable basis pursuant to § 13.2.1 of the QF/CHP Settlement, and recover the bundled customer costs associated with them in its Energy Resources Recovery Account.

5. Proposed Contingencies

Pursuant to Section 16.2 of the QF/CHP Settlement, it is not effective until and unless certain conditions precedent have been met, including approval by the FERC of a waiver of the utilities' obligations under Section 210(m) of PURPA. As of this time, those conditions have not been met, and D.10-12-035 approving the QF/CHP Settlement is the subject of three pending applications for rehearing.

In its opening brief, AReM requests that the Commission make approval of the power purchase agreements subject to any changes that may be made to the QF/CHP Settlement as the result of the Commission's resolution of the pending applications for rehearing D.10-12-035 or potential future petitions to modify the

decision, as well as any changes that may occur to the CHP Program as the result of potential future petitions to modify D.10-12-035 or future proceedings regarding the utilities' long term procurement planning. In its reply brief, AReM additionally requests that the Commission make approval of the power purchase agreements contingent on resolution of the pending applications for rehearing of D.10-12-035 and a FERC ruling approving PG&E's application for waiver from PURPA requirements.

It is inappropriate to make approval of this application contingent on the resolution of pending applications for rehearing of D.10-12-035. D.10-12-035 was made effective immediately upon its issuance and, therefore, the applications for rehearing do not suspend it. (See Rules of Practice and Procedure [Title 20, Division 1, of the California Code of Regulations], Rule 16.1(b).)

It is likewise inappropriate to make approval of this application subject to potential future changes to the QF/CHP Settlement, D.10-12-035, or the CHP Program, as it is entirely speculative whether future changes will be made or that, even if they are, any such changes would directly impact the issues addressed in this proceeding. If such changes are made in the future, the proper procedural approach would be for AReM to file a petition to modify this decision approving the power purchase agreements.

It is, however, appropriate to make approval of this application contingent on the QF/CHP Settlement becoming effective. The reasonableness of the proposed PPAs is premised, in large part, on their value relative to the Transition PPAs that the sellers could receive under the QF/CHP Settlement, and the appropriateness of PG&E's proposed recovery of costs is premised on it having entered into the PPAs pursuant to the QF/CHP Settlement. If the QF/CHP Settlement does not become effective, consistency with the settlement will not be

determinative of the reasonableness of the PPAs and appropriateness of PG&E's recovery of their costs.

We approve the PPAs and PG&E's recovery of their costs contingent on the QF/CHP Settlement becoming effective. In its reply comments on the proposed decision, PG&E attached a binding agreement between PG&E and all parties to the PPAs that the PPAs are not effective until and unless the QF/CHP Settlement becomes effective. Accordingly, this proceeding may be closed.

6. Comments on Proposed Decision

The proposed decision of Administrative Law Judge (ALJ) Yacknin 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 on February 28, 2011, by PG&E and the CAISO, and reply comments were filed on March 7, 2011, by PG&E.

Assignment of Proceeding

Michael Peevey is the assigned Commissioner, and Hallie Yacknin is the assigned ALJ in this proceeding.

Findings of Fact

1. As a result of this scheduling flexibility that they allow PG&E, the three power purchase agreements between PG&E and Kern Front Limited, Double C Limited, and High Sierra Limited will provide approximately \$12 million greater market value than the contracts that the sellers could receive in the event that they obtained must-take contracts under the QF/CHP Settlement.

2. The power purchase agreements provide greater operational benefits than PG&E could receive in the event that the sellers obtained must-take contracts under the QF/CHP Settlement.

3. The power purchase agreements may result in reduced GHG emissions than could occur in the event that the sellers obtained must-take contracts under the QF/CHP Settlement.

4. Procurement under the power purchase agreements will satisfy the Emissions Performance Standard adopted by D.07-01-039.

5. Procurement under the power purchase agreements qualifies to meet PG&E's MW targets and GHG emissions reductions under the QF/CHP Settlement.

6. Procurement under the power purchase agreements will serve the Commission's policy preference for the utilities to maintain their current level of QF capacity, as provided in D.07-12-052.

Conclusions of Law

1. The power purchase agreements are just and reasonable and should be approved.

2. Procurement under the power purchase agreements should count toward PG&E's MW and GHG emissions reduction targets.

3. PG&E should proportionately allocate annually the power purchase agreements' net capacity costs and all resource adequacy benefits associated with them to all bundled, electric service provider, community choice aggregator and departing load customers on a non-bypassable basis pursuant to § 13.2.1 of the QF/CHP Settlement, and recover the bundled customer costs associated with them in its Energy Resources Recovery Account.

4. As D.10-12-035 is not suspended by virtue of the pending applications for rehearing the decision, it is inappropriate to make this decision approving the power purchase agreements contingent on the resolution of those applications.

5. The proper vehicle for seeking to apply future potential changes to the QF/CHP Settlement, D.10-12-035, or the CHP Program to the power purchase agreements and/or PG&E's recovery of costs incurred under them is by petition to modify this decision approving the power purchase agreements.

6. As the PPAs are contingent on the QF/CHP Settlement taking effect, it is unnecessary to condition approval of the PPAs on such events

7. A.10-10-004 should be closed.

8. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company's power purchase agreements with Kern Front Limited, Double C Limited, and High Sierra Limited are approved.

2. Procurement under Pacific Gas and Electric Company's power purchase agreements with Kern Front Limited, Double C Limited, and High Sierra Limited shall count toward Pacific Gas & Electric Company's megawatt and greenhouse gas emissions reduction targets.

3. Pacific Gas and Electric Company shall proportionately allocate annually the net capacity costs of its power purchase agreements with Kern Front Limited, Double C Limited, and High Sierra Limited, and all resource adequacy benefits associated with them, to all bundled, electric service provider, community choice aggregator and departing load customers on a non-bypassable basis, and shall recover the bundled customer costs of the power purchase agreements in its Energy Resources Recovery Account.

4. Application 10-10-004 is closed.

This order is effective today.

Dated March 10, 2011, at San Francisco, California.

MICHAEL R. PEEVEY

President

TIMOTHY ALAN SIMON

CATHERINE J.K. SANDOVAL

Commissioners

I abstain.

/s/ MICHEL PETER FLORIO

Commissioner

