

Decision 06-07-032 July 20, 2006

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)
Order Instituting Rulemaking to Promote Consistency in Methodology and Input Assumptions in Commission Applications of Short-Run And Long-Run Avoided Costs, Including Pricing for Qualifying Facilities.	Rulemaking 04-04-025 (Filed April 22, 2004) (QF Issues)
Order Instituting Rulemaking Into Implementation of Pub. Util. Code § 390.	Rulemaking 99-11-022 (Filed November 11, 1999)

**OPINION ADOPTING SETTLEMENT AGREEMENT BETWEEN  
PACIFIC GAS AND ELECTRIC COMPANY AND THE  
INDEPENDENT ENERGY PRODUCERS ASSOCIATION  
REGARDING QUALIFYING FACILITIES**

**I. Summary**

This Decision grants the Joint Motion of Pacific Gas and Electric Company (PG&E) and The Independent Energy Producers Association (IEP)<sup>1</sup> for Commission adoption of the Settlement Agreement and Associated

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<sup>1</sup> The Joint Motion includes two amendments; one filed May 10, 2006, and the second amendment filed May 24, 2006.

Amendments entered into by some of the owners and/or operators of Qualifying Facilities (QFs) that have current purchase power agreements (PPA) with PG&E. This Decision does not address or resolve the remaining outstanding issues in Rulemaking (R.) 04-04-003, R.04-04-025 or R.99-11-022 nor does it close those proceedings.

In addition, this Decision does not foretell the Commission's future determinations in the three Rulemakings, on topics including, but not limited to: (1) heat rates; (2) prices; (3) length of contracts; (4) mandatory purchase obligations; (5) cost-calculation methodologies for short-run and long-run avoided costs; (6) true-up of payments to QF switchers;<sup>2</sup> and (7) refund payments from QFs for payments made between December 2000 and March 2001. This Decision does not prejudice the Commission's ability to make findings in subsequent Decisions that differ from those in this Decision adopting the Settlement Agreement.

## **II. Background**

In D.99-11-022, the Commission allowed QFs to switch to PX zonal day-ahead market clearing price in lieu of Commission-determined short-run avoided cost (SRAC) energy pricing, subject to the potential for a later true-up by the Commission. The PX terminated operations in January 2001 and the "QF switchers" were required to return to the SRAC pricing in effect at that time. The true-up issue for the QF switchers remains a matter to be settled in R.99-11-022. A briefing schedule has been established for the determination of this dispute.

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<sup>2</sup> Those QFs that switched to the California Power Exchange (PX) market clearing price beginning in June 2000.

There is also a remand order of the *California Court of Appeal in Southern California Edison v. Public Utilities Commission*, 101 Cal.App.4<sup>th</sup> 982 (2002) regarding SRAC pricing between December 2000 and March 2001. The remand issue is still pending in R.99-11-022.

In addition, there is a Petition to Modify D.01-02-072 filed by Rio Bravo in this proceeding, R.99-11-022, related to the calculation of QF payments.

R.04-04-003 is the Rulemaking the Commission initiated "To Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning," and as part of that proceeding, the Commission is reviewing the long-term policy for new and existing QFs. R.04-04-025 was initiated "To Promote Consistency in Methodology and Input Assumptions in Commission Applications of Short-run and Long-run Avoided Costs, Including Pricing for Qualifying Facilities." This proceeding is designated for addressing SRAC pricing issues for QFs including: (1) whether or not the Commission's current SRAC energy pricing formula, including existing time-of-delivery and line loss factors, should be altered, and if so, what changes should be made; and (2) updating current as-delivered capacity prices.

R.04-04-003 and R.04-04-025 were consolidated for evidentiary hearings on policy and pricing related to QF contracts.

Before evidentiary hearings began on the policy and pricing QF issues, the Commission encouraged all the parties to the QF proceedings to explore settlement possibilities. During December 2005, all of the parties interested in the QF issues from R.04-04-003 and R.04-04-025 met for a 10-day period with two mediators from the Commission's Administrative Law Judge (ALJ) Division to negotiate the issues and pursue possible settlement of some, or all, of the

outstanding issues. No settlements were reached at that time and the evidentiary hearings went forward January 18 through February 2, 2006.

