Date of Issuance – April 7, 2017

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION **RESOLUTION E-4799**

April 6, 2017

R E D A C T E D R E S O L U T I O N

Resolution E-4799. San Diego Gas & Electric Company requests approval of its Bilateral Power Purchase Agreement with CP Kelco, U.S., Inc. for procurement of combined heat and power energy and capacity.

PROPOSED OUTCOME:

- This Resolution approves the Power Purchase Agreement between San Diego Gas & Electric Company (SDG&E) and CP Kelco, U.S., Inc. (Kelco).

SAFETY CONSIDERATIONS:

- The terms of the Power Purchase Agreement (PPA) state Kelco must operate and maintain the facility within the terms of Prudent Electrical Practices. The Safety Plan, included in Supplemental Advice Letter 2897-E-B, filed on November 29, 2016, meets the requirements of D.15-06-028.

ESTIMATED COST:

- The cost of the Power Purchase Agreement (PPA) is confidential.

By Advice Letter 2897-E, filed on June 4, 2016, Advice Letter 2897-E-A, filed on July 13, 2016 and Advice Letter 2897-E-B, filed on November 29, 2016.

SUMMARY

This Resolution approves a bilaterally-negotiated Power Purchase Agreement (Proposed PPA) that San Diego Gas & Electric (SDG&E) executed with CP Kelco, U.S., Inc. (Kelco) for energy and capacity from its cogeneration facility on November 19, 2015. The intent of this Resolution is to replace the existing Transition PPA (Transition PPA) between SDG&E and Kelco with the Proposed PPA, which SDG&E submitted as Advice Letter 2897-E on June 3, 2016.

The Combined Heat and Power Transition Agreement Period (Transition Period) began November 23, 2011 and expired July 1, 2015. The Transition PPA was executed during the Transition Period, and has since been extended pursuant to voluntary letter agreements between SDG&E and Kelco. SDG&E filed a Supplement, Advice Letter 2897-E-A, on July 13, 2016 seeking cost recovery in rates for the costs of three Transition Period Extensions to the Transition PPA. SDG&E submitted comments on March 27, 2017 which stated that it improperly mischaracterized a series of letter agreements continuing the terms of the Transition PPAs as extensions of the Transition Period in AL 2897-E-A. In its comments, SDG&E requested the Commission deny without prejudice the request for cost recovery.

Compared to other offers in SDG&E's 2015 CHP Request for Offers (RFO), the Proposed PPA provides the greatest benefit in meeting SDG&E's CHP megawatt (MW) capacity goals without increasing costs to ratepayers. Kelco did not participate in the RFO, but the Independent Evaluator, Sedway Consulting, compared the Proposed PPA against offers submitted in response to the RFO. The Confidential Appendix of this Resolution includes cost-based analysis of this Proposed PPA against other offers received by SDG&E pursuant to the RFO.

BACKGROUND

Relevant Terms of the CHP QF Settlement

On December 16, 2010, the Commission adopted the Qualifying Facility and Combined Heat and Power Program Settlement Agreement (QF Settlement) with the issuance of Decision (D).10-12-035 (QF Settlement Decision). The Settlement resolves a number of longstanding issues regarding the contractual obligations and procurement options for facilities operating under legacy and qualifying facility contracts. The Settlement was subsequently revised in D.15-06-028 (Revised QF Settlement Decision).

The Settlement establishes MW procurement targets and Greenhouse Gas (GHG) Emissions Reduction Targets the investor-owned utilities (IOUs) are required to meet by entering into contracts with eligible CHP Facilities, as defined in the Settlement. Pursuant to D.10-12-035, the three large electric IOUs were ordered to procure a minimum of 3,000 MW of CHP and reduce GHG emissions consistent with the California Air Resources Board (CARB) Scoping Plan.[1]
Under the Revised QF Settlement Decision, the CHP Settlement Agreement Greenhouse Gas Emissions Reduction Targets were revised to collectively achieve 2.72 million metric tonnes (MMT) of emissions reductions from CHP facilities by 2020. To date, SDG&E has 0.26 remaining MMT GHG emissions reductions it still needs to achieve through the CHP program to meet its target of 0.28 MMT GHG emissions reductions. SDG&E also still needs to procure 72.66 MW to meet its 211 MW procurement target by 2018. Pursuant to D.15-06-028, utilities have until the end of 2020 to meet their GHG reduction target.

