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Decision 11-04-033 April 14, 2011

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into Combined Heat and Power Pursuant to Assembly Bill 1613.	Rulemaking 08-06-024 (Filed June 26, 2008)

ORDER GRANTING LIMITED REHEARING OF DECISION (D.) 10-12-055 ON THE ISSUE OF GHG COMPLIANCE COSTS, MODIFYING DECISION, DENYING REHEARING OF DECISION, AS MODIFIED, AND DENYING MOTION TO STAY

I. INTRODUCTION

Today's decision disposes of the applications for rehearing of Decision (D.) 10-12-055, filed by the Joint Utilities.[1] D.10-12-055 was issued in response to a Petition for Modification of D.09-12-042, filed by the Joint Utilities. In D.09-12-042, we adopted the policies and procedures for purchase of excess electricity from eligible Combined Heat and Power ("CHP") systems by an electrical corporation under The Waste Heat and Carbon Emissions Reduction Act, Assembly Bill 1613 (Stats. 2007, ch. 713) ("AB 1613").

On January 18, 2011, PG&E and SDG&E together filed a timely application for rehearing of D.10-12-055, and SCE separately filed a timely application for rehearing of D.10-12-055. Concurrently, the utilities jointly filed a motion for stay of D.10-12-055 until the later of resolution of the Joint Utilities' Petition for Enforcement pursuant to Section 210(h) of the Public Utility Regulatory Policies Act of 1978

[1] We refer to Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("SCE"), and San Diego Gas and Electric Company ("SDG&E") collectively as the "Joint Utilities".

("Enforcement Petition") filed with the Federal Energy Regulatory Commission ("FERC") on January 31, 2011,[2] or the effective date of a Commission decision resolving their applications for rehearing of D.10-12-055.

Both applications for rehearing claim that the price to be paid to AB 1613 generators violates both the Public Utility Regulatory Policies Act of 1978 ("PURPA")[3] and FERC regulations because it is higher than the utilities' avoided costs and contend that the record is insufficient to support the pricing adopted by D.10-12-055.[4] Specifically, PG&E/SDG&E argue that the AB 1613 price formula exceeds avoided cost because it pays a firm price for an as-available product. (PG&E/SDG&E's Rehrg. App., at p. 2.) SCE claims the price formula exceeds avoided costs because it is higher than other avoided costs paid to other QFs with "identical relevant characteristics." (SCE's Rehrg. App., at p. 2.) Both rehearing applications also offer multiple variations on these avoided cost arguments and also claim the location bonus and the pass through of greenhouse gas ("GHG") compliance costs to the purchasing utility affirmed in D.10-12-055 violate PURPA because they do not constitute avoided cost payments. (PG&E/SDG&E's Rehrg. App., at pp. 11-13; SCE's Rehrg. App., at pp. 10-13.)

San Joaquin Refining Company, Inc. ("San Joaquin") filed a response and California Clean DG Coalition ("CCDC") and FuelCell Energy Inc. ("FuelCell") filed a joint response to the Joint Utilities' rehearing applications and their motion for stay. The Joint Utilities filed a reply to the responses on their motion for stay.

We have reviewed each and every argument raised in the rehearing applications and are of the opinion that rehearing should be granted on the limited issue

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[2] See FERC Docket No. EL11-19-000.

[3] PURPA is codified in scattered sections of 16 U.S.C. including § 796 (definitions), § 824a-3, and §§ 2601 *et seq*.

[4] FERC regulations define "avoided costs" as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." (18 C.F.R. § 292.101(b)(6).)

of the GHG compliance costs, and that modifications to D.10-12-055, as described herein, are warranted to: (1) modify our treatment of GHG compliance costs to be consistent with avoided cost principles; (2) clarify why the market price referent ("MPR") based energy price adopted by D.09-12-042 and affirmed in D.10-12-055 is consistent with avoided cost principles; (3) clarify why the 10% Location Bonus is consistent with avoided cost principles, and (4) conform D.09-12-042 with the modifications ordered by D.10-04-055 and D.10-12-055, as modified herein. Rehearing of D.10-12-055, as modified, is denied. We also deny the Joint Utilities' motion for stay as without merit.

II. BACKGROUND

A. AB 1613

AB 1613 – The Waste Heat and Carbon Emissions Reduction Act – was enacted by the California Legislature in 2007 to be effective January 1, 2008, in order to further environmental objectives, particularly the reduction of GHG emissions. AB 1613 is codified at Public Utilities Code sections 2840 through 2845.

In short, AB 1613 requires the Commission to establish a "standard tariff" for qualifying CHP generators to sell their excess electricity to the utilities. (Pub. Util. Code, § 2841, subd. (b)(1).) AB 1613 anticipates that such a program will result in multiple benefits to California because it will:

> [(a)] advance the efficiency of the state's use of natural gas by capturing unused waste heat, and in doing so, help offset the growing crisis in electricity supply and transmission congestion in the state.
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> [(b)] reduce wasteful consumption of energy through improved . . . utilization of waste heat whenever it is cost effective, technologically feasible, and environmentally beneficial, particularly when this reduces emissions of carbon dioxide and other carbon-based greenhouse gases.

(Pub. Util. Code, § 2840.6, subds. (a) and (b).) The AB 1613 program seeks to enhance the efficiency of an existing class of industrial boilers and reduce GHG emissions by providing incentives to install heat recovery steam generators and turbines (CHP systems) at the tail end of these existing units. AB 1613 CHPs will capture and make useful the energy already produced by boilers, which until now, had been discharged to the atmosphere as waste heat.[5] AB 1613's policy goal to reduce carbon-based emissions is part of the state's overall objective to reduce GHG emissions, as articulated in Assembly Bill 32, California's "Global Warming Solutions Act of 2006" (Stats. 2006, ch. 488) ("AB 32").[6]

To advance these goals beyond a traditional CHP program, an AB 1613 CHP must meet strict efficiency and emission requirements, including the following: at least a 60% Energy Conversion Efficiency; a nitrogen oxide (NOx) emission standard of 0.07 pounds per megawatt-hour ("MWh"); a GHG emission standard of no more than 1,100 pounds of carbon dioxide ("CO_2") equivalent emissions per MWh; and an allocation of any more stringent carbon emissions compliance costs, which the California Air Resources Board ("CARB") may adopt under AB 32, and/or which the Federal government ultimately may impose. (Pub. Util. Code, § 2843.)

AB 1613 also imposes requirements to ensure reliable and continuous onsite generation to address the state's energy supply and transmission congestion challenges. An AB 1613 CHP must be sized to meet its onsite load, must "operate continuously in a manner that meets the expected thermal load," and may only sell its excess power to the utilities. (See Pub. Util. Code, §§ 2840.2, subds. (a) and (e), 2841, & 2843, with quotation from § 2843, subd. (a)(2).) In exchange, the entire physical generating capacity of the AB 1613 CHP, not just the excess energy sold to the utility, counts towards the purchasing utility's resource adequacy obligations. (Pub. Util. Code, § 2841, subd.(f).)

[5] This process and logic can be used to describe either topping-cycle or bottoming-cycle CHP; the policy goal to maximize the use of waste heat applies to both.

[6] AB 32 requires, among other things, that the California Air Resources Board adopt a statewide GHG emissions limit equivalent to the statewide GHG emissions levels in 1990, to be achieved by 2020, in consultation with this Commission and the California Energy Commission.

B. Commission Implementation of AB 1613

Rulemaking (R.) 08-06-024 was opened to develop the policies and procedures for the utilities to purchase excess electricity from AB 1613 CHPs pursuant to a standard tariff. The AB 1613 program has been very controversial because of the utilities' objections to a standard tariff that establishes a fixed price for purchases, also known as a "fixed price feed in tariff" or "FIT". Consequently, the utilities have opposed implementation of AB 1613 at the Commission and before FERC.

The Commission has now adopted three decisions in its efforts to implement the FIT portion of AB 1613: (1) D.09-12-042 initially implementing the AB 1613 program; (2) D.10-04-055 denying rehearing of D.09-12-042, as modified, to clarify certain discussions; and (3) D.10-12-055, granting in part, and denying in part, a Joint Utilities' petition for modification of D.09-12-042 (together "CHP decisions").[7] This last decision modified D.09-12-042 to implement the AB 1613 program pursuant to PURPA and consistent with two FERC orders issued after the Commission's adoption of D.10-04-055. However, D.10-12-055 ordered very few specific modifications to D.09-12-042, and most of those modifications were focused on contract terms. The modifications did not reflect the changed legal status of the program to a PURPA/Qualifying Facility ("QF") program. The history of these changes is described in more detail below.

The Commission adopted D.09-12-042 on December 17, 2009. On January 20, 2010, the Joint Utilities together filed an application for rehearing of D.09-12-042 on the grounds that its adopted price formula was preempted by federal law and violated the ratepayer indifference standard of AB 1613. On the same day, the Joint Utilities also filed a motion for stay, and the Alliance for Retail Energy Markets ("AReM") also filed a rehearing application of the same decision. San Joaquin, CCDC, AReM and the Division

[7] A fourth decision, D.11-01-010, was issued to address the "Pay as You Go" issues raised in the proceeding. That decision closed the proceeding.

of Ratepayer Advocates ("DRA") filed responses to the Joint Utilities' application for rehearing. San Joaquin and CCDC/FuelCell filed a response to the Joint Utilities' stay motion, and PG&E and DRA filed a response to AReM's rehearing application.

