DRAFT

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ID# 11167

ENERGY DIVISION **RESOLUTION E-4478**

April 19, 2012

REDACTED

R E S O L U T I O N

Resolution E-4478. Pacific Gas and Electric Company ("PG&E") requests approval of an amendment to an existing Qualifying Facility ("QF") contract with HL Power Company ("Honey Lake") 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 HL Power Company and PG&E without modification.

ESTIMATED COST: Actual costs are confidential at this time.

By Advice Letter 3949-E filed on November 16, 2011

SUMMARY

Pacific Gas and Electric Company's ("PG&E's") second Proposed Amendment to the existing Qualifying Facility ("QF") contract with HL Power Company ("Honey Lake") complies with QF contract extension provisions, and is approved without modification.

On November 16, 2011, PG&E filed Advice Letter ("AL") 3949-E requesting Commission approval of a three-year to four-year, eleven month QF contract amendment between PG&E and Honey Lake ("Facility"), which operates a 32 megawatt (nameplate) biomass facility. Honey Lake is currently being paid

under the existing PPA which is a 30-year interim Standard Offer contract that expires September 15, 2019. If approved the proposed amendment would take effect starting August 16, 2011.

The original PPA between PG&E and Honey Lake was executed on March 3, 1985 and commenced with initial energy deliveries in September 16, 1989. The existing PPA as amended expires September 15, 2019. HL Power has delivered electricity generated by the Facility under the PPA since the Facility began operations and started providing firm capacity in September 1989.

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 August 16, 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 of this resolution.

BACKGROUND

Recent Decisions related to the California QF Program

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. On November 23, 2011 the QF/CHP Settlement became effective.
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").[1]

Pursuant to these stipulations PG&E filed AL 3949-E seeking approval of a Proposed Amendment to an existing QF contract.

Overview of the Honey Lake Facility

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

HL Power Company ("Honey Lake") operates a 32 megawatt (nameplate) biomass generating facility ("Facility") located in Wendel, California. The Facility has historically burned biomass for its fuel.

The PPA between PG&E and Honey Lake Power was executed in 1985, and initial electricity delivery commenced in 1989. The existing PPA is a thirty-year standard offer contract that expires on September 15, 2019.

The Proposed Amendment provides a price increase in exchange for enhanced performance obligations. This amendment would modify the original PPA between PG&E and Honey Lake Power that expires on September 15, 2019. The amendment would true up payments to Honey Lake for deliveries provided from August 16, 2011 to the approval date of this Resolution, based on the pricing and performance terms approved herein.

NOTICE

Notice of AL 3949-E was made by publication in the Commission's Daily Calendar. PG&E states that a copy of these Advice Letters were mailed and distributed in accordance with Section 3.14 of General Order 96-B.

PROTESTS

There were no protests filed for Advice 3949-E.

DISCUSSION

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

On November 16, 2011, PG&E filed Advice Letter ("AL") 3949-E which seeks approval of a Proposed Amendment to an existing PPA between PG&E and Honey Lake. The requested amendment effective date is August 16, 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 August 15, 2015) and subsequently for another eleven months (i.e., until July 15, 2016).

PG&E expects Honey Lake to deliver 172 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 Honey Lake for the period starting August 16, 2011 to the date of the CPUC approval using the Proposed Amendment price. If approved, the Proposed Amendment will expire on August 15, 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, may 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 3949-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."[2] 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."[3]

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 ("Settlement") with the issuance of D.10-12-035. The Settlement became effective as of November 23, 2011. 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,

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

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

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. On November 23, 2011 the QF/CHP Settlement became effective.

The proposed amendment is consistent with the Settlement allowing for bilaterally negotiated contracts. We note that since Honey Lake is not a CHP resource, it does not count towards PG&E's megawatt and GHG reduction targets under the Settlement. Upon expiration of the price amendment, the energy price paid to the QF will revert to SRAC, as defined by the Settlement or updated by the CPUC, for any remaining term of the contract which expires September 15, 2019.

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, the Commission further refined these STCs in D.10-03-021, as modified by D.11-01-025.

While Honey Lake 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.