The Revised QF Settlement Decision also establishes a schedule of four competitive solicitations for CHP facilities during the Second Program Period, which began on November 23, 2015 and declared that the Settlement's Transition Period ended on July 1, 2015.[2] The Revised QF Settlement Decision did not allow extensions of the period during which utilities were required to engage in must-take contracts .[3]

1 https://www.arb.ca.gov/cc/scopingplan/document/scopingplandocument.htm

2 In D.10-12-035, the CPUC approved a set of Transition PPAs for existing facilities to allow for operational certainty for these facilities as they transitioned away from a must-take obligation under the Public Utilities Regulatory Policy Act and into a competitive solicitation.

3 In D.15-06-028, the Commission explicitly states that Transition PPAs may not be extended and it denied utilities' request to extend the terms of Transition PPAs.

In the Second Program Period, existing efficient CHP facilities may contribute towards GHG emissions reductions targets. An efficient CHP facility is one that meets the double benchmark of 80 percent boiler efficiency and a heat rate of 8,300 BTU/kWh.

Per Section 4.2 of the Settlement Term Sheet, the IOUs are directed to conduct Requests for Offers (RFO) exclusively for CHP resources as a means of achieving their MW and GHG Emissions Reduction Targets. In addition, per Section 4.3 of the Settlement Term Sheet, bilaterally negotiated and executed CHP PPAs are included among the procurement options in the CHP Program. Pricing, terms, and conditions will be determined according to the executed and approved PPA. The use of an independent evaluator (IE) is required for bilateral negotiations between an IOU and a CHP facility.

The Proposed PPA and Facility Operations

On June 3, 2016, SDG&E filed Advice Letter (AL) 2897-E requesting Commission approval of a Bilateral Power Purchase Agreement (Proposed PPA) with Kelco. The Kelco cogeneration facility consists of three gas turbines with nameplate ratings of 8.0, 9.3, and 9.35 MW, for a total of 26.65 MW. When operating, the natural gas burning turbines route the hot exhaust gases through a heat recovery steam generator to generate electricity for the manufacturing plant. SDG&E serves as an off-taker for the excess energy generated by the Kelco facility and has been in contract with the facility since 1998.

The term of the Proposed PPA is seven years, and begins the first day of the first month 30 calendar days after this Resolution is approved.[4] The Proposed PPA is the product of bilateral negotiations conducted in 2015 and was executed on November 19, 2015. In its Advice Letter, SDG&E asked the Commission to approve the Proposed PPA by August 1, 2016. SDG&E requests that the CPUC find that the 26.65 MW under the Proposed PPA count toward its MW targets for CHP facilities under the Settlement.

[4] Commission approval on April 6, 2017 would result in a start date of June 1, 2017.

On July 13, 2016, SDG&E filed a Supplement Advice Letter, 2897-E-A, in which it requested the Commission approve three Transition PPA extensions. Those extensions have allowed SDG&E to continue its procurement from Kelco during the period between the expiration of the Transition Period/Transition Agreement and the date of approval of the new PPA.

History of Kelco Transitional PPA Extensions

The Proposed PPA will take the place of the existing Transition PPA, which originally expired on July 1, 2015. SDG&E has extended the Transition PPA three times as shown below in Table 1. During the period prior to and during the Transition PPA extensions, SDG&E and Kelco successfully negotiated terms for the Proposed PPA.

Table 1: Extension Agreements to Transition PPA

Extension Execution Date	Extension End Date
June 23, 2015	December 31, 2015
December 15, 2015	August 31, 2016
July 7, 2016	December 31, 2016

The costs of these Extension Agreements are included in the Confidential Appendix. On July 13, 2016, SDG&E submitted Supplemental Advice Letter, 2897-E-A, requesting that it be allowed to recover the costs of these extensions in rates.

NOTICE

Notices of AL 2897-E, AL 2897-E-A and AL 2897-E-B were made by publication in the Commission's Daily Calendar. Copies of SDG&E's Advice Letters were mailed and distributed in accordance with Section 4 of General Order 96-B.