On February 2, 2010, the Joint Utilities timely filed a Joint Petition for Modification of D.09-12-042 ("Joint Utilities' PFM"). The Joint Utilities claimed to be seeking resolution of alleged problems with the implementation of D.09-12-042 as it stood at that time. San Joaquin, CCDC, FuelCell, and The Utility Reform Network ("TURN")/DRA filed comments on the Joint Utilities' PFM.

On April 26, 2010, the Commission issued D.10-04-055 denying both applications for rehearing and clarifying, through modifications, certain aspects of D.09-12-042.

On May 4, 2010, the Commission submitted a petition for declaratory order to FERC to find that the Federal Power Act ("FPA"), PURPA and FERC regulations do not preempt the Commission's decision to require California utilities to offer a certain price to CHP generating facilities of 20 MW or less that meet specific energy efficiency requirements.[8]

On May 11, 2010, the Joint Utilities together filed a separate petition at FERC for a declaratory order in which they argued that the Commission's decision is preempted by the FPA insofar as it sets rates for electric energy that is sold at wholesale.

On July 15, 2010, FERC issued *California Public Utilities Commission et al.* ("*FERC Declaratory Order*"), (2010) 132 FERC ¶ 61,047 which granted in part and denied in part the cross-petitions for declaratory order. In this order, FERC found:

> Although the CPUC has not argued that its AB 1613 program is an implementation of PURPA, we find that to the extent the CHP generators that can take part in the AB 1613 program obtain Qualifying Facility (QF) status, the CPUC's AB 1613 feed-in-tariff is *not* preempted by the FPA, PURPA or FERC regulations, subject to certain requirements.

[8] *California Public Utilities Commission,* FERC Docket No. EL10-64.

(*Id.* at P 65 (emphasis in original).) To comply with PURPA, FERC found that the Commission's AB 1613 CHP program needed to meet two requirements: (1) the CHP generators must be QFs pursuant to PURPA; and (2) the rate established by the Commission should "not exceed the avoided cost of the purchasing utility." (*Id.* at P 67.)

On August 16, 2010, the Commission filed with FERC a request for clarification, or, in the alternative, a request for rehearing, which sought clarification regarding the avoided cost rates for facilities participating in the AB 1613 program.

On September 9, 2010, the Commission issued an amended scoping memo and ruling in the proceeding ("Amended Scoping Memo") asking for further comment on certain issues brought up in the Joint Utilities' PFM. Comments in response to the Amended Scoping Memo were filed by the Joint Utilities, DRA, FuelCell, CCDC, San Joaquin, and Sustainable Conservation. Joint comments were filed by Pacific Corp and Sierra Pacific Power Corporation.

On October 21, 2010, FERC issued an order, which granted the Commission's August 16, 2010 request for clarification. (*California Public Utilities Commission* ("*FERC Clarification Order*") (2010) 133 FERC ¶ 61,059.) In this order, FERC clarified that the state has a wide degree of latitude in setting avoided cost, can utilize a multi-tiered avoided cost rate structure, and that this approach is consistent with the avoided cost requirements set forth in Section 210 of PURPA. (*Id.* at PP 24 & 30.) FERC also clarified that state procurement obligations can be considered when calculating avoided cost, and it specifically overruled its prior holding from *SoCal Edison* to the extent its current determination was inconsistent with that clarification. (*Id.* at PP 29-30 *referring to SoCal Edison* (1995) 71 FERC ¶ 61,269 at 62,080.)

With this FERC guidance, the Commission issued D.10-12-055 on December 16, 2010. Decision 10-12-055 granted in part and denied in part the Joint Utilities' PFM. Most significantly, D.10-12-055 stated that it was modifying D.09-12-042 to be consistent with the *FERC Declaratory Order* and the *FERC Clarification*

Order by acknowledging that the AB 1613 program was being implemented pursuant to PURPA, that all generators in the program must be QFs, and that the prices set were consistent with avoided cost principles. D.10-12-055 modified D.09-12-042 so that the price paid to AB 1613 generators would be calculated each year based on the most current market price referent (MPR) inputs. (D.10-12-055 at pp. 9-10.) D.10-12-055 also modified the standard contracts approved in D.09-12-042 to correct errors and to resolve ambiguities. (D.10-12-055 at pp. 13-14.) Finally, D.10-12-055 clarified that GHG compliance costs were not reflected in the adopted MPR-based pricing formula and are instead addressed in the contracts as a direct pass-through of actual compliance costs from the generator to the utility, similar to treatment of renewable energy credits ("RECs"). (D.10-12-055 at p. 14.) Significantly, with the exception of the specific changes ordered to the AB 1613 contracts, D.10-12-055 did not order any specific language changes to D.09-12-042.

Before issuance of D.10-12-055, on November 22, 2010, the Joint Utilities filed at FERC a request for rehearing, or, in the alternative, reconsideration, partial vacatur, or clarification of the *FERC Clarification Order*. FERC denied rehearing of its *Clarification Order* on January 20, 2011. (*California Public Utilities Commission* ("*FERC Rehearing Order*") (2011) 134 FERC ¶ 61,044.) Among other things, it deferred to the Commission to implement FERC's guidance before it would rule on the Joint Utilities' assertions that the Commission has violated PURPA. (*Id.* at P 35.)

On January 6, 2011, the Joint Utilities filed a motion to stay D.10-12-055. DRA and San Joaquin filed a response, and CCDG and FuelCell filed a joint response to this motion to stay on January 10, 2011. On January 12, the motion to stay was denied by an Assigned Commissioner's ruling on the basis that it was premature because the Joint Utilities had not yet filed their rehearing application of D.10-12-055.

As described above, the Joint Utilities timely filed their applications for rehearing of D.10-12-055. PG&E and SDG&E filed a joint rehearing application and SCE filed its own rehearing application. At the same time, the Joint Utilities filed another motion for stay of D.10-12-055. San Joaquin filed a response and CCDG and

FuelCell filed a joint response to both rehearing applications and the Joint Utilities' stay motion. The Joint Utilities filed a reply to the responses to the motion for stay.

On January 31, 2011, notwithstanding the *FERC Rehearing Order* that declined to rule on the Commission's implementation of the FERC guidance until implementation was complete (*Rehearing Order*, *supra*, 134 FERC ¶ 61,044 at P 35), the Joint Utilities filed their Enforcement Petition with FERC. In essence, the Joint Utilities claim that the Commission's AB 1613 decisions violate either the FPA's requirement that rates must be just and reasonable, or violate PURPA by setting rates above the utilities' avoided costs.

The Joint Utilities also filed their supplemental advice letters with the Commission on January 31, 2011, in compliance with Ordering Paragraphs 9, 10, and 11 in D.10-12-055. Energy Division issued a notice of suspension on February 18, 2011, which stayed Energy Division's action on those supplemental advice letters for up to 120 days for further staff review.

On February 22, 2011, the Commission filed at FERC a Notice of Intervention, Motion to Dismiss, and Protest to the Joint Utilities' Petition for Enforcement. On March 31, 2011, FERC issued its "Notice of Intent Not to Act," declining to initiate an enforcement action against the Commission.

III. DISCUSSION

A. Rehearing On The Issue Of Whether The MPR-Based Price Formula Is A Lawful Measure Of "Avoided Cost" Under PURPA Is Denied

The Joint Utilities allege that the AB 1613 price formula violates PURPA because it will exceed their avoided costs. Specifically, PG&E/SDG&E argue that the AB 1613 price formula exceeds avoided cost because it pays a firm price for an as-available product. (PG&E/SDG&E's Rehrg App., at p. 2.) SCE claims the price formula exceeds avoided costs because it is higher than other avoided costs paid to other QFs with "identical relevant characteristics." (SCE's Rehrg. App., at p. 2.) In addition, the Joint

Utilities raise several other related arguments discussed in more detail in Section III.A.3 below. The Commission denied these claims for the reasons explained below.

1. There Is No Merit To PG&E/SDG&E's Argument That The AB 1613 Price Formula Exceeds Avoided Cost Because It Pays A Firm Price For An As-Available Product

PG&E/SDG&E argue that the AB 1613 price formula exceeds avoided cost because it pays a firm price for an as-available product. (PG&E/SDG&E's Rehrg App., at p. 2.) The Joint Utilities raised this same issue in their application for rehearing of D.09-12-042, framed primarily as a state law claim that the firm price violated the ratepayer indifference requirement of AB 1613. (Joint Utilities' Rehrg. App., filed January 20, 2010, at p. 13.) In the order denying that rehearing application, D.10-04-055, we rejected the argument that pricing for the AB 1613 program must be based on an as-available power price because AB 1613 CHPs operate as firm resources. (D.10-04-055 at pp. 9-11.) Thus, this argument is an impermissible collateral attack of a prior Commission decision. (See Pub. Util. Code, § 1709; see also, *People v. Western Air Lines, Inc.* (1954) 42 Cal.2d 621, 630.)

