

Decision 08-01-028 January 31, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902 E) for Approval of a Power Purchase Agreement with Envirepel Energy, Inc., for Authority to Recover the Costs of Such Power Purchase Agreement in Rates and for Issuance of Certain Findings Related to Compliance with Renewable Portfolio Standard Program Requirements.

Application 07-09-017
(Filed September 26, 2007)

**ORDER APPROVING SAN DIEGO GAS & ELECTRIC COMPANY'S
POWER PURCHASE AGREEMENT WITH ENVIREPEL ENERGY, INC.**

1. Summary

This decision approves San Diego Gas & Electric Company's (SDG&E) application for a 1.5 megawatt (MW) short-term renewable (biomass) power purchase contract with Envirepel Energy, Inc. (Envirepel).

2. Procedural Background

Decision (D.) 04-12-048; Ordering Paragraph 14 states the following:

"We authorize the utilities to enter into short-term, mid-term, and long-term contracts, with contract delivery start date through 2014, provided that the IOUs submit the necessary compliance filings. We adopt The Utility Reform Network's (TURN) proposal that contracts with duration five years or longer be submitted to the Commission for preapproval."

Pursuant to this direction, SDG&E filed this application on September 26, 2007. No protests were received. SDG&E filed a supplement on October 9, 2007.

Pub. Util. Code § 399.11, *et seq.* sets a target of generating 20% of total retail sales of electricity in California from eligible renewable energy resources by December 31, 2010. The statute sets forth the framework for the Commission to regulate investor-owned energy utilities (IOUs) in pursuit of this target. Pub. Util. Code § 399.14(a)(4) provides: "In soliciting and procuring eligible renewable energy resources, each electrical corporation shall offer contracts of no less than 10 years in duration, unless the commission approves of a contract of shorter duration." Section 399.14(b)(2), requires the Commission to establish "for each retail seller, minimum quantities of eligible renewable energy resources to be procured either through contracts of at least 10 years' duration or from new facilities commencing commercial operations on or after January 1, 2005."

D.04-12-048 adopted Long-Term Procurement Plans (LTPP) and provided direction to the utilities on the procurement of the resources identified in the LTPPs. The decision determined that energy efficiency and demand-side resources should be employed first in the loading order of resources for procurement. Then, when these opportunities are captured, renewable generation were to be procured to the fullest extent possible, so that whenever an IOU issues a Request for Offer/Proposal (RFO/RFP) for generation resources, it must justify its selection of fossil generation over renewable generation offers. The decision found that selection of renewable generation is the rebuttable presumption guiding IOU generation procurement.

In general, D.04-12-048 directed IOUs to procure the maximum feasible amount of renewable energy in the general solicitations and allowed them to

credit this procurement towards their RPS targets, assuming that all RPS eligibility and program standards are met. To further this effort, the Commission committed to fully imbed the RPS into long-term planning, placing renewable energy development central to the IOUs' resource planning efforts.

D.07-05-028 addressed RPS eligibility of short-term (less than 10 years) contracts. The decision allowed RPS credit for short-term contracts only when the utility has satisfied specified requirements for minimum quantities of long-term contracts with new or existing facilities, and/or short-term contracts with new facilities. These specified requirements are known as the gate keeping function.

3. SDG&E's Proposal

SDG&E seeks approval of a Power Purchase Agreement and First Amendment, and Second Amendment thereto (together, the Proposed Agreement) with Envirepel. SDG&E also seeks recovery of costs associated with the Proposed Agreement and issuance of certain findings related to compliance with RPS requirements established under § 399.11, *et seq.*

SDG&E explains its RFO was issued in response to the reduction of resources resulting from the loss of the dispatchable California Department of Water Resources (CDWR)/Williams contract (known as Williams D) from SDG&E's portfolio. The RFO was issued on May 24, 2006 and solicited projects that would deliver in 2007, 2008 and/or 2009. SDG&E contends the RFO was conducted in accordance with guidance provided in D.04-12-048 and was open to all resources (conventional and renewable) bidding all types of projects (turnkeys, buyouts and Power Purchase Agreements).

SDG&E states that it met with its Procurement Review Group (PRG) several times during the course of the RFO process to communicate the status of

the evaluation, selection and contracting process. SDG&E says the Proposed Agreement resulted from a bid that was one of two renewable proposals that SDG&E received in response to its RFO. Both renewable bids were selected for the shortlist.

The Proposed Agreement involves the purchase of renewable (biomass) energy at Envirepel's Vista, California facility. This is a new facility. The Proposed Agreement states that delivery will begin no later than March 1, 2008. The Proposed Agreement will add approximately 1.5 MW of renewable energy to SDG&E's portfolio and will serve as a proof of concept project for Envirepel. The term of the Proposed Agreement is twenty two months, with five one-year options for extension of the Proposed Agreement (at SDG&E's option).

