PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION **RESOLUTION E-4427**
December 1, 2011

REDACTED

R E S O L U T I O N

Resolution E-4427. Pacific Gas and Electric Company ("PG&E") requests approval of an amendment to an existing Qualifying Facility ("QF") contract with DG Fairhaven Power LLC ("DG Fairhaven") for delivery of Renewable Portfolio Standard ("RPS")-eligible power. The amendment consists of an initial three-year period, after which time PG&E would have the option to extend the amendment for an additional year and, subsequently, the option to extend the amendment for another eleven months.

PROPOSED OUTCOME: This Resolution approves the Proposed Amendment of the existing QF contract between DG Fairhaven Power and PG&E with modifications.

ESTIMATED COST: Actual costs are confidential at this time.

By Advice Letter 3843-E filed on May 10, 2011.

SUMMARY

Pacific Gas and Electric Company's ("PG&E's") third Proposed Amendment to the existing Qualifying Facility ("QF") contract with DG Fairhaven Power LLC ("DG Fairhaven") complies with QF contract extension provisions, and is approved with modifications.

On May 10, 2011, PG&E filed Advice Letter ("AL") 3843-E requesting Commission approval of a three-year to four-year, eleven month QF contract amendment between PG&E and DG Fairhaven ("Facility"), which operates a

17.25 megawatt (nameplate) biomass facility.[1] The Proposed Amendment to the standard offer thirty-year Power Purchase Agreement ("PPA") is the third amendment since 2009 providing the Facility price relief.

The original PPA between PG&E and DG Fairhaven was executed in 1984 and commenced with initial energy deliveries in February 1987. The existing PPA as amended expires February 2, 2017. PG&E and DG Fairhaven executed the Proposed Amendment to the original PPA on February 28, 2011 and executed a letter agreement correcting the legal name of the seller and limiting the maximum term of the Proposed Amendment to four years and eleven months on April 1, 2011.

The Proposed Amendment modifies the existing contract price in exchange for stricter performance obligations. This price adjustment allows the Facility to recover costs for energy deliveries for the period beginning February 3, 2011 until the Proposed Amendment expiration date, subject to CPUC approval. The Proposed Amendment applies for an initial term of three years, after which time PG&E would have the option to extend the amendment terms for an additional year and then subsequently for another eleven months. Aside from the changes stipulated in the Proposed Amendment, the existing PPA remains unchanged.

The Proposed Amendment is intended to preserve the economic viability of the Facility over the next several years and in so doing secure renewable energy deliveries that can contribute toward PG&E's near term renewable procurement obligations pursuant to the Renewables Portfolio Standard. As described in more detail in the Confidential Appendix, the price included in the Proposed Amendment appears reasonable when compared to the prices reflected in PG&E 2011 Renewable Shortlist.

A detailed discussion of the terms of the Proposed Amendment is included in Confidential Appendix A.

BACKGROUND

Recent Decisions related to the California QF Program

[1] PG&E represents that the nameplate capacity of the facility is 17.25 MW, although firm capacity delivery is 16 MW.

On December 16, 2010, the Commission adopted the Qualifying Facilities and Combined Heat and Power (QF/CHP) settlement with the issuance of Decision ("D.")10-12-035. The settlement resolves a number of longstanding issues regarding the contractual obligations and procurement options for facilities operating under legacy and new QF contracts.

Among other things, D.10-12-035 updates methodologies and formulas for Short Run Avoided Cost (SRAC) energy price for QFs to be used in Transition PPAs, Legacy PPAs, other existing QF PPAs and Optional As-Available PPAs. The SRAC methodology under the QF/CHP settlement includes:

(1) by January 1, 2015, transitioning SRAC pricing from a formula that is based in part on administratively-determined heat rates to a formula that solely uses market heat rates;

(2) investor-owned utility ("IOU")-specific time-of-use ("TOU") factors to be applied to energy prices to encourage energy deliveries during the times when the energy is most needed by customers;

(3) a locational adjustment based on California Independent System Operator ("CAISO") nodal prices; and

(4) pricing options based on whether a cap-and-trade program or other form of greenhouse gas ("GHG") regulation is developed in California or nationally.

Approval for QF contract changes was previously addressed in D.98-12-066, which authorized the advice letter process to be used for restructured QF contracts that are supported by the utility, the QF and the Division of Ratepayer Advocates ("DRA"), and the application process to be used for controversial QF contract restructurings. More recently, D.04-12-048 stipulated that contracts with greater than a five-year term require an application and D.06-12-009 clarifies that modifications and amendments of QF contracts with terms less than five years may be addressed through the filing of an advice letter ("AL"). [2]

Pursuant to these stipulations PG&E filed AL 3843-E seeking approval of a Proposed Amendment to an existing QF contract.