Notwithstanding the fact that this argument is a collateral attack, we address this issue again here and will modify D.10-12-055 to clarify our position on this issue. In summary, paying AB 1613 generators an "all in" price for as-available energy that is calculated based on the long term costs of constructing and operating a proxy baseload resource is appropriate and does not exceed the utilities' avoided costs because AB 1613 CHPs operate as firm resources and avoid capacity procurement for the utilities.

a) AB 1613 Requires Eligible CHPs To Operate As Firm Resources And Allows Procuring Utilities To Avoid Resource Adequacy Obligations

AB 1613 CHPs are required by statute to operate as firm resources. Public Utilities Code sections 2843(a)(2) and (3) require that an eligible CHP system must "be sized to meet the eligible customer-generator's thermal load," and must "operate continuously in a manner that meets the expected thermal load and optimizes the efficient use of waste heat." Consistent with this obligation, section 2841(f) provides that the utilities are entitled to count the firm resource towards their resource adequacy obligations. These obligations are reflected in Sections 1.02 and 3.02 of the *pro forma* contracts approved in D.09-12-042, which require the generator to commit to an expected amount of energy production per term year and to pledge its generating capacity to the purchasing utility to use in meeting its resource adequacy obligations. Significantly, when a utility contracts with an AB 1613 CHP, it avoids a resource adequacy procurement obligation equivalent to the *full capacity* of the AB 1613 CHP (in other words, all of the power generated by the CHP), but the CHP is not paid for the full value of this avoided cost. Instead, the generator only receives a payment for the excess energy it sells to the utility. Thus, this payment clearly does not exceed the utility's avoided CCGT procurement costs.

b) FERC Rulings Recognize A State's Ability To Compensate QFs For Their Capacity Value

The Joint Utilities' continued attempts to challenge the firm/as available decision made by this Commission are troubling given the support for the Commission's actions. FERC expressly affirmed a state's ability to "determine that capacity is being avoided, and so … rely on the cost of such avoided capacity to determine the avoided cost rate" – which is exactly what the Commission is doing here. (*FERC Clarification Order, supra*, at P 26.) FERC went on to state:

> Further, in determining the avoided cost rate, just as a state may take into account the cost of the next marginal unit of generation, so as well the state may take into account obligations imposed by the state that, for example, utilities purchase energy from particular sources of energy or for a long duration.

(*Id.*) Here, consistent with AB 1613 requirements, the Commission has determined that an AB 1613 CHP will avoid capacity costs that the utility would otherwise incur, and quantifies those costs based on the marginal CCGT.

Reliance on a CCGT as the marginal unit is reasonable because, as we determined in all of the CHP decisions, it is much more likely that the Joint Utilities would seek to meet the baseload needs served by AB 1613 CHPs through a long term contract with a new, highly efficient CCGT. Among other things, the Commission's emission performance standards adopted in D.07-01-039 would likely compel such an outcome. That decision prohibits the utilities from entering into contracts of five years or longer with facilities that emit in excess of 1100 lbs/MWh of carbon dioxide equivalent. In effect, this means that the utilities are limited to procuring long term commitments[9] for sales of electricity from CCGTs, renewables, other non-carbon emitting resources such as hydroelectric power, and CHPs. (See, e.g., D.07-01-039 at Findings of Fact 2, 3, and 4.)[10]

A payment for capacity value based on avoided procurement is not new policy. FERC addressed this very issue when it adopted Order 69 implementing Section 210 of PURPA in 1980. In response to claims that avoided cost should not include capacity payments, FERC explained that purchases of power from QFs "will fall somewhere on the continuum between" firm and non-firm service or capacity and energy. For facilities that demonstrate "a degree of reliability that would permit the utility to defer or avoid construction of a generating unit or the purchase of firm power from another utility, then the rate for such a purchase should be based on the avoidance of both energy and capacity costs."[11] As AB 1613 CHPs must, pursuant to statute, provide this

[9] For GHG emissions purposes, Public Utilities Code section 8340(f) defines a "Long-term financial commitment" to mean a new or renewed contract for a term of five years of more. (Pub. Util. Code, § 8340, subd. (f).) Pub. Util. Code § 8341(a) prohibits the utilities from entering into contracts of 5 years or more for baseload generation that does not comply with the Commission's GHG emission performance standards. (Pub. Util. Code, § 8341, subd. (a).)

[10] While an AB 1613 CHP may contract for a term of one to ten years, we anticipate most AB 1613 CHPs to contract for ten years for financing purposes.

[11] Order No. 69, FERC Stats. & Regs., Regs. Preambles, 1977-1981, ¶ 30, 128 at 30,882 (1980).

degree of reliability and allow the utility to avoid local resource adequacy procurement, they provide both energy and capacity and are properly compensated for both.

For all of these reasons, the Joint Utilities' continued challenges to the firm/as-available decision made by the Commission in this proceeding are without merit and rehearing on this issue is denied.

2. There Is No Merit To SCE's Argument That The AB 1613 MPR-Based Price Is Not An Avoided Cost Because It Exceeds The Price Paid To Other QFs

In its rehearing application, SCE contends that the AB 1613 MPR-based price formula exceeds avoided costs because it is higher than other avoided costs paid to other QFs with "identical relevant characteristics." (SCE's Rehrg. App., at pp. 2, 13-17.) SCE claims that the Commission must reconcile its planned implementation of the AB 1613 CHP program with the short run avoided cost ("SRAC") adopted in D.07-09-040 and D.08-07-048 and the avoided cost price agreed to in the QF Settlement adopted in D.10-12-035. (SCE's Rehrg. App., at p. 5.)

To support its claim that these prices are lower than the MPR-based price formula, SCE provides an "illustrative" table comparing its projected AB 1613 price to its projections of other QF pricing formulas, including the "Option A" avoided cost price provided in the QF Settlement. (SCE's Rehrg. App., at p. 15.) SCE complains that the Commission has failed to explain "why it is appropriate for a CHP QF that begins operations after January 1, 2008 to receive a higher 'avoided cost' price than an identical CHP QF that begins operations on an earlier date" and why "it is appropriate to mandate a higher price for AB 1613 CHP QFs, as the efficiency and on-line date are the only two distinguishing factors between AB 1613 CHP QFs and other CHP QFs." (SCE's Rehrg. App., at p. 6 and p. 16.) Citing *Independent Energy Producers Association v. CPUC* (9th Cir. 1994) 36 F.3d 848, 854-855, SCE argues that "[i]t would be unlawful for the Commission to distinguish avoided cost pricing on the basis of efficiency…" (SCE's Rehrg. App., at p. 16, fn. 45.)

SCE's contention that the Commission is obligated to set the same rate for AB 1613 CHPs as older, less-efficient CHPs operating under the QF Settlement or some other arrangement, has no merit.

As an initial matter, SCE made the same argument and presented an identical price comparison chart in its joint comments with PG&E on the proposed decision disposing of the Joint Utilities' PFM. (SCE/PG&E Comments filed December 6, 2010, at p. 8).[12] In addressing the argument at that time, D.10-12-055 recognized that the short run avoided cost calculations provided from the QF Settlement were "outside the record of the proceeding, and should therefore be disregarded." (D.10-12-055 at pp. 18-19 and fn. 14.) SCE's identical "Table 1 Illustrative Levelized Price Comparison" provided on page 15 of its rehearing application is similarly "outside the record of the proceeding, and should therefore be disregarded."[13]

Notwithstanding this procedural infirmity, D.10-12-055 addressed the merits of SCE's claims, raised again here, that different avoided costs are not allowed under PURPA. The discussion in D.10-12-055 relied heavily on the *FERC Clarification Order*, which expressly addressed, and rejected, SCE's current argument:

> [T]he FERC Clarification Order supports a wide degree of latitude for the Commission to establish a utility's avoided cost; found that the concept of a multi-tiered avoided cost rate structure is consistent with the avoided cost requirements set forth in Section 210 of PURPA and FERC regulation; and recognizes that full avoided cost need not be the lowest possible avoided cost and can properly take into account real

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[12] A similar chart, comparing SRAC to the AB 1613 prices calculated by the Joint Utilities, was also provided on page 16 of the Joint Utilities rehearing application for D.09-12-042, filed on January 20, 2010.

[13] The record stands submitted prior to issuance of a proposed decision. (*See, e.g.,* Commission Rules of Practice and Procedure, Rules 13.14(a) and 14.2(a).) The Commission has routinely held that evidence outside the record will not be considered in disposing of an application for rehearing. (*See, e.g.,* D.06-06-070 at fn. 5: "This evidence, which occurred after the issuance of the Decision, is outside the record and its attempted introduction in an application for rehearing is improper. It is accordingly not considered in disposing of this application for rehearing.")

> limitations on alternate sources of energy imposed by state law.
>
> The significance of the FERC's Clarification Order is that in contrast to its *Southern California Edison Company* decisions in the 1990s, where FERC required states to consider purchases from "all sources," including coal-fired generation, in setting avoided costs, the FERC's Clarification Order rules that all sources can be limited to those that are available to the utilities under state law.

(D.10-12-055 at p. 28, relying on *FERC Clarification Order*, *supra*, 133 FERC ¶ 61,059 at PP 26-30 (footnotes omitted).)