PROTESTS

There were no protests to Advice Letter 2897-E, AL 2897-E-A or AL 2897-E-B.

DISCUSSION

On June 3, 2016, SDG&E filed Advice Letter 2897-E requesting approval of the Proposed PPA, which would replace the existing Transition PPA. The Proposed PPA will become effective after CPUC approval and will last for seven years. Specifically, SDG&E requested that the Commission approve the Proposed PPA in its entirety with an effective date of no later than August 1, 2016.

On July 13, 2016, SDG&E filed a Supplement to Advice Letter 2897-E-A in which it requested the Commission approve its three Transition PPA Extension Agreements along with the Proposed PPA and allow SDG&E to recover the costs of each of these agreements in rates.

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

- Consistency with Settlement Decision, including:
    - Consistency with MW Counting Rules;
    - Consistency with GHG Accounting Methodology;
- Need for Procurement;
- Cost Reasonableness;
- Public Safety;
- Project Viability;
- Consistency with the Emissions Performance Standard;
- Consistency with D.02-08-071 and D.07-12-052, which require Procurement Review Group ("PRG") and Cost Allocation Mechanism Group briefing;
- Analysis and recommendations of an Independent Evaluator (IE), if available; and
- Disadvantaged Community Designation and impacts.

Consistency with the QF Settlement Decision

Consistency with Definition of CHP Facility and Qualifying Cogeneration Facility

To be eligible to count towards Settlement MW and GHG goals, all CHP Facilities, excluding those that convert to Utility Prescheduled Facilities, must meet the federal definition of a qualifying cogeneration facility under 18 C.F.R. §

292.205 by the term start date and through the duration of the proposed PPA, and must also maintain QF certification. With reference to the federal regulations, the Settlement establishes minimum operating and efficiency requirements for topping-cycle facilities and establishes efficiency standards for bottoming-cycle facilities. Kelco is a topping cycle facility.[5]

As an existing CHP facility under contract to SDG&E since 1998, Kelco meets the definition of a CHP Facility and Qualifying Cogeneration Facility, consistent with the eligibility requirements of the QF/CHP Settlement

Consistency with Settlement MW Counting Rules

Kelco is an Existing CHP Facility within the definition provided in Settlement Term Sheet Section 5.2.3.1. This is appropriately reflected in the Advice Letter. The total 26.65 MW contract nameplate value for Kelco will count toward SDG&E's CHP MW procurement target of 211 MW.

The Proposed PPA will contribute the total 26.65 MW contract nameplate value for Kelco towards SDG&E's CHP MW procurement target of 211 MW.

Consistency with GHG Accounting Methodology

Per Term Sheet Section 5.1.3, the IOUs are directed to enter into PPAs to meet the MW and GHG Emissions Reduction Targets consistent with the CHP Procurement Processes in Section 4. The progress of an IOU procurement activity toward the IOU's GHG Emissions Reduction Target will be determined according to the GHG Emissions Accounting Methodology in Section 7. SDG&E still needs to procure GHG reductions of 0.26 MMT to meet its 0.28 MMT target under the CHP Agreement. However, because the Proposed PPA was signed on November 19, 2015, it was executed in the First Program Period of the CHP Agreement, which ended November 23, 2015. Because Kelco is an existing CHP facility and the Proposed PPA was executed in the First Program Period, the Proposed PPA will not contribute reductions towards SDG&E's GHG reduction target.

[5] In Advice Letter 2897-E on page 1 of Attachment A: Independent Evaluator Report

<u>The proposed PPA will not contribute GHG emissions reductions towards SDG&E's target under the Settlement.</u>

Need for Procurement

SDG&E's total CHP procurement target under the Settlement is 211 MW, and its total MW procurement under the Settlement is 139.34 MW. The existing Transition PPA, which expired in July 2015, does not count towards SDG&E's obligation to procure CHP resources set forth in the Settlement. This is the case because the Transition Period has expired and extensions to Transition Period PPAs are not allowed, but the Proposed PPA addressed by this Resolution will count towards SDG&E MW target.