[2] See D.06-12-009 at p.7.

Overview of the DG Fairhaven Facility

DG Fairhaven Power LLC ("DG Fairhaven") operates a 17.25 megawatt (nameplate) biomass generating facility ("Facility") near Eureka, California. The Facility has historically burned a mix of woody biomass.

The PPA between PG&E and DG Fairhaven was executed in 1984, and initial electricity delivery commenced in 1987. The existing PPA is a thirty-year standard offer contract that expires February 2, 2017.

The Proposed Amendment provides price relief in exchange for enhanced performance obligations. This is the third negotiated contract price amendment intended to encourage economic operations since 2009. The Facility has remained operational in accordance with the modified performance obligations since PG&E and DG Fairhaven executed the Proposed Amendment on February 28, 2011.

NOTICE

Notice of AL 3843-E was made by publication in the Commission's Daily Calendar. PG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section 3.14 of General Order 96-B.

PROTESTS

The Division of Ratepayer Advocates ("DRA") filed a protest on August 4, 2011 identifying several concerns:

(1) PG&E does not need RPS-eligible energy beyond the initial term of the Amendment, i.e., beyond February 2014.
(2) PG&E's claim that state policy support for the facility should not include Executive Order ("EO") S-06-06, as the EO does not require PG&E to maintain its biomass portfolio.
(3) Ratepayers should not be responsible for continued price relief to economically operate the DG Fairhaven facility that is over 20 years old.

In its reply to DRA's protest, PG&E noted that the Proposed Amendment provides PG&E the opportunity to extend the Proposed Amendment if needed,

but extension is not required. PG&E states that its RPS compliance is set by Senate Bill 2.

PG&E's need for the RPS-eligible energy is dependent on variables including, but not limited to:

- Continued deliveries from operating contracts
- Timely and successful completion of projects

Based on the uncertainty related to these variables, PG&E recommends that the Commission approve the Proposed Amendment and allow PG&E to determine in 2014 whether to extend the amendment terms.

The protest and response are further detailed in the confidential portion of the Resolution.

DISCUSSION

PG&E requests Commission approval of a Proposed Amendment to the existing QF contract with DG Fairhaven.

On May 10, 2011, PG&E filed Advice Letter ("AL") 3834-E which seeks approval of a Proposed Amendment to an existing PPA between PG&E and DG Fairhaven. The amendment effective date is February 3, 2011.

The Proposed Amendment modifies performance obligations and the contract price under the PPA for an initial three-year period. In addition, the Proposed Amendment would give PG&E the option to extend the price modification for an additional year (i.e., until February 2, 2015) and subsequently for another eleven months (i.e., until January 3, 2016).

PG&E expects DG Fairhaven to deliver 106 gigawatt-hours ("GWh") of renewable power to PG&E per year during the contract term. The Proposed Amendment will become effective when it is approved by the CPUC. PG&E has agreed to true-up payments made to DG Fairhaven for the period starting February 3, 2011 to the date of the CPUC approval using the Proposed Amendment price. If approved, the Proposed Amendment will expire on February 2, 2014, unless PG&E exercises its option to extend the Proposed Amendment as described above.

Specifically, PG&E requests that the Commission:

1. Approve the Proposed Amendment without modification as just and reasonable; and,

2. Determine that all costs associated with the Proposed Amendment, including any costs incurred if PG&E elects to exercise its option to extend the Proposed Amendment for up to one year and eleven months, be recovered through PG&E's Energy Resource Revenue Account ("ERRA").

Energy Division evaluated the Proposed PPA Amendment based on the following criteria:

- Consistency with D.06-12-009 and D.07-09-040
- Consistency with D.10-12-035 (QF/CHP Program Settlement)
- Consistency with RPS standard terms and conditions
- Consistency with RPS Resource Eligibility Guidelines
- Consistency with the RPS resource needs identified in PG&E's 2011 RPS Procurement Plan
- Consistency with D.02-08-071, which requires Procurement Review Group (PRG) participation
- Cost reasonableness
- Project viability
- Contract term reasonableness

In considering these factors, we also consider the analysis and recommendations of the Independent Evaluator.

The Proposed Amendment filing is consistent with D.06-12-009 and D.07-09-040 allowing modifications and amendments for QF contract extensions of less than five years duration.