PG&E and IEP continued their negotiations, reached a settlement and noticed a settlement conference, pursuant to Rule 51.1(b),<sup>3</sup> for April 7, 2006. Following that meeting, the settlement was finalized and on April 18, 2006, PG&E and IEP filed and served a Joint Motion for approval of the Settlement Agreement and Associated Amendments.

### **III. Settlement Agreement**

The Settlement Agreement<sup>4</sup> addresses issues in three open Commission proceedings, R.99-11-022; R.04-04-003; and R04-04-025 and resolves those issues only as they relate to PG&E and the settling IEP QF members. Each QF that settles with PG&E executes an Amendment. As of the date of the Joint Motion, April 18, 2006, 41 QFs had executed Amendments. By May 10, 2006, when the First Amendment to the Joint Motion was filed, an additional 74 Amendments had been executed, and as of May 24, 2006, when the Second Amendment was filed, an additional three Amendments had been executed. In total PG&E represents that it has now obtained executed Amendments for 121 projects, including 14 cogeneration projects, representing 28% of that portfolio, and 107 non-gas fired projects, representing 83% of that portfolio. That represents almost

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<sup>3</sup> All references to Rules are to the Commission's Rules of Practice and Procedure and references to Codes are to the California Public Utilities Code.

<sup>4</sup> The Settlement Agreement, including the amendments filed May 10 and May 24, 2006, is marked for identification as Exhibit Settlement 1, and is received into evidence as part of the record in this proceeding.

52.04% of generation deliveries from all QFs currently under contract with PG&E.

This Settlement Agreement represents the culmination of negotiations that have been on-going between PG&E and the IEP QFs for a considerable time period and are a comprehensive compact as between these parties only. The Commission is adopting and approving this Settlement Agreement without prejudice to the decision it will issue on the remaining outstanding issues.

As represented by PG&E and IEP in their Joint Motion, for PG&E and all the QFs that sign an Amendment, the Settlement Agreement resolves all subjects at-issue in the two QF policy and pricing proceedings, R.04-04-003 and 04-04-025. The settlement also settles the following issues in R.99-11-022: (1) PG&E's claims for a retroactive adjustment of SRAC payments made to QFs from December 1, 2000 to March 31, 2001 arising from the Court of Appeal remand; (2) PG&E's claims for a retroactive adjustment of energy payments made to QF Switchers from June 1, 2000 through January 18, 2001; and (3) QF claims that PG&E should recalculate the SRAC energy payment as related to transmission line loss factors for QF Switchers.

In summary, the Settlement Agreement provides the following:

- A variable energy price option derived from an average annual heat rate of 8,700 British Thermal Unit (Btu)/kilowatt-hour (kWh) (Summer and Winter) to which revised time of delivery factors are applied, and monthly burner-tip gas prices plus a variable Operations and Maintenance (O&M) adder of \$2 megawatt-hour (MWh); this option is available to natural gas-fired QFs and effective until September 30, 2009.
- A fixed energy price option equal to \$64.50/MWh for the first year of the Fixed Price Period, with a 1% annual

escalation factor starting on the day one year after the Fixed Price Periods begins; this option is available to Renewable QFs and QFs whose fuel source is not natural gas for a term of up to five years.

- The Amendment for Renewable QFs is conditioned on a Commission finding that PG&E will continue to receive full credit for its purchases of energy and capacity toward meeting PG&E's Renewable Portfolio Standard (RPS) requirements and thereby furthers the Commission's policy promoting renewable energy resources.
- An as-delivered capacity price of \$50/kW-year that will remain effective for a specified period of time, and conditioned on a Commission finding that such capacity qualifies for Resource Adequacy purposes based on the historic deliveries methodology the Commission adopted for QFs in D.04-10-035.
- Energy line loss factors equal to the QF's project GMM divided by the system average GMM as defined in D.01-01-007, provided that the loss factor for renewable QFs shall not be less than 95% and conditioned further on a Commission finding that PG&E is entitled to and shall receive full credit for all energy PG&E purchases pursuant the Amendments with Renewable QFs for purposes of complying with RPS requirements.
- A mutual release and waiver of claims arising from the settled issues as fully described in the settlement agreement.
- Agreement that SRAC pricing for QFs operating under PPAs should transition to an electricity market-based mechanism following a Commission determination that the California Independent System Operator's (CAISO) Day-Ahead Energy Market or an equivalent market is functioning properly for purposes of SRAC pricing.