SDG&E states that approval of the Proposed Agreement will assist SDG&E in its efforts to achieve the RPS objective of a 20% renewable portfolio by 2010 by adding approximately 1.5 MW of renewable energy to SDG&E's portfolio. Once Envirepel is able to prove that its technology is successful, SDG&E envisions that it will be able to procure energy from additional Envirepel facilities pursuant to contracts that the parties have executed for larger projects using the same technology. SDG&E claims that the sooner that Envirepel is able to begin deliveries from its Vista facility, the sooner SDG&E will be able to eliminate risk involved with the new technology and move forward with larger Envirepel projects that will have a greater impact on SDG&E's renewable portfolio.

SDG&E points out that Envirepel has received RPS certification for the Vista facility.

SDG&E's proposes to use its Energy Resource Recovery Account (ERRA) to recover the costs associated with the Proposed Agreement from bundled customers. Based upon direction previously provided by the Commission,¹ SDG&E intends to seek relief from costs associated with debt equivalence issues through its cost of capital proceedings.

4. Discussion

Fairness of Contracting Process

SDG&E claims the Proposed Agreement remained an attractive choice when compared to shortlisted bids from the other three solicited resource alternatives. SDG&E contends the project was selected because, in competition with all other offers in the RFO, it was included in the lowest cost portfolios that helped SDG&E meet its identified local and system resource adequacy needs. In addition, SDG&E notes that while the Envirepel bid competed successfully with all other offers bid into the RFO, SDG&E's selection of this bid also reflects SDG&E's adherence to the preferred loading order and the Commission's direction to procure the maximum feasible amount of renewable energy in all-source solicitations.

SDG&E provided in its application a copy of the "Report of the Independent Evaluator on the All Source 2007-2009 Request for Offers," dated June 13, 2007, from PA Consulting Group (PA). In D.04-12-048, the Commission required "the use of an Independent Evaluator in resource situations where there are affiliates, IOU-built, or IOU-turnkey bidders" (p. 135) in order to guard against any tendency for the utility to favor itself, its affiliates or its shareholders.

¹ See, D.07-02-011, *mimeo.*, p. 32.

SDG&E retained PA because it anticipated that there might be affiliate bids in the RFO (as in fact there were).

The detailed PA Report states that it reviewed the RFO for clarity and fairness with the objective of ensuring a competitive, open and transparent process. The Report states that PA (a) observed SDG&E's process, (b) analyzed SDG&E's methods, and (c) reviewed in detail the RFO process. The Report concluded that SDG&E designed a fair evaluation for ranking bids and fairly applied this method to determine its short list. PA also concluded that the Envirepel contract is reasonable based on the fairness of the contract process. We note that Envirepel is not affiliated with SDG&E.

After reviewing SDG&E's application and testimony, and considering the detailed report of the Independent Evaluator, we conclude that the RFO process was fair and reasonable.

Reasonableness of Proposed Agreement

SDG&E provided the Master Power Purchase and Sales Agreement (Proposed Agreement) with Envirepel. SDG&E has a model PPA which complies with the standard terms and conditions set forth by the Commission for RPS agreements in D.04-06-014, as subsequently modified. SDG&E claims the Proposed Agreement conforms to SDG&E's model PPA in all ways except for one.

The only modification to the Commission-approved "non-modifiable" RPS standard terms is the duration of the Proposed Agreement (less than five years). SDG&E states that this term is non-standard for RPS solicitations, but does comply with the RFO from which it was selected. Because this contract is intended to be a proof-of-concept agreement for potential larger projects from Envirepel, SDG&E believes the short-term nature of the Proposed Agreement

will allow it to protect ratepayers for liability for payments pursuant to a long-term contract for energy from a not-yet-proven technology.

At the time this application was filed, contract lengths were limited to 10, 15, or 20 years. This has since been changed in D.07-11-025 to a modifiable term. Therefore, SDG&E's contract is compliant with Commission-approved terms.

We have reviewed the Proposed Agreement and its terms, including confidential data such as price and delivery amounts. The Proposed Agreement adheres to our standards and is consistent with other similar agreements. We find the Proposed Agreement to be reasonable.

RPS Eligibility

D.04-12-048 provides that "IOUs are directed to procure the maximum feasible amount of renewable energy in the general solicitations authorized by this decision, and will be allowed to credit this procurement towards their RPS targets."²

SDG&E requests that the Commission find that the generation procured pursuant to the Proposed Agreement constitutes eligible renewable energy for purposes of determining SDG&E's compliance with applicable RPS requirements. SDG&E submits that RPS credit is appropriate in the instant case, notwithstanding the fact that the Proposed Agreement resulted from a utility solicitation of short-term contracts.

The first issue to consider is whether SDG&E's all-source bidding process was an appropriate method to produce this renewables contract. The Commission noted in D.07-05-028 that it had placed limitations on the ability of

² D.04-12-048, *mimeo.*, p. 70.

RPS-obligated entities to solicit certain short-term contracts (*i.e.*, contracts of less than 10 years' duration) in RPS solicitations.³ SDG&E claims this limitation does not extend to contracts negotiated outside of the RPS solicitation context, for example, bilateral contracts or contracts resulting from all-source solicitations. We agree. D.04-12-048 specifically directs RPS-obligated utilities to procure renewable energy through all-source solicitations and places no limitation on the ability of the utilities to avail themselves of the short-term contracting authority granted under that decision.

