

Decision 09-04-034 April 16, 2009

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)
(QF Issues)

And Related Matter.

Rulemaking 04-04-025
(Filed April 22, 2004)
(QF Issues)

DECISION GRANTING IN PART AND DENYING IN PART PETITION TO MODIFY DECISION (D.) 07-09-040 AND MOTIONS TO ADJUST PACIFIC GAS AND ELECTRIC COMPANY'S JANUARY 2008 AVOIDED COST POSTING

1. Summary

This decision addresses the petition for modification (Petition) of Decision (D.) 07-09-040 (Decision) filed by the California Cogeneration Council (CCC). D.07-09-040 addresses the policies and price of energy purchased from qualifying facilities (QFs) by the investor-owned utilities (IOUs). Specifically, this decision denies CCC's Petition requesting to reinstate the non-price contract terms of firm capacity QFs currently on interim Standard Offer 1 (SO1) contracts and to update as-available capacity and firm capacity prices on an annual basis. This decision also modifies D.07-09-040 to clarify that the Market Index Formula (MIF) and newly adopted as-available capacity prices are effective the month

after the Commission approves a resolution adopting the IOUs' joint Tier 3 advice letter implementing the MIF.

This decision also addresses motions filed by CCC and jointly by the Cogeneration Association of California and the Energy Producers and Users Coalition (CAC/EPUC) to adjust the January 2008 avoided cost posting of Pacific Gas and Electric Company (PG&E). As a result of the modifications ordered in response to the petition to modify D.07-09-040, CCC and CAC/EPUC's motions are granted in part and denied in part. The motions are granted to the extent that PG&E may not utilize the new as-available capacity price until the Commission issues a resolution approving the Tier 3 advice letter implementing the MIF.

2. Background

In D.07-09-040, we adopted specific policies and pricing mechanisms applicable to the purchase of energy and capacity from QFs by PG&E, Southern California Edison Company (SCE) and San Diego Gas & Electric Company (SDG&E) (collectively, the IOUs).¹ Among other things, D.07-09-040 replaced the Transition Formula, which specified the methodology for calculating the

¹ On September 3, 2008, SCE and The Utility Reform Network (TURN) filed a petition in the California Court of Appeal, Second Appellate District for a writ of review of D.07-09-040 and D.08-07-048, the decision disposing of applications for rehearing of D.07-09-040. (Case No. B210398.) Among other things, SCE/TURN challenged the MIF. On November 4, 2008, SCE filed Application (A.) 08-11-001 seeking retroactive application of the MIF from July 1, 2003 to July 31, 2008. Finally, on November 24, 2008, the Commission issued D.08-11-062. In D.08-11-062, the Commission, on its own motion, decided to reconsider the administrative heat rate component of the MIF. This decision does not prejudge any issues under consideration in A.08-11-001 or the reconsideration of the administrative heat rate component of the MIF, nor waive any arguments or defenses that the Commission may raise in response to the Petition for Writ of review.

short-run avoided cost (SRAC) energy price that the IOUs pay QFs, with the MIF.² The Prospective QF Program included a new one-to-five year, as-available standard offer contract, a one-to-ten year contract for firm capacity and a contract for “small” QFs under 20 megawatts (MW). Further, in recognition of the time involved in negotiating contract terms, the Decision included provisions to allow QFs with existing contracts for firm capacity that expire before the new firm capacity contracts are available to continue service. This provision would allow those QFs to extend the non-price terms and conditions of the expiring contract and receive payments based on pricing adopted in D.07-09-040 until the final contract is available.

On March 3, 2008, CCC filed a Petition to modify D.07-09-040. The Petition requests that D.07-09-040 be modified to permit firm capacity QFs whose contracts expired prior to the issuance of the Decision and who are currently operating under the interim SO1 contracts authorized in D.02-08-071, D.03-12-062, D.04-01-050 or D.05-12-009 to revert back to the non-price terms of their expired contracts along with the new firm capacity price adopted in D.07-09-040. CCC further requests that D.07-09-040 be modified to require that the prices for as-available capacity and firm capacity be updated annually and to clarify that the newly-adopted MIF and as-available capacity values become effective prospectively the first month following the Commission’s adoption of the resolution approving the IOUs’ joint Tier 3 MIF advice letter. CAC/EPUC filed a response supporting CCC’s Petition. PG&E, SCE and SDG&E filed responses opposing the Petition.