- Agreement that each QF executing an Amendment thereby agrees, for itself and all of its successors and assigns, that following the expiration of its PPA, such QF shall be entitled to exercise of the mandatory purchase obligation available to QFS under Public Utility Regulatory Policies Act (PURPA) solely by invoking the following options: (1) participation in PG&E's all-source or renewable solicitations or; (2) execution of a one-year PPA with PG&E (renewable for successive one-year terms) under which PG&E shall pay for energy deliveries a price equal to the CAISO Day-Ahead Market Price for the applicable delivery period or such other market-based mechanism as specified by the Commission. The Parties remain free to negotiate mutually acceptable bilateral agreements independent of the exercise of the QF's rights under PURPA.

The Amendment to the Settlement Agreement is the same for all signing QFs except for the following exceptions: Wheelabrator has a "switch month" of November rather than July; Fresno Cogen's switch month is January; Rio Bravo will receive an expense reimbursement; and Calpine needs to obtain bankruptcy court approval.

#### **IV. Requested Findings**

In addition to approving the Settlement Agreement and Amendments, PG&E and IEP request that the Commission make findings as follows:

- PG&E will receive Resource Adequacy (RA) Credit, pursuant to the methodology adopted for QFs in D.04-10-035, for as-delivered capacity PG&E purchases pursuant to the Amendments.
- The 95% line loss factor floor for Renewable QFs is adopted and approved.

- PG&E is entitled to and shall receive full credit for all energy purchased pursuant to the Amendments from Renewable QFs in satisfaction of PG&E's RPS requirements.
- PG&E shall fully recover in rates all payments made pursuant to the Amendments, subject only to ongoing Commission review for administration of the Amendments.

## **V. Discussion**

PG&E and IEP urge the Commission to adopt the Settlement Agreement and Associated Amendments and pursuant to Rule 51.1(e) find that it is "reasonable in light of the whole record, consistent with the law, and in the public interest."

As moving parties present, the QF issues in R.04-04-003 and R.04-04-025 have been the subject of extensive discovery, settlement negotiations, mediation sessions, testimony, briefs and evidentiary hearings with cross-examination. The QF Switcher issues from R.99-11-022 have been addressed by briefs in that proceeding. PG&E and IEP have been strong adversaries and at opposite sides of the QF issue. Therefore, from the Commission's perspective, if these two adversaries can put together a negotiated settlement, it meets the reasonableness test. While not all QFs in PG&E's service territory have signed the Settlement Agreement, the fact that such a large percentage, just over 50%, have signed it attests to its reasonableness from the QF perspective, as well as the utility's.

Numerous QF representatives filed comments indicating that they had no objection to the Settlement, but were very concerned that the Commission not be influenced by the Settlement terms when it was deciding the remaining issues in the proceeding. In particular, parties asked the Commission to factor in that 107 of the settling parties are renewable QFs, whereas only 14 settling QFs are cogenerators. Some of the representatives allege that some of the particular

terms in the Settlement agreement, such as the term of the contracts, the heat rate, and waiver of the right to enforce the must-offer' obligation from the Public Utility Regulatory Policies Act of 1978 (PURPA), while acceptable to many renewable QFs, could be fatal to the continuation of some gas-fired QFs. Many of the settlement terms are in fact antithetical to the litigation position taken by the non-settling parties.

Some of the factors that have fueled the long and vitriolic dispute between all the utilities and all the QFs in general, and between PG&E and IEP specifically, are the federal and state requirements and the different sides' interpretation of those legal mandates. However, if PG&E and IEP voluntarily agree to prices and terms, there is no contravention of either federal or state law. PG&E and IEP also contend that their settlement is consistent with Commission precedent since the price in the Amendment is consistent with a fixed price option authorized by the Commission in D.01-06-015. In addition, on the QF Switcher issue, Settling Parties argue that it is properly within the Commission's domain to decide just and reasonable prices, as it will when it issues a decision in R.99-11-022. Therefore, it is reasonable if PG&E and IEP reach an agreement on the QF Switcher price and reduce the litigation risk of waiting for the Commission's final decision.