<u>The Proposed PPA will contribute 26.65 MW towards SDG&E's MW target under the Settlement and satisfies a reasonable procurement need.</u>

Cost Reasonableness

The energy price for this Agreement will be the Short Run Avoided Cost (SRAC)[6] and the capacity price in the Agreement conforms to the pricing established in D.07-09-040.[7] SRAC is a proxy for market price. Compared to competing offers in SDG&E's 2015 CHP RFO, the Proposed PPA is a more cost effective means for SDG&E to meet its CHP MW requirement. The Confidential Appendix contains a detailed explanation of the Proposed PPA's cost and how it compares with other offers.

<u>The costs of the Proposed PPA are reasonable.</u>

Public Safety

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[6] This report is published monthly and summarizes SDG&E's SRAC paid to QFs: http://www2.sdge.com/srac/

[7] This Decision established QF pricing methodologies and calculation of the SRAC price.

The PPA requires Kelco to operate under Prudent Electrical Practices, which include compliance with safety regulations and practices including worker safety standards and equipment maintenance. Further, Revised QF Settlement Decision, Ordering Paragraph (OP) 10, requires a safety plan to be included with all CHP contracts. A safety plan was not initially included with SDG&E's Advice Letter. Pursuant to the direction from Energy Division staff, SDG&E provided Kelco's Safety Plan as Supplement AL 2897-E-B on November 29th, 2016. That Safety Plan meets the requirements of OP 10 of D.15-06-028.

<u>Kelco's Safety Plan meets the requirements of OP 10 of the Revised QF Settlement Decision.</u>

Project Viability

Kelco is an existing cogeneration facility and has been in contract with SDG&E since November 19, 1998. As an existing Qualifying Facility, the project faces minimal project development risk. In response to Energy Division Data Request questions about the facility's long term viability, Kelco responded that the facility's lease runs longer than the seven years of the Proposed PPA and therefore, is viable beyond that term and is thus a viable project.

<u>Kelco is a viable CHP facility.</u>

Emission Performance Standard

D.07-01-039 adopted the Emission Performance Standard that establishes an emissions rate for obligated facilities to levels no greater than the greenhouse gas emissions of a combined-cycle gas turbine power plant. The Emission Performance Standard is applicable for a PPA of five years or more for facilities with an Annualized Plant Capacity Factor above 60%. Because the Proposed PPA term is for seven years and the capacity factor exceeds 60%, it is subject to the Emissions Performance Standard. More details regarding Kelco and the Emission Performance Standard are in the Confidential Appendix.

Because Kelco's emissions are below the limit provided in D.07-01-039, the Proposed PPA meets the Emissions Performance Standard.

Cost Allocation Mechanism Notification

The CHP Settlement requires SDG&E to brief the Cost Allocation Mechanism (CAM) group meeting regarding negotiated Bilateral PPAs. SDG&E briefed the CAM about the Proposed PPA on March 20, 2015, June 19, 2015 and October 16, 2015.

SDG&E briefed the Cost Allocation Mechanism Group on the Proposed PPA

Independent Evaluator

The QF Settlement Decision requires an Independent Evaluator (IE) to review bilaterally negotiated PPAs. The evaluation was submitted to Energy Division Staff by Sedway Consulting on April 27, 2016. The evaluation concluded that, compared to offers in SDG&E's 2015 CHP RFO, the Proposed PPA provides the highest net market value for SDG&E shareholders and ratepayers. More details about this evaluation are in the Confidential Appendix.

SDG&E employed an Independent Evaluator to analyze the contract. The Proposed PPA was the most cost effective option to satisfy QF procurement needs.

Disadvantaged Community Designation

Senate Bill 350 (de León, Chapter 547, Stats. 2015) contains disadvantaged community goals that are cross-cutting and therefore are integrated into all policy areas. Thus, in evaluating the PPA at issue, the Commission will analyze its impact on such communities.

Energy Division Staff notes that the facilities addressed in the Proposed PPA, including the CHP generating unit, are physically located in a CalEnviroScreen Version 2.0 designated Disadvantaged Community.

CalEnviroScreen[8] indicates the surrounding Census Tract, 6073005000, is a Disadvantaged Community in San Diego, CA and is in the 92th percentile for pollution statewide. It is in the 95th percentile for groundwater threats, the 98th percentile for hazardous waste and the 97th percentile for poverty. Energy Division staff notes that the continuing operation of this existing facility will not exacerbate local environmental conditions.