² In this decision, all references to the “Transition Formula” are to the formula that was adopted in D.96-12-028, as modified by D.01-03-067 and D.02-02-028.

At the same time it filed its Petition, CCC filed a motion (CCC Motion) seeking to adjust PG&E's January 2008 avoided cost postings. CAC/EPUC filed a similar motion (CAC/EPUC Motion) on that date as well.³ Both motions opposed PG&E's use of the new as-available capacity prices adopted in D.07-09-040 in the January 2008 postings and sought to reinstate the as-available capacity prices in effect before the Decision. Further, the CCC Motion requests that the Commission determine that the effective date for the MIF and new as-available capacity prices be the first month following the Commission's resolution approving the IOUs' joint Tier 3 advice letter. The CAC/EPUC Motion requests that there be no changes to the current QF payments until the Commission has approved not only the joint Tier 3 advice letter implementing the MIF, but also the new standard offer contracts. PG&E and SCE filed responses opposing both motions.

3. CCC's Petition

3.1. Reinstatement of Expired Non-Price Terms for Expired Firm Capacity QFs on Interim SO1 Contracts

Beginning in 2002, the Commission issued a series of decisions addressing IOU purchase of power from QFs with expiring contracts until a more complete strategy for procuring QF power was adopted. (*See generally*, D.02-08-071, D.03-12-062, D.04-01-050 and D.05-12-009.) Under D.02-08-071 and D.03-12-062, the IOUs were required to offer one-year SO1 contracts to QFs with expired or

³ Both CCC and CAC/EPUC had initially submitted "protests" to the *PG&E Avoided Cost Posting* on January 31, 2008. These documents were rejected by the Commission's Docket Office. Pursuant to direction from the assigned ALJ and Energy Division, CCC and CAC/EPUC were direct to file motions opposing the *PG&E Avoided Cost Posting*.

expiring contracts, with pricing based on the Transition Formula. (D.02-08-071, at p. 32; D.03-12-062, at p. 56.) In D.04-01-050, the Commission determined that IOU purchase of power from QFs with expiring contracts could be addressed through the following means: (1) voluntary QF participation in IOU competitive bidding processes; (2) bilateral contracts; and (3) the SO1 contract extensions ordered in D.02-08-071 and D03-12-062. (D.04-01-040, at p. 157.) However, to encourage existing QFs to continue providing power and to make efficiency upgrades, the contract extensions were increased to five years in length. (*Id.*) Effective January 1, 2006, D.05-12-009 continued the interim relief provided in D.04-01-050 for QFs with expired or expiring contracts until a final decision in these proceedings was adopted. (D.05-12-009, at p. 8.)

The prospective QF program adopted in D.07-09-040 provides for two contract options: a one-to-five year as-available contract and a one-to-ten year firm capacity contract. In addition, the program adopts contract provisions for “small” QFs under 20 MW. The Decision further notes that QFs may also enter into contracts with the IOUs through participation in competitive solicitations and bilateral negotiations. (*See*, D.07-09-040, at pp. 120-122.) Finally, the Decision provides that for existing firm capacity QFs whose contracts expire before the contracts required by D.07-09-040 are available, “[t]he QF may extend the non-price terms and conditions of the expiring contract and continue service with the pricing set forth in this Decision until the final contract is available.” (D.07-09-040, at p. 126.)

CCC asserts that since the SO1 contract is an as-available capacity contract, QFs whose firm capacity contracts had expired and had entered into the interim SO1 contracts are receiving lower capacity payments. It maintains that since these QFs have been providing the equivalent of firm capacity to the IOUs, QFs

on the interim SO1 contracts have been underpaid for their product. (Petition, p. 3.) Consequently, CCC requests that QFs whose firm capacity contracts had expired prior to the adoption of D.07-09-040 and had entered into the interim SO1 contracts be allowed to reinstate the non-price terms of their expired firm capacity contracts, along with the new pricing contained in the Decision.