Settling Parties also contend that the Settlement Agreement will benefit the public since it reasonably balances competing issues and reaches a result whereby ratepayers will be paying less for energy. Particularly, under the terms of the settlement, payments for energy will be reduced with an all-in annual heat rate for gas-fired QFs of 8,700 Btu/kWh plus a \$2/MWh variable O&M adder. The Settling Parties contend that this will result in lower payments for energy

and that the energy price will more closely reflect short-term energy prices in the market.

Non-gas fueled QFs, including renewables, will receive a five-year fixed energy price of \$64.50/MWh, with a 1% annual escalation. This price is 15% below PG&E's current<sup>5</sup> posted SRAC price and 45% below the formula yielded SRAC price for January 2006. PG&E also requests that full credit for renewable QF purchases count for the RPS goal.

Under the Settlement Agreement, Standard Offer No. 1 as-delivered capacity payments are reduced by 27%, taking the PPAs from \$68.27/kW-year to \$50/kW-year. Settling Parties's request that PG&E receive capacity credit. This will also benefit ratepayers since they will get the capacity benefit of the as-delivered capacity payments they are making.

QFs also agree that when the PPAs they execute pursuant to the Settlement Agreement expire, their only mandatory purchase entitlement under PURPA<sup>6</sup> shall be to (1) participate in PG&E's solicitations, (2) execute a year-to-year PPA with PG&E at market based pricing, or (3) negotiate a mutually acceptable bilateral agreement.

Finally, ratepayers will receive an explicit energy price reduction of \$.90/MWh for PG&E's claims on the QF Switcher issue.

When all of the above cost savings are viewed as a whole, ratepayers of PG&E will pay less for the energy PG&E receives from QFs signing the Amendment. Even though the signing QFs do not represent all of the QFs

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<sup>5</sup> April 2006.

<sup>6</sup> The Public Utility Regulatory Policies Act of 1978, as modified and amended.

selling power to PG&E, the reduction in energy payments made possible by the Settlement is anticipated to be between \$100-\$200 million annually, depending on how many QFs ultimately execute the Amendment. This savings will significantly benefit PG&E customers. In addition, PG&E and the settling QFs have planned for and contracted for a competitive mechanism to direct future utility/QF dealings. PG&E and IEP agree that SRAC pricing should transition to a market-based mechanism, if and when the Commission determines that the CAISO day-ahead energy market, or an equivalent market, is functioning properly.

## **VI. Other Comments**

Pursuant to Commission Rules of Practice and Procedure, Rule 51.4, parties to the proceedings had an opportunity to comment on the Settlement Agreement and comments were received from Modesto Irrigation District (MID), the California Cogeneration Council (CCC) and the Cogeneration Association of California and Energy Producers and Users Coalition (CAC/EPUC). PG&E and IEP filed a joint reply to the comments.

In summary, except for the comments by CCC, the other non-settling QFs do not oppose the Settlement Agreement, per se, but are unanimously adamant that the Commission not view the Settlement as precedential or in any way binding on the Commission's future decisions in the proceeding. As these QFs argue, the Settlement is an voluntary, negotiated agreement, that does not reflect the record from the evidentiary hearings, nor does it necessarily serve the interests of the non-settling parties. The main plea from CAC/EPUC is that the Commission not apply any of the settlement terms and conditions to the QFs that did not sign the Settlement Agreement. MID is primarily concerned with a stipulation MID and PG&E entered into concerning an ongoing competition

transition charge (OCTC) and seek confirmation from the Commission that it is not addressing recovery through the OCTC of the costs of any of the QF contracts subject to the Settlement. We agree and will not decide in this decision adopting the Settlement Agreement recovery of the OCTC.