Under the proposed amendment, the PPA for the Honey Lake Facility includes the Commission adopted RPS "non-modifiable" standard terms and conditions, as set forth in D.08-04-009, D.08-08-028, and D.10-03-021, as modified by D.11-01-025.

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

Pursuant to Pub. Util. Code § 399.25, 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.[4]

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 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."[5]

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.

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

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

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 2011 RPS Procurement Plan (Plan) was approved by D.11-04-030 on April 14, 2011. 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 Honey Lake Facility will deliver 172 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.[6]

[6] 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

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 June 14, 2011.

The costs in the Proposed Amendment are reasonable.

Honey Lake provided PG&E with a financial pro forma including a forecast income statement, cash flow statement and balance sheet. Honey Lake has provided PG&E with financial information which demonstrates that a price adjustment is needed to enable the Facility to operate economically. Energy Division reviewed the report of the Independent Evaluator, as well as work papers showing the cash flow of the facility.

In addition to analyzing the cash flow model, Energy Division compared the price for capacity and energy under the Proposed Amendment against other 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 Honey Lake'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 Honey Lake is subject and promote more reliable deliveries as compared to its existing PPA.

The project is viable

Honey Lake is an existing facility and as such, from a project development standpoint, viability is not in question. As explained in the Confidential Appendix, we do have some reservations regarding the longer term operational viability of the project; however, these reservations do not rise to the level of rejecting the Proposed Amendment, but are important considerations.

The Proposed Amendment is Reasonable

We find that the initial term of the Proposed Amendment, starting August 16, 2011 through August 15, 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, with the expiration date subject to CPUC approval. The amendment also includes provisions which Energy Division believes provide incentives for better performance relative to the existing contract.

Although in the near term, deliveries from the Facility will help fulfill PG&E's renewable mandates, the need for this energy is unclear 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 eleven 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. Arroyo Seco Consulting evaluated the Amendment and concluded that the Amendment merits CPUC approval. The IE noted some concerns about the second amendment which PG&E addressed in their Confidential Appendices.

<u>CONFIDENTIAL INFORMATION</u>

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.

FINDINGS AND CONCLUSIONS

1. Honey Lake Power, Inc., operates a 32 megawatt (nameplate) biomass generating facility.

2. The PPA between PG&E and Honey Lake Power, Inc., was executed in 1985, and initial electricity delivery commenced in 1989; the existing PPA is a thirty-year standard offer contract that expires on September 15, 2019.

3. On September 12, 2011, Pacific Gas and Electric Company executed the final Proposed Amendment with Honey Lake Power, Inc., to modify the existing contract price in exchange for enhanced performance obligations.

4. The Honey Lake facility has historically burned biomass.

5. Honey Lake Power, Inc., 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.

6. Pacific Gas and Electric Company expect Honey Lake Power, Inc., to deliver 172 gigawatt-hours of renewable power to PG&E per year during the term of the Proposed Amendment.

7. Pacific Gas and Electric Company's Proposed Amendment to the existing QF PPA with Honey Lake Power, Inc., 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.

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

9. 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.

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

11. Pacific Gas and Electric Company's Procurement Review Group (PRG) was notified of the Proposed Amendment to the existing QF PPA with Honey Lake Power, Inc., on June 14, 2011.

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

13. The facility operated by Honey Lake Power, Inc., is viable.

14. 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.

15. Under the proposed amendment, the PPA for the Honey Lake facility will include the Commission adopted RPS "non-modifiable" standard terms and conditions, as set forth in D.08-04-009, D.08-08-028, and D.10-03-021, as modified by D.11-01-025.

16. 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 3949-E, as amended by Advice Letter 3949-E-A, requesting Commission approval of a three year amendment to an existing Qualifying Facility (QF) contract and the option to extend the proposed amendment by one year, and subsequently, an additional eleven months, with Honey Lake Power, Inc., is approved.

2. 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 April 19, 2012; the following Commissioners voting favorably thereon:

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PAUL CLANON
Executive Director

Confidential Appendix A

Summary and Analysis of Proposed Amendment

[REDACTED]