(Petition, p. 4.) CCC asserts that this modification is warranted “in light of the years [QFs with expired contracts received] as-available SO1 capacity prices for firm capacity.” (Petition, p. 4.)

We do not find CCC’s arguments persuasive on this point. The interim SO1 contracts were never intended to replace firm capacity contracts. Rather, they were to serve as interim relief, allowing existing QFs with expired or expiring contracts to continue to operate while a QF policy was considered and adopted by the Commission. (*See, e.g.*, D.02-08-071, at p. 31; D.03-12-062, at p. 56.) Further, as noted in D.04-01-050, QFs with expired and expiring contracts were not required to enter into these contract extensions. Instead, they could have participated in an IOU’s competitive solicitation or entered into bilateral contracts with the IOU. (D.04-01-050, at p. 158.) Therefore, these QFs could have pursued these options had they wanted to enter into firm capacity contracts and receive the corresponding higher payments.

We also disagree with CCC’s assertion that there is no rational basis to provide different forms of relief to firm capacity QFs whose contracts expired before D.07-09-040 was adopted and to firm capacity QFs whose contracts expire after the Decision was adopted. As CCC is aware, the interim SO1 contracts were only available to QFs whose contracts expired prior to adoption of D.07-09-040. (D.05-12-009, at p. 8.) With the adoption of D.07-09-040, this interim relief is no longer available. Thus, unlike QFs whose contracts expired prior to the

adoption of D.07-09-040, QFs with existing contracts at the time the Decision was adopted would have not been able to enter into new contracts if the new firm capacity contracts were not available at the time their existing contracts expired. Therefore, the Commission included provisions to provide interim relief for these existing firm capacity QF resources. Finally, the relief adopted in D.07-09-040 applies to QFs with existing firm capacity contracts that are expiring, whereas, QFs whose contracts expired prior to adoption of D.07-09-040 no longer have an existing firm capacity contract. Therefore, the difference in treatment between QFs whose contracts expired before the adoption of D.07-09-040 and QFs whose contracts expire after the Decision was adopted reflects different circumstances and is reasonable.

Finally, CCC's request would allow QFs to terminate their existing interim SO1 contracts and resurrect firm capacity contracts that no longer exist. CCC suggests that such an outcome is appropriate in light of the number of years that these QFs had been providing firm capacity at as-available capacity prices. (CCC Petition, pp. 3-4.) However, CCC fails to acknowledge that the interim SO1 contracts were offered as a means to ensure that QFs with expired contracts could continue to provide power and make efficiency upgrades while a decision on future QF policy and pricing was adopted. Accordingly, QFs who had elected to enter into an interim SO1 contract should be expected to honor these contracts through the duration of the contract or until the QF enters into a new firm capacity contract with the IOU.

In light of these considerations, we deny CCC's request to modify D.07-09-040 to allow firm capacity QFs currently on interim SO1 contracts with the IOUs to reinstate the non-price terms of their expired firm capacity contracts and to receive payment based on the new firm capacity value.

3.2. Annual Update of As-Available Capacity and Firm Capacity Prices

CCC maintains that the cost assumptions used to set as-available capacity and firm capacity prices in D.07-09-040 are outdated and should to be updated on an annual basis. (Petition, p. 5.) It asserts that because the capacity prices adopted in D.07-09-040 were based on data from 2004 and 2005, they do not reflect increases in power plant construction costs after that time. CCC maintains that by not considering these updated costs, the as-available capacity and firm capacity prices adopted in D.07-09-040 do not reflect prevailing capacity costs and violate Public Utility Regulatory Policies Act (PURPA). Consequently, CCC proposes that the Decision be modified to update capacity prices annually and requests that the as-available capacity and firm capacity prices adopted in D.07-09-040 be immediately revised to reflect values based on what it considers to be the appropriate updated costs.