<u>The Proposed PPA is with a facility in a designated Disadvantaged Community.</u>

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.

The 30-day comment period for the draft of this Resolution was neither waived nor reduced. Accordingly, this draft Resolution was mailed to parties for comments on February 27, 2017. SDG&E filed comments on March 27, 2017.

In its comments, SDG&E stated it had authority to extend the Kelco PPA as part of its Bundled Procurement Plan (BPP), which pre-approves the short term contracting undertaken regarding the Kelco PPA. Therefore, SDG&E argues it did not need to extend the must-take requirement of the Transition PPA.

SDG&E requested that the Resolution be modified to find that the request for cost recovery in AL 2897-E-A is procedurally incorrect and to direct SDG&E to make the appropriate filings to recover the costs of the short-term interim

[8] http://oehha.ca.gov/calenviroscreen/report/calenviroscreen-version-20

agreements through its energy resource recovery account (ERRA) pursuant to its authority under its approved BPP.

We agree that the relief requested in AL 2897-E-A is procedurally incorrect and accept SDG&E's suggested modifications. Therefore, an ordering paragraph which denies AL 2897-E-A without prejudice and directs SDG&E to make the appropriate filings under ERRA has been added to this Resolution, and the Resolution has been modified in response to SDG&E's comments.

FINDINGS

1. Commission Decision 10-12-035 directed SDG&E to procure 211 MW of combined heat and power capacity and established a .26 MMT GHG reduction target.
2. On June 3, 2016, SDG&E filed Advice Letter 2897-E seeking Commission approval of a bilaterally negotiated CHP PPA with CP Kelco, U.S., Inc.
3. The total 26.65 MW nameplate value for the Kelco facility may count toward SDG&E's 211 MW procurement target for CHP capacity.
4. The Proposed PPA will not count toward GHG reductions under the CHP Settlement because the contract was signed in the Initial Program Period.
5. The costs associated with Proposed PPA are just and reasonable.
6. The Revised QF Decision did not allow contract extensions of Transitional Period PPAs beyond July 1, 2015.
7. Kelco is an existing and viable CHP facility.
8. Kelco is compliant with the Emissions Performance Standard.
9. Kelco's Safety Plan meets the requirements of OP 10 of the Revised QF Decision.
10. In its execution of the Proposed PPA, SDG&E has complied with the Commission's requirements for consultation with the CAM.
11. SDG&E employed an Independent Evaluator to analyze the contract.

12. Analysis shows this Proposed PPA is with a facility in a designated Disadvantaged Community, but approval of the PPA will not negatively impact the surrounding community.
13. On July 13, 2016, SDG&E filed a Supplement Advice Letter, 2897-E-A, in which it requested the Commission approve three Transition PPA extensions. Those extensions have allowed SDG&E to continue procurement from Kelco during the period between the expiration of the Transition Period and the date of approval of a new bilaterally-negotiated PPA.
14. SDG&E's request for cost recovery through AL 2897-E-A is procedurally incorrect because it has the authority to recover costs under its approved Bundled Procurement Plan.

THEREFORE IT IS ORDERED THAT:

1. The Proposed PPA is approved.
2. San Diego Gas & Electric shall recover costs of the Proposed PPA via Cost Allocation Mechanism as proposed in Advice Letter 2897-E.
3. San Diego Gas & Electric's request for cost recovery in Advice Letter 2897-E-A is denied without prejudice, and it shall make the appropriate filings to recover the costs of the short-term interim agreements through its energy resource recovery account pursuant to its authority under its approved Bundled Procurement Plan.

4. The Safety Plan included in Supplemental Advice Letter 2897-E-B, meets the requirements of D.15-06-028 and is approved.

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 6, 2017; the following Commissioners voting favorably thereon:

/s/ *TIMOTHY J. SULLIVAN*
TIMOTHY J. SULLIVAN
Executive Director

MICHAEL PICKER
President
CARLA J. PETERMAN
LIANE M. RANDOLPH
MARTHA GUZMAN ACEVES
CLIFFORD RECHTSCHAFFEN
Commissioners

Confidential Appendix

Analysis of the Power Purchase Agreement with SDG&E & CP Kelco, U.S., Inc

[Redacted]