The filing of AL 3770-E is consistent with Commission procedures for the extension of QF contracts. D.04-12-048, which adopts the IOUs' long-term procurement plans, concludes that "contracts with duration five years or longer [shall] be submitted with an application to the Commission for preapproval."[3] D.06-12-009 clarifies that based on D.04-12-048, QF contract extensions for less than five years should be authorized through the advice letter process. Because the contractual changes embodied in the Proposed Amendment would, at most, modify the existing contract for 4 years 11 months, we find that filing of the Proposed Amendment via Advice Letter is consistent with D.06-12-009. Furthermore, D.07-09-040 states that "in recognition of the often lengthy process involved in negotiating contract terms… the 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 [QF Standard Offer] contract is available."[4]

Consistency with D.10-12-035 (QF/CHP Program Settlement)

On December 16, 2010, the Commission adopted the QF/Combined Heat and Power (CHP) settlement with the issuance of D.10-12-035. The settlement resolves a number of longstanding issues regarding the contractual obligations and procurement options for facilities operating under legacy and new QF contracts. Among other things, it establishes methodologies and formulas for calculating SRAC to be used in Transition Power Purchase Agreements (PPAs), Legacy PPAs, other existing QF PPAs and Optional As-Available PPAs. Furthermore, the Settlement allows for bilaterally negotiated contracts with QFs to determine alternative energy and capacity payments mutually agreeable by relevant parties and subject to CPUC approval. Finally, it establishes specific CHP procurement targets and greenhouse gas (GHG) reduction targets for each named utility.

The QF/CHP Settlement is pending effectiveness which is expected before the end of 2011. The Proposed Amendment which is the subject of this resolution is consistent with the not-yet effective Settlement allowing for bilaterally negotiated contracts. Since DG Fairhaven is not a CHP resource, it does not count towards PG&E's megawatt and GHG reduction targets under the

[3] D.04-12.048 at p.108.

[4] D.07-09-040 at p.126.

Settlement. Upon expiration of the price amendment, the energy price paid to the QFs will revert to SRAC, as defined by the Settlement or updated by the CPUC, for any remaining term of the contracts.

Approval of the Proposed Amendment is contingent upon demonstration that it includes all relevant RPS non-modifiable standard terms and conditions.

The Commission adopted a set of standard terms and conditions ("STCs") required in RPS contracts, four of which are considered "non-modifiable." The STCs were compiled in D.08-04-009 and subsequently amended in D.08-08-028. More recently in D.10-03-021, as modified by D.11-01-025, the Commission further refined these STCs.

While DG Fairhaven is currently operating under a QF contract, and will continue to do so under the Proposed Amendment, since the Facility is delivering RPS-eligible power, it is prudent to ensure the contract includes the most recent RPS non-modifiable terms and conditions. This will help ensure consistency in managing renewable power generated to meet the utility's RPS obligations.

Approval of the Proposed Amendment is contingent upon demonstration that the Facility meets the RPS Resource Eligibility Guidelines.

Pursuant to Pub. Util. Code § 399.13, the CEC certifies eligible renewable energy resources. Generation from a resource that is not CEC-certified cannot be used to meet RPS requirements. To ensure that only CEC-certified energy is procured under a Commission-approved RPS contract, the Commission has required standard and non-modifiable "eligibility" language in all RPS contracts. That language requires a seller to warrant that the project qualifies and is certified by the CEC as an "Eligible Renewable Energy Resource," that the project's output delivered to the buyer qualifies under the requirements of the California RPS, and that the seller uses commercially reasonable efforts to maintain eligibility should there be a change in law affecting eligibility.[5]

The Commission requires a standard and non-modifiable clause in all RPS contracts that requires "CPUC Approval" of a PPA to include an explicit finding that "any procurement pursuant to this Agreement is procurement from an

[5] *See, e.g.* D. 08-04-009 at Appendix A, STC 6, Eligibility.

eligible renewable energy resource as certified by the California Energy Commission for purposes of determining Buyer's compliance with any obligation that it may have to procure eligible renewable energy resources pursuant to the California Renewables Portfolio Standard (Public Utilities Code Section 399.11 et seq.), Decision 03-06-071, or other applicable law."[6]

The Commission has no jurisdiction to determine whether a project is an eligible renewable energy resource, nor can the Commission determine prior to final CEC certification of a project, that "any procurement" pursuant to a specific contract will be "procurement from an eligible renewable energy resource."

Therefore, while we include the required finding here, this finding has never been intended, and shall not be read now, to allow the generation from a non-RPS-eligible resource to count towards an RPS compliance obligation. Nor shall such finding absolve the seller of its obligation to obtain CEC certification, or the utility of its obligation to pursue remedies for breach of contract. Such contract enforcement activities shall be reviewed pursuant to the Commission's authority to review the utilities' administration of contracts.