The second issue raised by SDG&E is whether SDG&E's contract qualifies for RPS credit. D.07-05-028 provides a gate keeping requirement that RPS credit for short-term contracts (less than 10 years) will be available only where the utility has satisfied Commission-established requirements for minimum quantities of long-term contracts (with new or existing facilities) and/or short-term contracts with new facilities. Ordering Paragraph 1 of the decision states:

Beginning in calendar year 2007, each load-servicing entity (LSE) obligated under the renewables portfolio standard (RPS) program must, in order to be able to count for any RPS compliance purpose energy deliveries from contracts of less than 10 years' duration ("short-term") with RPS-eligible facilities that commenced commercial operation prior to January 1, 2005 ("existing facilities"), in each calendar year enter into contracts of at least 10 years' duration ("long-term") and/or short-term contracts with facilities that commenced commercial operation on or after January 1, 2005 ("new facilities") for energy deliveries equivalent to at least 0.25% of that LSE's prior year's retail sales (the "minimum quantity").

SDG&E claims it has satisfied these minimum quantity requirements and RPS credit for the Proposed Agreement should be granted. In 2007, SDG&E

³ D.07-05-028, *mimeo.*, pp. 4-5.

claims that it signed three RPS contracts with Envirepel. One of these is the Proposed Agreement; the other two agreements are long-term agreements that have yet to be submitted to the Commission. SDG&E states that the two not-yet-submitted contracts each have 15-year terms. SDG&E has presented testimony⁴ that these long-term contracts make up 0.49% of SDG&E's 2006 retail sales, thus exceeding the 0.25% minimum threshold required by D.07-05-028 and permitting SDG&E to count all generation procured pursuant to the Proposed Agreement toward RPS compliance.

The question before us is whether SDG&E's two long-term renewable contracts SDG&E says it signed in 2007 open the gate for SDG&E's short-term Envirepel contract to count for 2007 RPS purposes. SDG&E states "Once Envirepel is able to prove its technology by successfully delivering to SDG&E, SDG&E will be able to procure energy from additional Envirepel facilities pursuant to PPAs that the parties have executed for larger projects using the same technology."⁵

SDG&E's proposed agreement with Envirepel's Vista facility is for a new facility. Per the language in D.07-05-028 quoted above, short-term contracts with new facilities (those commencing operation on or after January 1, 2005) need not meet the minimum quantity requirement. Thus, SDG&E's long-term contracts with Envirepel have no bearing on whether SDG&E may count the short-term Envirepel contract towards RPs compliance.

⁴ SDG&E Testimony of Michael McClenahan, p. 19.

⁵ SDG&E Testimony of Michael McClenahan, p. 4.

5. Comments on Proposed Decision

The proposed decision of ALJ Gamson 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 SDG&E on January 8, 2008. SDG&E clarified that the proposed agreement with Envirepel for the Vista facility is a new facility. We have modified the proposed decision to find that the minimum quantity requirement does not pertain to a new facility.

6. Assignment of Proceeding

The assigned Commissioner is Michael R. Peevey and the assigned ALJ is David M. Gamson.

Findings of Fact

1. The facility will begin deliveries no later than March 1, 2008.
2. The Independent Evaluator's Report concludes that SDG&E in its RFO designed a fair evaluation for ranking bids, and fairly applied this method to determine its short list.
3. The proposed agreement is for a new facility.
4. The RPS Program requires each utility, including SDG&E, to increase the amount of renewable energy in its portfolio to 20% by 2010, increasing by a minimum of one percent per year.
5. D.07-11-025 set forth standard terms and conditions to be incorporated into RPS PPAs.
6. SDGE filed a supplemental application on December 20, 2007 to amend certain terms and conditions to conform with D.07-11-025.

Conclusions of Law

1. SDG&E's RFO process was fair and reasonable.

2. SDG&E's Proposed Agreement is reasonable.
3. The minimum quantity requirements of D.07-05-028 are met because the short-term contract is with a new facility.
4. The costs of the contract between SDG&E and Sellers are reasonable and in the public interest; accordingly, the payments to be made by SDG&E are fully recoverable in rates over the life of the project, subject to CPUC review of SDG&E's administration of the PPA.

O R D E R

IT IS ORDERED that:

1. The Proposed Agreement is approved.
2. San Diego Gas & Electric Company (SDG&E) may seek to have the generation procured under the Proposed Agreement count toward its renewable portfolio standard compliance obligations.
3. The costs of the contract between SDG&E and Sellers are reasonable and in the public interest; accordingly, the payments to be made by SDG&E, at or below the MPR, are fully recoverable in rates over the life of the project, subject to CPUC review of SDG&E's administration of the PPA.
4. Application 07-09-017 is closed.

This order is effective today.

Dated January 31, 2008, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON

Commissioners