CCC, on the other hand, opposes the settlement on the grounds that the settled terms benefit renewable QFs and a small percentage of gas-fired QFs, but would be unreasonable and unduly discriminatory if it was applied to most gas-fired cogenerators, particularly cogeneration QFs that operate in a baseload fashion. While the CCC does not take issue with the right of individual QFs to execute voluntary amendments with PG&E, CCC does have a problem with the Settlement Agreement as a whole since if imposed on non-settling parties, it would negatively impact more than three quarters of the natural gas-fired cogeneration QFs that have contracts with PG&E and have not signed the Settlement Agreement. In fact, CCC argues that the Settlement Agreement, because it is so discriminatory to its QF members, does not meet the “reasonable in light of the whole record, consistent with law, or in the public interest” test of Rule 51.

In their joint reply, PG&E and IEP reiterate that the Settlement Agreement is only applicable to the parties willing to voluntarily sign the amendments, and clearly does not pertain to the non-settling QFs.

The Commission is cognizant of the totality of the package negotiated between PG&E and the settling QFs, and understands that the terms and conditions therein are not acceptable to the non-settling parties. That is especially true if one focuses on the individual terms, rather than the aggregate

of the agreement. This Settlement Agreement is not precedential,<sup>7</sup> nor will we allow it to prejudice our future decision making. We will also factor into our analysis of the Settlement Agreement the fact that it is a voluntary agreement that was acceptable to primarily renewable QFs. We know the issues that remain to be decided involve all non-settling QFs, renewable as well as gas-fired, and that the terms and conditions in the Settlement Agreement were not acceptable to them. The record developed in the proceeding will be the cornerstone of the final decision, for non-settling parties not the Settlement Agreements.

## **VII. RPS Requirements**

In Section V, Requested Findings, Settling Parties ask the Commission to find that “PG&E is entitled to and shall receive full credit for all energy purchased pursuant to the Amendments from Renewable QFs in satisfaction of PG&E’s RPS requirements.” Because RPS obligation issues are the subject of another Commission proceeding, R.06-02-012, and not all parties to R.06-02-012 are parties to the QF proceedings, notice was given to the RPS service list that an RPS issue was being considered in the QF proceeding. An Administrative Law Judge (ALJ) ruling on May 18, 2006, invited comments from the service lists for both R.06-02-012 and R.06-02-013 on the RPS.

In response to the ALJ ruling, TURN, SCE, Central Hydroelectric Company And Mega Renewables, a General Partnership, aka Shasta Hydro (Shasta Hydro) and PG&E filed comments. Responding parties all agree that this provision in the Settlement Agreement is consistent with applicable state and federal laws and Commission decisions. As PG&E states, this provision is

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<sup>7</sup> Rules of Practice and Procedure, Rule 51.8.

intended to “preserve the status quo, i.e., that the renewable QFs’ output PG&E now purchases may continue to be counted towards PG&E’s RPS requirements for the term of the Amendment for those QFs that have signed the Amendment.” (PG&E Comments, June 1, 2006, p. 2.)

PG&E made it clear that it is not seeking to change the status quo vis-à-vis renewable energy credits (REC) and does not purport to bind any other party or require a determination by the Commission with respect to issues raised in R.06-02-012.

We agree with the parties that we can make the finding requested by PG&E without compromising any issues yet to be resolved in R.06-02-012.

### **VIII. Conclusion**

We find that the Settlement Agreement between PG&E and the settling IEP QFs meets the requirements of Rule 51.1(e) and we approve the Agreement and the Associated Amendments. The Settlement Agreement is reasonable in light of the substantial record that exists on the long, on-going disputes between the utilities and the QFs, is consistent with federal and state law and Commission decisions, and is in the public interest.

As mentioned earlier in the Decision, this Decision does not foretell what the Commission will decide when it issues subsequent Decisions in the three Rulemakings, on topics including, but not limited to: (1) heat rates; (2) prices; (3) length of contracts; (4) mandatory purchase obligations; or (5) cost-calculation methodologies for short-run and long-run avoided costs, (6) true-up of payments to QF switchers;<sup>8</sup> and (7) refund payments from QFs for payments made between

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<sup>8</sup> Those QFs that switched to the California Power Exchange (PX) market clearing price beginning in June 2000.

December 2000 and March 2001. This Decision does not prejudice the Commission's ability to make findings in subsequent Decisions that differ from those in this Decision adopting the Settlement Agreement.