The Proposed Amendment is consistent with the RPS resource needs identified in PG&E's 2011 RPS Procurement Plan.

Under its existing QF contract, PG&E is obligated to pay the Facility short run avoided cost for its output pursuant to the utilities' must take obligations under the Public Utility Regulatory Policies Act. However, because the price under the Proposed Amendment is justified on the basis of the contribution that deliveries from the Facility will make toward PG&E's RPS goals, we evaluate the Proposed Amendment for consistency with PG&E's most recently approved RPS procurement plan, which in part, identifies PG&E's need for RPS-eligible energy.

PG&E's 20011 RPS Procurement Plan (Plan) was approved by D.09-06-018 on June 8, 2009. Pursuant to statute, PG&E's Plan includes an assessment of supply and demand to determine the optimal mix of renewable generation resources. While the Proposed Amendment relates to an existing QF contract negotiated bilaterally outside of the competitive RPS solicitation process, we find that it is consistent with the RPS resource needs identified in PG&E's Plan. The DG

[6] See id. at Appendix A, STC 1, CPUC Approval.

Fairhaven Facility will deliver 106 GWh/year of RPS-eligible resources in the near-term, and the project is already delivering renewable energy under its existing contract. As described in more detail in the Confidential Appendix, the deliveries anticipated under this contract will help PG&E fulfill near term RPS obligations. However, beyond the initial three years of the proposed amendment, the need for the deliveries this project is anticipated to provide is less certain given the level of contracting PG&E has undertaken to date. For these reasons we believe the option to extend the amendment terms is reasonable as it affords the opportunity to retain this facility and its output based on an assessment of need and value at that time, as opposed to committing PG&E, and by extension ratepayers, to future procurement today that may prove unnecessary and/or costly relative to alternatives.

We also note that approval of the Proposed Amendment supports California Executive Order S-06-06, establishing targets for the use and production of biofuels and biopower and directing state agencies to work together to advance biomass programs in California while providing environmental protection and mitigation.[7]

Consistency with D.02-08-071

PG&E's Procurement Review Group (PRG) was notified of the Proposed Amendment. PG&E discussed the Proposed Amendment with its PRG on February 8, 2011.

The costs in the Proposed Amendment are reasonable.

DG Fairhaven provided PG&E with a financial pro forma including a forecast income statement, cash flow statement and balance sheet. In addition, DG Fairhaven provided PG&E with its actual costs and revenues for the period 2006 to 2009. Energy Division reviewed the report of an Independent Evaluator, including work papers showing the DG Fairhaven cash flow model.

In addition to analyzing the cash flow model, Energy Division compared the price for capacity and energy under the Proposed Amendment against other

[7] Executive Order S-06-06 by the Governor of the State of California (April 2006). http://www.dot.ca.gov/hq/energy/Exec%20Order%20S-06-06.pdf

biomass and RPS transactions as well as to bids in the 2011 RPS solicitation, as is standard in the Commission's reasonableness review of RPS PPA prices.

Using these comparisons and the confidential cash flow analysis provided by the report from the Independent Evaluator, the Commission determines that the price under the Proposed Amendment is reasonable.

We also note that DG Fairhaven's existing contract is structured in a manner which provides incentives for it to deliver power only during on-peak months and provides little incentive to deliver throughout the course of the year.

The Proposed Amendment would modify the performance requirements to which DG Fairhaven is subject and promote more reliable deliveries as compared to its existing PPA.

The project is viable

DG Fairhaven is an existing facility and as such, from a project development standpoint, viability is not in question. However, as explained in the Confidential Appendix, we do have concerns regarding the longer term operational viability of the project. These concerns do not rise to the level of rejecting the Proposed Amendment, but are important considerations.

We note that after the term of the Proposed Amendment, the Facility will revert to its original contract terms and pricing. PG&E and DG Fairhaven have indicated their intention to continuing negotiations during the term of the Proposed Amendment to develop a longer-term solution for viability of the Facility.

The Proposed Amendment is Reasonable

We find that the term of the Proposed Amendment, starting February 3, 2011 through February 3, 2014 is reasonable. The Proposed Amendment provides Seller with immediate relief so it can continue operating economically, and provides PG&E near-term deliveries of renewable energy at reasonable cost. PG&E will provide true-up payments to the Seller for the period agreed to by Seller and Buyer.

Although in the near term, deliveries from the Facility will help fulfill PG&E's renewable mandates, beyond three years the need for this energy is less clear given the amount of renewable contracting PG&E has done to date and future potential contracting activities. We agree with PG&E that it may be appropriate to extend the amendment terms for as much as one year and 11 months beyond the initial 3-year period, with the prudency of that decision depending on PG&E's compliance position at that time, and the state of the renewable energy market. In light of this we believe the option to extend the Proposed Amendment term is reasonable as it preserves the ability to retain this generation if it is needed.