The Petition proposes that updated combustion turbine (CT) costs be based on “the average of the SCE and [California Energy Commission] CT capital costs” (Petition, p. 6) and that updated combined cycle gas turbine (CCGT) costs be based on costs used to calculate the most recently adopted market price referent for renewable generation (Petition, p. 7). It further proposes that updated energy rent and ancillary service revenues be based on “the four-year ... average of the California Independent System Operator’s (CAISO’s) calculation.” (Petition, pp. 7 & 8.)

The Petition notes that using more recent CT and CCGT costs would result in higher as-available and firm capacity payments than what is currently

available under D.07-09-040. However, the mere fact that capacity payments would be higher if more current costs were used does not, by itself, demonstrate that PURPA has been violated and that an annual update is necessary. In this proceeding, the Commission was presented with various competing proposals on how as-available capacity and firm capacity prices should be calculated. (See, D.07-09-040 at pp. 79-96 & 102-116.) After considering this conflicting evidence, the Commission determined that the methodology presented by TURN for determining as-available capacity pricing and the methodology proposed by the Independent Energy Producers (IEP) for determining firm capacity pricing were the most reasonable and should be generally adopted. (D.07-09-040, at pp. 96-100.) These adopted methodologies utilized costs that were presented in the proceeding and determined to be reasonable bases for establishing avoided cost. Aside from noting that capacity payments adopted in D.07-09-040 are lower than capacity payments using selected current CT and CCGT costs, the Petition includes no analysis or explanation why the costs adopted in D.07-09-040 to calculate capacity payments are unreasonable or fail to represent utility avoided cost. Further, CCC fails to demonstrate that its proposed costs would result in as-available capacity and firm capacity values that more properly reflect utility avoided cost.

Indeed, CCC made a similar proposal to use current information in setting as-available capacity and firm capacity prices in its comments to Commissioner Grueneich's Alternate Proposed Decision, which was ultimately adopted as D.07-09-040. (CCC Comments to Alternate Proposed Decision, pp. 14-15.) CCC's proposal was not adopted in D.07-09-040. The Petition presents no new arguments why such an update is warranted. Consequently, we remain

unpersuaded that capacity payments need to be update annually, as proposed in the Petition.

Additionally, the costs proposed in the Petition are not part of the record and are disputed. Indeed, SCE and PG&E question CCC's proposal to calculate updated capacity prices based on *current* capital costs and *historical* energy and ancillary services costs. Therefore, even if we were persuaded that costs to determine capacity payments should be updated annually, which we are not, we would not adopt CCC's proposed methodology without first providing parties an opportunity to test this methodology and to present their own methodologies for updating these costs.

For these reasons, we deny CCC's request to update as-available and firm capacity payments on an annual basis using current CT and CCGT cost information.

3.3. Effective Date of MIF and As-Available Capacity Prices

CCC states that the Decision was unclear as to when the MIF and new as-available capacity payments would start to be employed in existing and new contracts. CCC recites that, while the IOUs agreed at the workshop to implement the MIF prospectively upon the approval of the joint Tier 3 MIF advice letter, SCE also reserved the right to seek retroactive application of the MIF. (CCC Petition, pp. 9-10.) Further, CCC states that PG&E's avoided cost postings started reflecting the new as-available capacity value in January 2008, while both SCE and SDG&E have continued to use the as-available capacity values in effect before the Decision. As a result, CCC contends that there is confusion over the effective date. CCC further argues that regardless of the effective date, the IOUs should implement the MIF and new as-available capacity

prices consistently and at the same time. Consequently, CCC requests that the Decision be modified to state that the effective date of the MIF and as-available capacity values will be the month after the Commission approves a resolution adopting the IOUs' joint Tier 3 advice letter implementing the MIF. (Petition, p. 11.)

We acknowledge that there appears to be some ambiguity regarding the date when the MIF and new as-available capacity price are to be made effective. As CCC points out, the timing of the IOUs' implementation of the MIF and new as-available capacity prices has not been consistent. We agree with CCC that this implementation should occur concurrently for all IOUs.