Although D.10-12-055 addressed SCE's claims, it did not order specific modifications to D.09-12-042. To ensure that the Commission's position on this issue is clear, and for the convenience of the parties, we order a number of additional modifications to D.10-12-055 (modifying D.09-12-042), based on the discussion below, to further clarify our positions on this issue.

a) The Pricing Terms Established By The QF Settlement Do Not Apply To The AB 1613 Program

SCE's constant refrain that the Commission must harmonize the AB 1613 CHP price with the QF Settlement – or that it cannot adopt an avoided cost that is more than the QF Settlement price - has no basis in either the record of this proceeding or the QF Settlement decision. The QF Settlement decision, D.10-12-035, expressly declined to apply the QF Settlement price to AB 1613 CHPs:

> The Proposed Settlement is comprehensive, but it does not resolve issues in numerous Commission proceedings implementing recent statutory requirements that pertain to QFs of 20 MW or less, such as new CHP systems under Assembly Bill 1613 (codified as Pub. Util. Code sections 2840-2845), except to acknowledge that the megawatt (MW) and GHG reductions will count toward the investor-owned utilities' MW and GHG reduction targets.

(*See* D.10-12-035 at p. 2.) Consequently, SCE's claim that the Commission must harmonize the AB 1613 program with the QF Settlement has no merit.

b) The AB 1613 Program Does Not Unduly Discriminate Against Non-AB 1613 CHPs

To the extent SCE insists that the MPR-based AB 1613 CHP price formula is "discriminatory" under the FPA as compared to the QF Settlement price, SCE overstates its case. (SCE's Rehrg. App., at pp. 13-16). The legal standard applied by FERC is *undue* discrimination. Thus, when contract clauses differentiate among energy sellers, FERC looks to whether there is a reasonable basis for such different treatment. In *ISO New England*, FERC upheld ISO New England's right to provide grandfathered contracts one type of oversupply clause, and new contracts another type of oversupply clause. FERC stated: "What is prohibited by the Federal Power Act is undue discrimination, not all differences in treatment no matter the justification." (*ISO New England* (2008) 122 FERC ¶61,016 at P 29.)

FERC has routinely engaged in differentiation among generators in its implementation of PURPA. In the preamble discussion to FERC Order 69 implementing PURPA, FERC found that it was appropriate to apply a potentially lower form of pricing to facilities in existence prior to the adoption of PURPA that might have qualified as QFs, and a higher "full avoided cost" to those that commenced construction on or after the date of PURPA's enactment. (Order No. 69, FERC Stats. & Regs., Regs. Preambles, 1977-1981, ¶ 30,128 at 30,882 (1980).) FERC reasoned that the distinction was "intended to reflect the need for further incentives and the reasonable expectations of persons investing in cogeneration or small power production facilities prior to or subsequent to the enactment of this law." (*Id.*) Thus, FERC itself acknowledged that differing treatment among units with "identical relevant characteristics," including development "incentives," were appropriate in the context of an avoided cost.

Similarly, FERC has recognized that QFs 20 MW or below represent a special class of "small QFs" which has routinely been subjected to different standards than "large QFs" (those above 20 MW) in various FERC regulations. Samples of this treatment include FERC's "rebuttable presumption" that a QF 20 MW or smaller does not have nondiscriminatory access to energy markets;[14] FERC's continued exemption of QFs 20 MW or smaller from Sections 205 and 206 of the FPA;[15] and FERC's determination that QFs 20 MW or smaller operate under different interconnection rules than large generators.[16]

Given FERC's own precedent, it can hardly be considered undue discrimination if a short run avoided cost payment is paid to existing CHPs, and another type of avoided cost payment is paid to encourage new AB 1613 CHPs that will operate under a different statutory and contractual framework – one that imposes higher efficiency standards and provides resource adequacy benefits to the utilities. Both payments comply with avoided cost principles.

With regard to SCE's implication that older CHPs are unfairly discriminated against because they will be paid the SRAC agreed upon in the QF Settlement, the Fifth Circuit Court of Appeals has recognized that to the extent parties agree to something in a settlement, it is not undue discrimination to hold parties to their bargain. (*Public Service Co. v. FERC* (5th Cir. 1988) 851 F.2d 1548, 1557.) Similarly, the U.S. Supreme Court has recognized that, consistent with FERC regulations, a QF and a utility "may negotiate a contract setting a price that is lower than a full avoided cost rate." (*American Paper Institute v. American Electric Power Service Corp.* (1982) 461 U.S. 402, 416; *see also* 18 C.F.R. § 292.301(b)(1).) It therefore follows that paying older CHPs one price and newer CHPs another price does not necessarily constitute undue discrimination.

[14] *See, e.g.,* Order No. 688-A, 72 Fed. Reg. 35872 (June 29, 2007) at PP 94-100.

[15] *See, e.g.,* Order No. 671, 71 Fed. Reg. 7852 (February 15, 2006) at P 99.

[16] *See, e.g.,* Order No. 688, 71 Fed. Reg. 64342 (November 1, 2006) at P 76.

c) A PURPA Contract May Include Sanctions For Non-Compliance With State Efficiency Requirements

In D.10-12-055 the Commission explained its two tier pricing structure. AB 1613 CHPs are to receive the MPR-based price so long as they comply with AB 1613. Should they fail to comply with AB 1613, but retain their QF status, they will receive payments pursuant to the most current SRAC. SCE claims that pursuant to the Ninth Circuit decision in *Independent Energy Producers* "[i]t would be unlawful for the Commission to distinguish avoided cost pricing on the basis of efficiency…" (SCE's Rehrg. App., at p. 16, fn 45.) We disagree. So long as the two prices in the two tier pricing structure do not exceed the utilities' avoided cost, and payment is based on contract compliance, SCE's claim has no merit.[17]

The state may require higher efficiency from CHPs, and pay a lower avoided cost for failure to meet these requirements; such a program advances both state and federal goals to encourage efficient CHPs. Both PURPA and the Energy Policy Act of 2005 ("EPAct 2005"), like AB 1613, recognize CHPs as a special class of highly efficient facilities, with EPAct 2005 expressly directing FERC to consider revising its CHP criteria to ensure "continuing progress in the development of *efficient* electric energy generating technology." (See, e.g., 18 C.F.R. § 292.205 and 16 U.S.C. §824a-3(n)(1)(A)(iii) (emphasis added); see also Conf. Rep. No. 95-1750, pp. 97-98 (1978).) Several courts have also acknowledged, with approval, the efficiency benefits of CHPs. In particular, the U.S. Supreme Court upheld FERC's decision to pay "full avoided costs" to CHPs and other small power producers as a development incentive to encourage fuel efficiency:

> … it was not unreasonable for the Commission to prescribe the maximum rate authorized by PURPA. The Commission's order makes clear that the Commission considered the

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[17] The *FERC Clarification Order* also addressed the two tier pricing structure, and those holdings are described in more detail in Section III.A.3.c) below.

> relevant factors and deemed it most important at this time to provide the maximum incentive for the development of cogeneration and small power production, in light of the Commission's judgment that the entire country will ultimately benefit from the increased development of these technologies and the resulting decrease in the Nation's dependence on fossil fuels. …The basic purpose of § 210 of PURPA was to increase the utilization of cogeneration and small power production facilities and to reduce reliance on fossil fuels.

(*American Paper Inst. v. American Elec. Power* ("*American Paper*") (1983) 461 U.S. 402, 417-418.) The Supreme Court in *American Paper* also recognized that "a qualifying facility and a utility may negotiate a contract setting a price that is lower than a full-avoided cost rate." (*Id.* at 416.)

Given the holdings of *American Paper*, SCE's reference to *Independent Energy Producers* as a barrier to the AB 1613 CHP two-tier payment structure is both inaccurate and inapposite here. *American Paper* clearly supports the two-tier payment structure we adopt here, and the holdings of *Independent Energy Producers* are irrelevant to the issue. *Independent Energy Producers* focused on QF status determinations, and whether a state could delegate QF status determinations to the utilities. It determined that only FERC could make a QF status determination, and thus the delegation was improper. In that context, the Court noted that a state could not sanction a QF for failure to meet *federal* QF efficiency standards. The QF status issues addressed by *Independent Energy Producers* are not at issue here; compliance with *state* law requirements is at issue. To the extent that a QF does not comply with *state* efficiency standards, that is up to the state to police and this is properly done through contracting requirements that provide sanctions for failure to comply.

We recognize that, consistent with *Independent Energy Producers*, we may not revoke a facility's QF status, delegate that authority to a utility, or reduce the price paid to below avoided cost, and we do not attempt to do so here. To the extent that the price adjustment terms for failure to meet state efficiency requirements are reflected in the AB 1613 contract, and that both the high and low prices are avoided costs, it is a valid provision that meets both state and federal efficiency goals and the holdings in *Independent Energy Producers* do not preclude us from establishing such a structure.

d) There Are Legitimate Distinctions Between Short Run and Long Run Avoided Costs

There is an appropriate difference between the short run avoided cost paid to the QF Settlement CHPs – which is "short run" compensation paid based on the time of delivery for as-available energy, and the "long run" or "full avoided cost" compensation envisioned by the AB 1613 CHP program. SCE dismisses this distinction as "without merit." (SCE's Rehrg App., at p. 17.) However, both FERC and the U.S. Supreme Court have recognized the "merit" to such a distinction. (Order No. 69, FERC Stats. & Regs., Regs. Preambles, 1977-1981, ¶ 30, 128 at 30,882 (discussed in Section III.A.2.b), *supra*); *American Paper, supra*, at 412-418 (upholding requirement that QFs receive full avoided costs rate).)