More details of the contract term and request for extension are included in Confidential Appendix A.

Independent Evaluator Review

Although it was not required, PG&E elected to have an Independent Evaluator ("IE") review the amendment. Lewis Hashimoto from Arroyo Seco Consulting evaluated the Amendment and concluded that the Amendment merits CPUC approval. The IE noted some concerns that PG&E addressed in their Confidential Appendices. More details of the IE review are included in the Confidential Appendix A.

CONFIDENTIAL INFORMATION

The Commission, in implementing Pub. Utils. Code § 454.5(g), has determined in D.06-06-066, as modified by D.07-05-032, that certain material submitted to the Commission as confidential should be kept confidential to ensure that market sensitive data does not influence the behavior of bidders in future RPS solicitations. D.06-06-066 adopted a time limit on the confidentiality of specific terms in RPS contracts. Specified information, such as price, is confidential for three years from the date the contract states that energy deliveries begin, except contracts between IOUs and their affiliates, which are public.

The confidential appendices, marked "[REDACTED]" in the public copy of this resolution, as well as the confidential portions of the advice letter, should remain confidential at this time.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

Staff issued a draft resolution on November 1, 2011. No parties filed comments on the draft resolution. Minor changes were made to correct errors or enhance clarity; however, these changes do not affect the outcome of the resolution, which approves the DG Fairhaven advice letter without modification.

FINDINGS AND CONCLUSIONS

1. DG Fairhaven, LLC operates a 17.25 megawatt (nameplate) biomass generating facility.

2. DG Fairhaven, LLC has been making deliveries to Pacific Gas and Electric Company for renewable power pursuant to a QF Interim Standard Offer No. 4 Power Purchase Agreement for over 20 years.

3. On April 1, 2011, Pacific Gas and Electric Company executed the final Proposed Amendment with DG Fairhaven, LLC to modify the existing contract price in exchange for enhanced performance obligations.

4. Pacific Gas and Electric Company expects DG Fairhaven, LLC to deliver 106 gigawatt-hours of renewable power to PG&E per year during the term of the Proposed Amendment.

5. Pacific Gas and Electric Company's Proposed Amendment to the existing QF PPA with DG Fairhaven, LLC is consistent with D.06-12-009 and D.07-09-040 allowing modifications and amendments for QF contract extensions of less than five years duration.

6. The Proposed Amendment is consistent with the bilateral contracting provisions allowed in D.10-12-035, the QF/CHP Settlement.

7. Approval of Pacific Gas and Electric Company's Proposed Amendment is contingent upon demonstration that it includes all relevant RPS non-modifiable standard terms and conditions.

8. Approval of Pacific Gas and Electric Company's Proposed Amendment is contingent upon demonstration that it includes RPS standard contract terms and conditions consistent with RPS Resource Eligibility Guidelines.

9. Pacific Gas and Electric Company's Proposed Amendment is consistent with the RPS resource needs identified in PG&E's 2011 RPS Procurement Plan.

10. Pacific Gas and Electric Company's Procurement Review Group (PRG) was notified of the Proposed Amendment to the existing QF PPA with DG Fairhaven, LLC

11. The costs in Pacific Gas and Electric Company's Proposed Amendment are reasonable.

12. The facility operated by DG Fairhaven, LLC, is viable.

13. The modified performance obligations under Pacific Gas and Electric Company's Proposed Amendment provide stronger incentives relative to the existing contract to provide more reliable deliveries throughout the year.

14. Deliveries from the Facility will help fulfill PG&E's near term RPS obligations, however beyond the initial term, the need for the energy from these projects is less certain given the contracting PG&E has done to date and potential future contracting activities.

THEREFORE IT IS ORDERED THAT:

1. Pacific Gas and Electric Company's Advice Letter 3843-E requesting Commission approval of a three year amendment to an existing Qualifying Facility (QF) contract and the option to extend the proposed amendment by 1 year, and subsequently, an additional 11 months, with DG Fairhaven, LLC is approved.

2. Within 30 days from the effective date of this resolution, Pacific Gas and Electric Company shall file a Tier 1 Advice Letter compliance filing to

demonstrate that the DG Fairhaven, LLC Power Purchase Agreement has been amended to include all relevant non-modifiable standard terms and conditions currently required by the Commission.

3. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on December 1, 2011; the following Commissioners voting favorably thereon:

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PAUL CLANON
Executive Director

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK J. FERRON
Commissioners

Confidential Appendix A

[REDACTED]