In order to resolve any confusion or ambiguity regarding this issue, and to ensure concurrent and consistent implementation among the three IOUs, we are granting CCC's petition, and modify the Decision to state that the effective date of the MIF and as-available capacity values will be the month after the Commission approves a resolution adopting the IOUs' joint Tier 3 advice letter implementing the MIF.⁴

CCC argues that an effective date prior to the date the advice letters are filed would be "retroactive application of the MIF [and] such retroactivity would seriously disrupt prior commercial decisions made by the QFs." (Petition, p. 10.) CCC is essentially advocating for regulatory certainty in the implementation of the MIF. We are persuaded by CCC's argument as it involves the implementation of the MIF.

⁴ As CCC acknowledges, SCE proposed that the MIF be effective on the date of the underlying decision. (Petition, p. 9.)

Therefore, we believe it is preferable as a matter of policy to implement the MIF prospectively upon the approval of the joint Tier 3 MIF advice letter.

D.07-09-040 clearly requires the IOUs to file a joint Tier 3 advice letter to implement the MIF, and the advice letter becomes effective upon Commission approval.⁵ We believe that CCC's proposal to implement the MIF prospectively upon the approval of the joint Tier 3 MIF advice letter provides such regulatory certainty. Therefore, we adopt CCC's proposal to set the implementation date of the MIF on the first day of the month after the Commission approves a resolution adopting the IOUs' joint Tier 3 advice letter.

We recognize there is some risk that basing the effective date of the MIF and new as-available capacity prices on when the joint IOU Tier 3 advice letter is approved might provide an incentive to some parties to either expedite or delay, depending on their circumstances, the advice letter process to their advantage. We hope that this will not happen, but put parties on notice that no such gaming of the Commission's processes will be tolerated.

4. CCC and CAC/EPUC Motions

On January 10, 2008, PG&E posted its 2008 *Avoided Cost Posting for As-Delivered Capacity Prices for Qualifying Facilities (QFs) and Energy Prices for QFs (PG&E Avoided Cost Posting)*. The *PG&E Avoided Cost Posting* included the new as-availability capacity value adopted in D.07-09-040. In contrast, the 2008 avoided cost postings for SDG&E and SCE continued to use the as-available capacity prices currently in effect. Both CCC and CAC/EPUC filed motions opposing the *PG&E Avoided Cost Posting* on March 2, 2008.

⁵ See D.07-09-040 at Ordering Paragraph 3 (as modified by D.08-09-024).

The CCC and CAC/EPUC motions maintain that all three IOUs should implement the MIF and new as-available capacity values in a consistent manner. Both motions assert that the Decision was unclear on when the new values are to be effective. CCC proposes that the MIF and new as-available capacity values should not be in effect until after the resolution approving the joint IOU advice letter is issued, while CAC/EPUC asserts that these new values cannot be in effect until after the new standard offer contracts are also approved. These are essentially the same arguments raised in CCC's Petition and have been addressed above.

Consistent with our discussion above, CCC's motion is granted, and CAC/EPUC's motion is denied to the extent it differs from CCC's motion regarding the effective date for the MIF and new as-available capacity values. However, both motions are granted in that PG&E shall revise the *PG&E Avoided Cost Posting* to reflect the as-available capacity value currently in effect. As determined in this decision, the MIF and new as-available capacity value shall not be utilized until after the resolution approving the joint IOU Tier 3 advice letter is approved. Underpayments to the QFs from January 1, 2008 to the date of this decision shall be recovered over a 12-month period.

5. Comments on Alternate Proposed Decision

The alternate proposed decision of the assigned Commissioner 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 March 16, 2009 by SCE, SDG&E, Independent Energy Producers Association, jointly by PG&E and The Utility Reform Network (TURN), and jointly by CCC and CAC/EPUC. Reply comments were filed on March 23, 2009 by SCE, SDG&E, Independent Energy

Producers Association, PG&E, TURN, and jointly by CCC and CAC/EPUC. This decision has been revised, as appropriate, to reflect these comments and reply comments.

6. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Amy C. Yip-Kikugawa is the assigned Administrative Law Judge in both proceedings.

Findings of Fact

1. Beginning in 2002, the Commission issued a series of decisions allowing QFs with expired contracts to enter into interim SO1 contracts with pricing based on SRAC until a more complete strategy for procuring QF was adopted.
2. The interim SO1 contracts were to allow QFs with expiring contracts to continue to operate while a QF policy was considered and adopted.
3. The interim SO1 contracts were only available to those QFs whose contracts expired before D.07-09-040 was issued.
4. The Prospective QF Program adopted in D.07-09-040 provides for both an as-available capacity and a firm capacity contract option.
5. The Prospective QF Program includes a provision to allow QFs with existing contracts for firm capacity that expire before the new firm capacity contract adopted in D.07-09-040 is available to continue service.
6. The relief adopted in D.07-09-040 applies to QFs with existing firm capacity contracts that are expiring.
7. QFs whose contracts expired prior to adoption of D.07-09-040 no longer have an existing firm capacity contract.
8. CCC proposes to calculate updated capacity prices based on current capital costs and historical energy and ancillary services costs.

9. CCC's proposed costs and data for calculating updated capacity values are not part of the record and have not been subject to cross-examination.

10. The IOUs have not been implementing the MIF and the new as-available capacity prices consistently or concurrently.

11. PG&E's 2008 *Avoided Cost Posting for As-Delivered Capacity Prices for Qualifying Facilities (QFs) and Energy Prices for QFs* included the new as-available capacity value adopted in D.07-09-040, while SDG&E and SCE's 2008 postings continued to use the as-available capacity values in effect at the time.

Conclusions of Law

1. It would be unreasonable to reinstate the non-price terms and conditions of expired firm capacity contracts.

2. The mere fact that capacity prices would be higher if more recent CT or CCGT costs were used does not, by itself, demonstrate a PURPA violation.

3. There has been no showing that the costs adopted in D.07-09-040 to calculate capacity prices are unreasonable or result in a payment that does not reflect utility avoided cost.

4. There has been no showing that CCC's proposed methodology to update capacity prices is reasonable or results in a payment that better reflects utility avoided cost.

5. The IOUs should implement the MIF and new as-available capacity prices consistently and at the same time.

6. Tier 3 advice letters require Commission approval before becoming effective.

7. The IOUs should not begin utilizing the MIF and new as-available capacity prices until after the joint IOU Tier 3 advice letter implementing the MIF is approved.

8. D.07-09-040 should be modified to clarify the effective date of the newly adopted prices and policies.

9. CCC's motion opposing PG&E's 2008 *Avoided Cost Posting for As-Delivered Capacity Prices for Qualifying Facilities (QFs) and Energy Prices for QFs* should be granted, as described above.

O R D E R

IT IS ORDERED that:

1. The California Cogeneration Council's Petition for Modification of Decision (D.) 07-09-040 is granted, as described above.

2. Ordering Paragraph 1 of D.07-09-040 is modified as follows:

"Pacific Gas and Electric Company, San Diego Gas & Electric Company and Southern California Edison Company shall revise their qualifying facilities (QFs) programs, including the short-run avoided cost calculations and the implementation of their prospective QFs program, in conformance with the discussion, findings and conclusions set forth in this decision as summarized in Table 1. Unless otherwise provided, the energy and capacity prices adopted in this decision are effective immediately the first month following the Commission's adoption of the resolution approving the IOUs' joint Tier 3 MIF advice letter."

3. The March 3, 2008 motion filed by the California Cogeneration Council to adjust Pacific Gas and Electric Company's January 2008 *Avoided Cost Posting for As-Delivered Capacity Prices for Qualifying Facilities (QFs) and Energy Prices for QFs* is granted, as described above.

4. Rulemaking (R.) 04-04-003 and R.04-04-025 remain open.

This order is effective today.

Dated April 16, 2009, at San Francisco, California.

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