Further, SCE's own arguments support the Commission's point here. SCE explains that historically only firm capacity QFs have been allowed longer term contracts, in part because they allow the utilities to "more precisely avoid the procurement of additional capacity." (SCE's Rehrg App., at p. 17, *citing* D.07-09-040 at p. 92 (slip op.).) Because eligible AB 1613 CHPs will, by statute, operate as firm resources and permit the utilities to avoid procurement of resource adequacy capacity, it is appropriate for AB 1613 CHPs to be compensated as long term resources. This logic supports the Commission's determination in D.10-12-055 to pay SRAC only as a second tier payment to those CHPs operating as QFs, but not in compliance with AB 1613 eligibility requirements. (D.10-12-055 at pp. 29-32). Where a CHP operates as a firm resource and meets the higher efficiency and emission standards of AB 1613, it is entitled to a long run avoided cost payment. Where it fails to meet these requirements, but operates as any other CHP QF, it is entitled to the same SRAC payment as those other units.

3. There Is No Merit To The Joint Utilities' Remaining Arguments, That The MPR-Based Price Does Not Constitute An Avoided Cost

In their rehearing applications, in addition to the specific arguments regarding the MPR-based price discussed in Sections III.A.1 and III.A.2 above, the Joint Utilities offer a series of overlapping arguments. They assert that: (1) the MPR-based price was adopted prior to the Commission's recognition that the AB 1613 program needed to comply with PURPA and its avoided cost requirements, and as a result, the record is insufficient to establish that a CCGT is a reasonable proxy for the unit avoided by an AB 1613 CHP (PG&E/SDG&E's Rehrg. App., at pp. 5-7; SCE's Rehrg. App., at pp. 2-3, 7-9, and 13); (2) the MPR-based price was not established in accordance with the criteria for avoided cost set forth in FERC regulations at 18 C.F.R. § 292.304 (PG&E/SDG&E's Rehrg. App., at pp. 5-6; SCE's Rehrg. App., at p. 9); and (3) use of a CCGT as the avoided cost proxy does not meet FERC's conditions for a resource-specific avoided cost (PG&E/SDG&E's Rehrg. App., at p.10; SCE's Rehrg. App., at p. 7).

For many of the reasons already discussed in Sections III.A.1 and III.A.2 above, these arguments are without merit. Notwithstanding the fact that D.09-12-042 was originally adopted outside of the PURPA regime and did not characterize its adopted AB 1613 price as an "avoided cost," the Commission sought, in that decision, to set the energy prices paid to the AB 1613 generators at the utilities' avoided costs in order to meet the AB 1613 requirement of ratepayer indifference. (See Pub. Util. Code, § 2841(b)(4).) As the Final Staff Proposal explained:

> The MPR is based on the costs of a proxy power plant (gas-fired combined-cycle plant) that would be necessary if not for some other form of new generation, in this case CHP. Basing the price paid for excess electricity from a CHP facility on the estimated cost of a marginal generating unit, meets the

ratepayer indifference requirement of PUC Section 2841(b)(4).[18]

FERC regulations define "avoided costs" as: "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." (18 C.F.R. § 292.101(b)(6).) Consistent with the Final Staff Proposal, D.09-12-042 found that a CCGT represents a reasonable proxy for the generation that a utility would have to procure if not for a CHP facility participating in the AB 1613 program. (D.09-12-042 at p. 35.) This is the essence of avoided cost.

For clarity, and at the risk of redundancy, we address each of the Joint Utilities' specific arguments below.

a) The Record Reflects That The MPR-Based Price Is An Avoided Cost

The Joint Utilities assert that the record is insufficient to establish that a CCGT is a reasonable proxy for the unit avoided by an AB 1613 CHP because the MPR-based price was adopted prior to the Commission's recognition that the AB 1613 program needed to comply with PURPA and its avoided cost requirements. (PG&E/SDG&E's Rehrg. App., at pp. 5-7; SCE's Rehrg. App., at pp. 2-3, 7-9, and 13.)

As discussed above, the Joint Utilities are correct that the MPR-based price was adopted at a time when the Commission took the position that the AB 1613 CHP program was not subject to PURPA. However, this point is irrelevant. The legitimate question is not when the AB 1613 price was adopted, or under what circumstances, but whether or not the record demonstrates that the AB 1613 price is an appropriate avoided cost. As discussed above, notwithstanding its belief that the AB 1613 program did not need to be implemented pursuant to PURPA, the Commission confined itself to an MPR-

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[18] The Final Staff Proposal was Attachment A to the "Administrative Law Judge's Ruling Incorporating Energy Division Final Staff Proposal Into the Record and Providing for Comments Thereon," filed August 4, 2009 ("Final Staff Proposal").

based price in order to comply with AB 1613's ratepayer indifference standards. As the Joint Utilities argued in their first rehearing application:

> By definition, "avoided cost" should be the measure of ratepayer indifference. That is, if ratepayers are simply paying the price they would have otherwise paid "but for" the AB 1613 purchase, they are indifferent to the existence of the AB 1613 tariff.

(Joint Utilities' Rehrg. App. Filed January 20, 2010, at pp. 12-13.) We agree with the Joint Utilities. In D.09-12-042 we found that the MPR-based price, as a reasonable proxy for the generation the utilities would have purchased "but for" the AB 1613 purchase requirements, met the ratepayer indifference standard of AB 1613. By the Joint Utilities' own definition, it is also a finding of avoided cost.

To elaborate on the background supporting our decision on this matter, which is not reflected in the text of our prior CHP decisions, the MPR is intended to represent the long term market price of electricity for fixed price contracts. (Pub. Util. Code, § 399.15, subd. (c)(1).) The MPR is derived from the construction, operating and maintenance costs associated with a highly efficient 500 MW CCGT. The MPR inputs and methodology were developed pursuant to Public Utilities Code section 399.15(c) through a public process and the Commission relies on a public process to periodically update the MPR inputs and methodology.[19]

Based on this history of the MPR, and the fact that many of the pricing components of the MPR correspond to AB 1613's pricing requirements,[20] the Commission found in D.09-12-042 and affirmed in D.10-04-055 that the MPR's CCGT is the unit most likely to be procured by the utilities in the absence of the AB 1613 procurement obligation. (D.09-12-042 at p. 35 (slip op.); D.10-04-055 at pp. 8-9 (slip op.).) In those decisions, the Commission relied upon a statement in the record made by

[19] *See, e.g.*, D.05-12-042; D.07-09-024; D.08-10-026; and the Commission's MPR website at http://www.cpuc.ca.gov/PUC/energy/Renewables/mpr

SDG&E/SoCal Gas that the "export profile [of a small CHP facility] is closest to that of a CCGT." (*Id.*, citing to SDG&E/SoCal Gas Comments filed August 24, 2009, at p. 3.) PG&E/SDG&E now seek to distance themselves from that assertion by claiming that it has been taken out of context. In their rehearing application they point out that the discussion which follows the statement went on to distinguish an AB 1613 CHP from a CCGT:

> However, the characteristics of small CHP (less than 20 MW) do not match precisely those of a CCGT in that a CCGT is able to provide firm capacity and ancillary services. SDG&E and SoCalGas' key reservation with regard to whether [the MPR-based price] meets the test of ratepayer indifference is whether paying a firm price for as-available capacity is consistent with ratepayer indifference.

(PG&E/SDG&E's Rehrg. App., at pp. 6-7.) In this manner, PG&E/SDG&E simply retread their argument, rejected in Section III.A.1, and in both D.09-12-042 and D.10-04-055, that an AB 1613 CHP is not a firm resource and should not be paid as a firm resource.

Because the Commission has found that a price based on the MPR's CCGT unit most closely approximates the costs avoided by procuring energy from AB 1613 CHPs, and the utilities have failed to present a reasonable argument that this is not the case, we find that the MPR-based price will not exceed the utilities' avoided costs and that the Joint Utilities' claim is without merit.

b) The AB 1613 Price Addresses Many of The Factors Set Forth in FERC's Regulations

The Joint Utilities argue that the MPR-based price was not established in accordance with the criteria for avoided cost set forth in FERC regulations at 18 C.F.R. § 292.304 (PG&E/SDG&E's Rehrg. App., at pp. 5-6; SCE's Rehrg. App., at p. 9). It is

(footnote continued from previous page)

[20] See Final Staff Proposal at 10.

true that the Commission did not consult FERC's regulations when developing the MPR-based price; however, the AB 1613 price is consistent with those regulations, and that is all that is required. The *FERC Clarification Order* reiterated:

> As the Commission has previously explained, "states are allowed a wide degree of latitude in establishing an implementation plan for section 210 of PURPA, *as long as such plans are consistent with our regulations*. Similarly, with regard to review and enforcement of avoided cost determinations under such implementation plans, we have said that our role is generally limited to ensuring that the plans are *consistent with section 210 of PURPA*…."