## **IX. Comments**

The proposed decision of ALJs Brown, Halligan and DeBerry was mailed to the parties in accordance with Public Utilities Code Section 311(d) and Rule 77.1 of the Rules of Practice and Procedure, along with an ALJ ruling requesting parties to stipulate to a reduced comment time in order to have the matter appear on the Commission's July 20, 2006 agenda. PG&E and IEP filed joint comments on the proposed decision on June 28, 2006. CCC filed comments on July 11, 2006. PG&E and IEP filed joint reply comments on July 17, 2006.

## **X. Assignment of Proceedings**

All three Rulemakings are assigned to Commissioner Peevey and R.04-04-003 is assigned to ALJ Carol Brown; R.04-04-025 to ALJ Julie Halligan; and R.99-11-022 to ALJ Bruce DeBarry.

## **Findings of Fact**

1. PG&E and IEP presented the Commission with a Joint Settlement Agreement and Associated Amendments entered into by some of the owners and/or operators of QFs that have current PPAs with PG&E.
2. The Settlement Agreement addresses issues in three open Commission proceedings, R.99-11-022, R.04-04-003, and R.04-04-025 and resolves those issues only as they relate to the settling parties, PG&E and the IEP, and those QFs who signed the Amendment.
3. The Settlement Agreement resolves all subjects at-issue as between PG&E and IEP in R.04-04-003 and R.04-04-025, with respect to those QFs that have signed the agreement.

4. The Settlement Agreement settles the following issues in R.99-11-022: (1) PG&E's claims for a retroactive adjustment of SRAC payments made to QFs from December 1, 2000 to March 31, 2001 arising from the Court of Appeal remand; (2) PG&E's claims for a retroactive adjustment of energy payments made to QF Switchers from June 1, 2000 through January 18, 2001; and (3) QF claims that PG&E should recalculate the SRAC energy payment as related to transmission line loss factors for QF Switchers.

5. The Settlement Agreement does not compromise the rights of PG&E or IEP to litigate the outstanding issues as to other parties in the three proceedings.

6. PG&E will receive RA credit, pursuant to the methodology adopted for QFs in D.04-10-035, for as-delivered capacity PG&E purchases pursuant to the Amendments.

7. The 95% line loss factor floor for Renewable QFs is adopted and approved.

8. PG&E is entitled to and shall receive full credit for all energy purchased pursuant to the Amendments from Renewable QFs in satisfaction of PG&E's RPS requirements.

9. PG&E shall fully recover in rates all payments made pursuant to the Amendments, subject only to ongoing Commission review for reasonable administration of the Amendments.

10. We find that based on the long adversarial historic relationship between PG&E and the IEP QFs, that the negotiated settlement is reasonable.

11. We find that the Settlement Agreement is consistent with federal and state law and with Commission precedent.

12. We find that the Settlement Agreement benefits the public since it results in lower payments for energy.

13. The competitive mechanism to direct future utility/QF dealings for QFs that have signed the Amendment contained in the Settlement Agreement is reasonable.

**Conclusions of Law**

1. The Settlement Agreement, with Associated Amendment, meets the requirements of Rule 51.1 of the Commission's Rules of Practice and Procedure and is adopted by the Commission.

2. Notwithstanding Rule 51.8, the Settlement Agreement is not binding on all parties to the underlying proceedings.

3. In accordance with Rule 51.8, our approval of the Settlement Agreement does not constitute approval of, or precedence regarding any principle or issue in the underlying proceedings or in any future proceeding.

**O R D E R**

**IT IS ORDERED** that:

1. The Settlement Agreement, with Associated Amendments, entered into between Pacific Gas and Electric Company (PG&E) and the owners and/or operators of Qualifying Facilities that have current power purchase agreements with the utility and who signed the Amendments is adopted.

2. This Settlement Agreement does not compromise the respective rights of PG&E, IEP or any non-settling QF to litigate the outstanding issues that still exist as to other parties in the three proceedings, Rulemaking (R.) 99-11-022, R.04-04-003, and R.04-04-025.

This order is effective today.

Dated July 20, 2006, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
GEOFFREY F. BROWN  
DIAN M. GRUENEICH  
JOHN A. BOHN  
RACHELLE B. CHONG  
Commissioners

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