(*FERC Clarification Order*, *supra*, at P 24 (emphases added), with the following cases cited in the footnote: *American REF-FUEL Company of Hempstead* (1989) 47 FERC ¶ 61,161, at 61,533; *Signal Shasta* (1987), 41 FERC ¶ 61,120 at 61,295; *see also LG&E Westmoreland Hopewell* (1993) 62 FERC ¶ 61,098, at 61,712.)

FERC's regulations regarding the setting of avoided cost rates are set forth at 18 C.F.R. § 292.304. Subsection (e) of those regulations sets forth the factors that a state shall "to the extent practicable" take into account when determining an avoided cost. As reflected in the *FERC Clarification Order*, these factors are considered "guidance"; they are not mandatory requirements.[21] Notably, the Commission's MPR-based price takes many of these factors into account including, among other things, time of delivery factors, the expected reliability of the QF, contractual terms, sanctions for non-compliance (all set forth at § 292.304(e)(2)), and the ability of the AB 1613 CHP to allow the utility to defer capital additions and reduce fossil fuel use (§ 292.304(e)(3)).

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[21] See, also *Plymouth Rock Energy Associates v. Dept. of Pub. Utils.*, (1995) 648 N.E.2d 752, 754 ("Although FERC's regulations provide guidelines for the calculation of avoided costs, 18 C.F.R. § 292.304 (e), FERC has granted the States flexibility in implementing rates for purchase and, specifically, determining avoided costs."); *Cogen Lyondell, Inc*. (2001)95 F.E.R.C. ¶ 61,243 at P 61,838 ("The Commission implemented section 210(b) of PURPA by promulgating 18 C.F.R. § 292.304 (2000), which states that rates for purchases from QFs shall satisfy the requirements of section 210(b) of PURPA if the rate equals "avoided costs" and which sets forth guidance on how a state regulatory authority or nonregulated electric utility shall determine avoided costs."); similar at *City of Ketchikan, Alaska,* (2001)

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Consequently, the Commission's AB 1613 price is consistent with FERC regulations and the Joint Utilities' arguments on this issue have no merit.

c) The AB 1613 Price Complies With FERC's Guidance On Multi-Tier Avoided Costs

The Joint Utilities argue that use of a CCGT as the avoided cost proxy unit does not meet FERC's conditions for a resource-specific avoided cost. (PG&E/SDG&E's Rehrg. App., at p.10; SCE's Rehrg. App., at p. 7). SCE points out that "there is no percentage or quantity procurement requirement in the AB 1613 statute" or the Commission's decisions implementing the statute. (SCE's Rehrg. App., at p. 7.) "As such, there is no basis to create a separate avoided cost for AB 1613 CHP pursuant to the Clarification Order." (*Id.*)

The Joint Utilities' argument is flawed. The Commission does not attempt to adopt a "resource-specific" avoided cost here. Rather, it establishes a two-tiered avoided cost, with the top of the tier – a long run avoided cost - defined by a CCGT avoided unit, and the bottom of the tier – a short run avoided cost - defined by the current SRAC.

The *FERC Clarification Order's* discussion of a "resource specific cost" is only relevant here to the extent that FERC clarified that an avoided cost determination need not to consider "all sources" of energy, but only those sources "able to sell to the utility." Nothing in the *FERC Clarification Order* suggests that the two-tier structure may only be implemented under a "resource specific" program where the state specifies a percentage of procurement from the specific resource. Rather, FERC was clear that the Commission need only comply with section 210 of PURPA and its existing regulations, and such a two-tier rate structure would be acceptable.

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94 F.E.R.C. ¶ 61,293 at P 62,061.

The Commission's intended two-tier rate structure was clearly presented to FERC. The Commission requested clarification from FERC that it could implement a two tiered rate structure where AB 1613 CHPs receive full avoided cost rates based on their higher efficiency and non-AB 1613 CHPs receive SRAC rates. (See, e.g., *FERC Clarification Order* at PP 20-21.)

The *FERC Clarification Order* responded:

> [W]e find that the concept of a multi-tiered avoided cost rate structure can be consistent with the avoided cost rate requirements set forth in section 210 of PURPA and in the Commission's regulations.

(*FERC Clarification Order* at P 20; see also P 30.) FERC then outlined the relevant statutory and regulatory framework: (1) that Section 210(b) of PURPA requires that QF purchases be at rates that are just and reasonable, not discriminatory, and not in excess of avoided costs; (2) that pursuant to § 292.303 of FERC's regulations, utilities must purchase from QFs consistent with § 292.304; (3) that § 202.304 set forth the factors to be considered in determining avoided cost; and (4) that states are allowed a wide degree of latitude in determining avoided cost as long as their plans are consistent with section 210 of PURPA and FERC regulations. FERC then explained that that there was no record on which to rule whether the Commission's proposed rates would either satisfy or violate the avoided cost requirements of section 210 of PURPA or its regulations. (*FERC Clarification Order* at PP 22-25.) Thus, while FERC declined to explicitly determine whether the Commission's proposed rates were reasonable, it provided guidance that the Commission needed simply to comply with FERC's existing regulations on setting avoided costs. As described herein, the Commission has met this requirement. The Joint Utilities' arguments that the Commission is somehow obligated to comply with FERC's comments regarding a "resource-specific cost" are inapposite and without merit.

B. Rehearing On The 10% Location Bonus Is Denied

The AB 1613 program provides that an AB 1613 CHP located in a local resource adequacy area shall be paid a 10% location bonus calculated based on its total energy payment. Both of the Joint Utilities' rehearing applications claim that this 10% location bonus violates PURPA because it is not based on the utilities' avoided costs of upgrades to the transmission and distribution ("T&D") system. (PG&E/SDG&E's Rehrg. App., at pp. 11-12; SCE's Rehrg. App., at pp.10-11.)

The Joint Utilities raised this same issue in their January 20, 2010 application for rehearing of D.09-12-042. The decision denying rehearing on this issue, D.10-04-055, explained that the basis for the payment was the value of deferred T&D upgrades, as well as the value of local grid stability and reliability:

> [D.09-12-042] determines that a 10% location bonus is appropriate in constrained areas because CHP sited in these areas would provide system benefits such as transmission and distribution upgrade deferrals and local grid stability and reliability. (D.10-04-055, at p. 10).

(D.10-04-055, at p. 10).

While D.10-04-055 cited to the record to generally support this conclusion, the Joint Utilities are correct it did not explain the avoided cost basis for the 10% location bonus. In other words, there was no showing of utility avoided costs that justified the 10% number. This is because the Commission at that time was not implementing the program pursuant to PURPA.. Rehearing on this issue is not warranted. However, given the intervening change, we modify D.10-12-055 (modifying D.09-12-042) so that the clarifying discussion provided below is added to D.09-12-042 to describe the record basis for the 10 % location bonus, how it is related to an "actual determination" of the utilities' avoided costs, and how it was applied in an extremely conservative manner that assures it will, in no event, exceed the utilities' avoided T&D costs.

1. Record On The 10% Location Bonus

At the initiation of this rulemaking, the California Cogeneration Council ("CCC") filed comments noting that the Commission currently uses a model to calculate average T&D avoided cost values for each utility's service area, by each utility division or planning region. (CCC Comments, filed July 31, 2008.) CCC provided, as Attachment A to its comments, a sample of the T&D avoided costs calculated for each utility by the model ("CCC Attachment A"). The spreadsheet model is commonly referred to as the "E3 Model" in the parties' comments. To calculate T&D avoided costs, the E3 Model relies upon each utility's marginal T&D costs adopted in their general rate cases.

Based on the avoided cost numbers reflected in CCC Attachment A, CCC proposed to pay an avoided T&D cost "adder" to AB 1613 generators located in areas that would produce higher than average avoided cost benefits to ratepayers, but did not specifically identify the amount of the adder. (CCC Comments, filed July 31, 2008, at pp. 10-14 and Attachment A.) CCC proposed that the generators would cooperate with the utilities to identify the best areas to site such projects to generate the highest avoided costs. In making this proposal, CCC acknowledged that the utilities have traditionally argued against such a T&D avoided cost on the basis that such costs are "highly site-specific and that a case-by-case analysis is needed." (CCC Comments, filed July 31, 2008, at pp.12-13.) CCC noted that "to the CCC's knowledge, no CHP or renewable projects have ever been compensated for such locational benefits." (CCC Comments, filed July 31, 2008, at p. 13.)

In commenting on CCC's proposal to identify T&D avoided costs, all three utilities agreed that distributed generation facilities have the potential to avoid T&D costs; however, each one argued that this proceeding was not the forum for quantifying those costs. (See, e.g., SCE Comments, filed August 15, 2008, at p. 4.) Among other things, they argued, as CCC anticipated, that each DG facility must be considered separately, on a case-by-case basis, to calculate such avoided costs. (See, e.g., SCE Comments, filed August 15, 2008, at p. 4 .)[22] None of the utilities suggested that the E3 Model avoided cost calculations provided in the CCC Attachment A were inaccurate.

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[22] SCE argued: "Because identifying a T&D price adder would require a case-by-case analysis of each participating system and physical assurance, and because AB 1613 contemplates a standard offer tariff with no distinction for location or physical assurance, the Commission should reject CCC's proposal for a T&D price adder." (SCE Comments, filed August 15, 2008, at p. 4; see also PG&E Comments, filed August 15, 2008, at pp. 7-8; and SDG&E/SoCal Gas Comments, filed August 15, 2008, at p. 2 (outlining

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On August 4, 2009, an Administrative Law Judge's ruling incorporated the Energy Division Final Staff Proposal into the record of the proceeding and requested party comments on the proposal.[23] The Final Staff Proposal suggested a 10% location bonus under both proposed pricing options for any eligible CHP located in a distribution or transmission constrained area. The Final Staff Proposal reasoned that CHP systems situated in constrained areas could provide system benefits such as transmission and distribution upgrade deferrals and local grid stability and reliability. The Final Staff Proposal asked parties to comment on how to determine location or distribution constrained areas for purposes of applying this bonus.

SCE and PG&E/TURN argued that the proposed location bonus of 10% was unsupported by analysis and unreasonable. (PG&E/TURN Comments, filed August 24, 2009, at p.13; SCE Comments, filed August 24, 2009, at p. 12.) They also asserted that the "locational marginal price" ("LMP") values in the California Independent System Operator Corporation ("CAISO") market are the only accurate reflection of actual congestion and losses on the grid. (PG&E/TURN Comments, filed August 24, 2009, at p.13; SCE Comments, filed August 24, 2009, at p. 14.) SCE also pointed out that adopting a generic location adder would be inconsistent with the generator-specific methodology adopted in D.03-02-068. (SCE Comments, filed August 24, 2009, at pp. 12-14.)

SDG&E/SoCalGas contended that if certain facilities received a bonus because of their favorable location, then facilities located in less than favorable locations should receive less. (SDG&E/SoCalGas Comments, filed August 24, 2009, at p. 6.) SDG&E/SoCalGas also contended that CHP located in its service territory is more valuable than CHP located elsewhere in the CAISO-controlled grid given the need for

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SDG&E's 4 criteria proposal for when a facility may qualify for T&D avoided costs, adopted in D.03-02-068).)

[23] See note 18, *supra*.

local resources in their service territory. They argued that locational value should only be provided to CHP located in areas with local resource adequacy requirements when contracting with the local utility. (SDG&E/SoCalGas Comments, filed August 24, 2009, at p. 6.)

CCDC and FuelCell supported the Final Staff Proposal's location bonus. CCDC and FuelCell suggested that the location bonus should be provided to any location where the CAISO nodal LMP exceeds the zonal price. (CCDC Comments, filed August 24, 2009, at 9; FuelCell Comments, filed August 24, 2009, at p. 9.)

2. Analysis of the 10% Location Bonus

Historically, the Commission has agreed with the utilities that while distributed generation facilities unquestionably generate avoided T&D costs, a facility-specific analysis was required before a T&D avoided cost could be paid to generators. The Commission has therefore previously declined to adopt a uniform avoided cost calculation for T&D. Instead, D.03-02-068, issued February, 2003, established four facility-specific criteria to be met for a facility to qualify for avoided T&D costs. To our knowledge, which is consistent with CCC's, no facility has ever qualified for T&D avoided costs under this test.

Notwithstanding the determinations in D.03-02-068, the Commission's position on this matter has evolved over the last eight years in other proceedings so that today the E3 Model is used to calculate avoided T&D costs to determine the cost effectiveness of the utilities' energy efficiency and demand response programs.[24] The utilities benefit from the inclusion of uniform avoided T&D costs in these programs. The more cost-effective the program, because of the addition of T&D avoided costs, the more money utility shareholders may receive in the form of performance incentives.

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[24] The E3 Model for calculating avoided costs for energy efficiency was adopted in D.05-04-024 and updated in 2008 to apply to the utilities' 2009-2011 energy efficiency portfolio plans. (Assigned Commissioner's and Administrative Law Judge's Ruling, R. 06-04-010, April 21, 2008.) These updates did not include changes to the methodology for calculating avoided T&D.

We previously found merit to SDG&E/SoCal Gas's contention that a location bonus is appropriate for generators located in areas with local resource adequacy ("RA") requirements. As a result, we adopted a 10% location bonus for eligible CHP systems located in CAISO-identified location-constrained resource areas, which the Commission identifies as Local RA areas for purposes of establishing local RA procurement requirements. (D.09-12-042, pp. 38-39.)

For background, the Local RA program, approved in D.06-06-064, is intended to ensure that the utilities have acquired sufficient generation capacity to serve defined, transmission constrained local areas. Each year the Commission adopts Local RA requirements and identifies Local RA areas based on the CAISO's annual study of local capacity requirements.[25] The CAISO study identifies the specific substations included in each Local RA area – constrained areas that require the purchase of a specified amount of Local RA resources to avoid T&D system failures.

In D.09-12-042, we determined that eligible CHP interconnected within any of the identified Local RA areas should receive the location bonus. We required each utility to make these location bonus areas, including the specific substations included in each area, publicly available on its website. This information is required to be updated each year upon adoption by this Commission of the Local RA program requirements.[26] The location bonus is to be applied for the entirety of an AB 1613 CHP's contract term based on the Local RA areas identified in the year the contract is executed.

To the extent that parties believe that the 10% location bonus does not reflect avoided cost, or will push the MPR-based price above avoided cost, they are wrong. As an initial matter, it should be noted that all of the utilities agree that distributed generation, which includes AB 1613 CHPs, results in avoided T&D

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[25] The CAISO's 2008 Local Capacity Requirement (LCR) Study is available from the CAISO website, http://www.caiso.com/1c44/1c44bbc954950.html

[26] 2010 Resource Adequacy program requirements were adopted by this Commission in D.09-06-028.

investment. Nevertheless, the 10% location bonus will only be made available to new AB 1613 facilities constructed in Local RA areas. AB 1613 CHPs located in these Local RA areas will generate avoided costs to the utilities well above the 10% location bonus the utilities will pay them.

CCC Attachment A sets forth utility-specific avoided T&D costs by geographic "divisions" which average $5.60/MWh for PG&E's service area, $6.66/MWh for SCE's service area, and $13.03/MWh for SDG&E's service area, assuming a baseload profile, which is the profile of an AB 1613 generator. Based on these average avoided costs for T&D, a 10% location bonus paid to CHP facilities located in Local RA areas for avoided T&D investment is a conservative estimate of the actual T&D costs avoided in Local RA areas for several reasons.

First, the 10% location bonus is only paid on the amount of energy sold to the utility, and not on the amount of energy that the utility avoids producing due to the existence of the AB 1613 generator. Thus, the AB 1613 CHP will receive a payment for far less than the T&D costs it actually avoids. For example, when a utility achieves 10 MWh in energy efficiency savings, it gets credit for 10 MWh of avoided T&D costs, measured by the E3 Model and reflected in the CCC Attachment A. However, if an AB 1613 generator generates 10 MWh of energy, but only sells 1 MWh to the utility, while it avoids 10 MWh of generation, and thus, produces savings similar to 10 MWh of energy efficiency, the AB 1613 generator is only paid the 10% location bonus on the 1 MWh sold to the utility. Pursuant to AB 1613, generators must size output to load and may only sell their excess power to the utility. Thus, any payment to an AB 1613 generator for avoided T&D costs will be less than actual T&D costs avoided.

Second, the CCC Attachment A averages calculated from the data provided in the E3 model are based on avoided T&D investment in the *entire* utility service area. The 10% adder will only be paid to generators located in Local RA areas, which are the most constrained resource areas and will therefore have the highest avoided T&D costs. For example, CCC Attachment A shows that avoided T&D costs are as high as $9.17/MWh in PG&E's service area, $8.33 in SCE's service area, and $13.03 in

SDG&E's service area. In that regard, the 10% Location Bonus based upon "average" T&D costs is a conservative estimate of the cost actually avoided by the utility for T&D. Further, the avoided T&D costs reflected in CCC Attachment A are likely to increase as a result of utility filings for increases in transmission rates at FERC, and increases in distribution rates in Commission proceedings.

In adopting the 10% location bonus for AB 1613 generators located in local RA areas, the Commission recognizes that it must be consistent with federal law. The *FERC Clarification Order* explained that if the adder is based on an actual determination of expected costs of T&D upgrades it would constitute an avoided cost determination and be consistent with PURPA and Commission regulations:

> [I]f the CPUC bases the avoided cost "adder" or "bonus" on an actual determination of the expected costs of upgrades to the distribution or transmission system that the QFs will permit the purchasing utility to avoid, such an "adder" or "bonus" would constitute an actual avoided cost determination and would be consistent with PURPA and our regulations.

(*FERC Clarification Order*, *supra*, 133 FERC ¶ 61,059 at P 31.)

Further, the Commission has a great deal of discretion in determining this expected avoided cost. As the Ninth Circuit Court of Appeals recognized in *Independent Energy Producers*, the Commission has broad authority to implement Section 210 of PURPA, "states play the primary role in calculating avoided costs," and states have "a great deal of flexibility … in the manner in which avoided costs are estimated …." (*Independent Energy Producers Association, supra*, 36 F.3d 848, 856.) FERC recently affirmed and further clarified these principles in its *Clarification Order.* There, it emphasized the fact-specific nature of avoided cost determinations and its reluctance to "second guess" state determinations:

> As the Commission has previously explained, "states are allowed a wide degree of latitude in establishing an implementation plan for section 210 of PURPA, as long as such plans are consistent with our regulations. Similarly,

> with regard to review and enforcement of avoided cost determinations under such implementation plans, we have said that our role is generally limited to ensuring that the plans are consistent with section 210 of PURPA…." [*See American REF-FUEL Company of Hempstead*, 47 FERC ¶ 61,161, at 61,533 (1989); *Signal Shasta*, 41 FERC ¶ 61,120 at 61,295; *see also LG&E Westmoreland Hopewell*, 62 FERC ¶ 61,098, at 61,712 (1993).] In this regard, the determinations that a state commission makes to implement the rate provisions of section 210 of PURPA are by their nature fact-specific and include consideration of many factors, and we are reluctant to second guess the state commission's determinations; our regulations thus provide state commissions with guidelines on factors to be taken into account, "to the extent practicable," [18 C.F.R. § 292.304(e) (2010)] in determining a utility's avoided cost of acquiring the next unit of generation.

(*FERC Clarification Order* at P 24.)

The U.S. Supreme Court's holdings in *American Paper* further support the Commission's determination to adopt a uniform T&D avoided cost in the form of the 10% location bonus, instead of requiring the project-specific determination of prior years. In that case, the Supreme Court found that FERC appropriately adopted a uniform rule that every CHP was entitled to full avoided cost payments. Among other things, the Supreme Court referred to PURPA's legislative history stating that such rate determinations should not be subject to the same level of scrutiny typically applied to utility rate applications. The Supreme Court quoted that legislative history at length, including the directive to encourage CHPs:

> "[C]ogeneration is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications, but rather in a less burdensome manner. The establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production."

(*American Paper, supra,* at p. 414, quoting from H. R. Conf. Rep. No. 95-1750, pp. 97-98 (1978).) The Supreme Court examined FERC's policy reasons for adopting the full avoided cost rule, instead of a generator-specific avoided cost. Among them, the Supreme Court recognized FERC's desire to provide development incentives, and that such development would serve the public interest:

> The Commission recognized that the full-avoided-cost rule would not directly provide any rate savings to electric utility consumers, but deemed it more important that the rule could "provide a significant incentive for a higher growth rate" of cogeneration and small power production, and that "these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy." [footnote omitted] 45 Fed. Reg. 12222 (1980).

(*Id.* at 415.) The Supreme Court properly noted that "[t]he Commission would have encountered considerable difficulty had it attempted to determine an appropriate rate less than full avoided cost." (*Id.* at p. 416.) Similarly here, the Commission's project-specific T&D adder has proven to be unworkable. To encourage CHP consistent with both federal and state law, the Commission adopts a uniform rule here to compensate AB 1613 CHPs located in Local RA areas for some portion of the T&D costs they allow the utility to avoid. Such a uniform rule is consistent with both FERC orders, and the Supreme Court's holdings in *American Paper.*

In summary, the 10% location bonus the Commission adopted in D.09-12-042 is consistent with FERC's regulations because it is based on an "actual determination" of the utilities expected T&D costs, as established in their general rate cases and incorporated into the E3 Model relied on here. Based on these costs, and as explained above, the 10% location bonus is a conservative under-estimate of the avoided T&D costs associated with AB 1613 generators situated in location constrained resource areas and will not result in AB 1613 generators receiving more than avoided costs for their energy sales to the utilities.

C. Limited Rehearing Is Granted To Modify D.10-12-055 To Cap the GHG Compliance Cost Pass-Through At Avoided Cost

1. Overview

A major point of discussion in this proceeding has related to GHG compliance costs and how these costs should be addressed in the AB 1613 contract. The Final Staff Proposal recommended that the utility Buyers should pay for GHG compliance costs for the excess electricity sold to the grid. This proposal was adopted in D.09-12-042. To cap the utilities' cost exposure, D.09-12-042 also provided that the Buyer's GHG cost obligation would only be up to the emissions associated with operating the CHP facility at the CEC's minimum efficiency levels ("CEC-based cap"). D.09-12-042 required the CHP facility to be responsible for any additional GHG compliance obligation deriving from suboptimal operation of the facility.[27]

The Joint Utilities PFM raised issues regarding administration of the GHG compliance pass-through. In response, an Amended Scoping Memo issued September 9, 2010 reopened the record to take comment on the following GHG compliance cost issues:

> (1) If Sellers require reimbursement for GHG allowance costs, at what intervals should invoices be submitted to the Buyers?
>
> (2) Is a test (market based or some other method) needed to ensure that the invoices submitted by the Seller leave the ratepayer no worse off than if the Buyer had managed these compliance costs? If so, how should the market test be structured?[28]

Parties' comments on the GHG questions posed in the Amended Scoping Memo reflected a wide range of views. Most parties focused on the questions asked.

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[27] D.09-12-042, pp. 48-49 (slip op.).

[28] Amended Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge dated September 9, 2010, at p. 5.

PG&E and SCE raised PURPA-based objections to the GHG compliance cost pass through. They referenced the *FERC Declaratory Order* in support of their claims. PG&E argued that the cost of GHG allowances should not be treated as a pass-through but as a component of the generator's production costs and included in the avoided cost payments due under the Seller's monthly invoice for delivered energy. (PG&E Comments, filed September 29, 2010 at pp. 4-5.) SCE contended that any resolution of issues related to GHG costs must be consistent with the global QF Settlement Agreement filed with the Commission on October 8, 2010.[29] (SCE Comments, filed September 29, 2010 at p. 3.) Fuel Cell and CCDC replied that the Commission should ignore these PG&E and SCE comments as they were outside the scope of the Amended Scoping Memo and therefore erroneous.

In response to comments received, D.10-12-055 determined that:

(1) Comments from PG&E and SCE regarding short run avoided cost calculations, as provided in the QF Settlement, are outside the scope of the Amended Scoping Memo and outside the record of this proceeding, and should therefore be disregarded. (D.10-12-055 at pp. 18-19);

(2) GHG compensation costs are "environmental externalities" like RECs and are therefore "external to avoided cost rates." (D.10-12-055 at p. 19); and

(3) The Seller may elect who will procure the GHG allowances for the excess power sold to the utility – either the Seller or the Buyer. (D.10-12-055 at p. 20). Thus, the Seller may elect to recover its costs up to the established CEC-based cap from the Buyer, or the Buyer will procure GHG allowances for the excess power purchases, up to the CEC-based cap.

[29] *Joint Motion for Approval of Qualifying Facility and Combined Heat and Power Program Settlement Agreement*, filed in the following dockets: Application 08-11-001, R.06-02-013, R.04-04-003, R.04-04-025, and R.99-11-022.

2. Joint Utilities' Applications for Rehearing

In their Applications for Rehearing of D.10-12-055, the Joint Utilities argue that the GHG compliance cost pass-through does not comply with avoided cost principles. Specifically, they claim that avoided cost is based on the *utilities'* costs avoided through the purchase of QF power, not the *generators'* costs, and that it is inconsistent with PURPA to provide for a direct pass through of a generator's production costs. (SCE's Rehrg. App., at p. 11; PG&E/SDG&E's Rehrg. App., at pp. 12-13.) They argue that D.10-12-055's reliance on the *FERC Clarification Order* is in error. PG&E/SDG&E characterize GHG compliance costs as production costs similar to other environmental compliance costs: "Like other costs incurred to comply with air quality, water quality, and land-use restrictions, GHG compliance costs are another cost of doing business." (PG&E/SDG&E's Rehrg App., at p. 13.) SCE similarly argues that, contrary to the position taken in D.10-12-055, the *FERC Clarification Order* supports the view that GHG compliance costs are not like renewable energy credits ("RECs"), but are production costs which cannot be passed through. SCE states:

> Contrary to the Decision … nothing in the Clarification Order supports a pass-through of the seller's production costs, regardless of the type of costs. The Clarification Order describes RECs as "separate commodities from the energy and capacity produced by QFs" and provides that "if a state chooses to create these separate commodities, they are not compensation for capacity and energy." [citation to Clarification Order at 16, n. 62.]
>
> Here, GHG compliance costs are not a "renewable energy credit" and they are not a separate commodity or product.

(SCE's Rehrg. App., at p. 12.)

3. Discussion

In determining how to best allocate GHG compliance costs, the Commission initially focused on the preliminary and evolving nature of the GHG compliance regulatory regime. As the Final Staff Proposal noted:

> It is difficult to know the value of GHG attributes and GHG compliance costs, if any, associated with eligible generation under this program until rules and regulations are established.

(Final Staff Proposal at p. 5.)

The Commission similarly recognized that California's GHG compliance regime was in its infancy. Because compliance will not begin until January 1, 2012, at the earliest,[30] the regime will not apply to all facilities at that time, and many critical elements of the regime have not yet been finalized, the Commission could not accurately quantify the costs the GHG compliance regime would impose. Consequently, the Commission determined it was appropriate to adopt the Final Staff Proposal's suggested cost pass-through. (See, e.g., D.09-12-042, at pp. 46-49.) The Commission was concerned that any other approach could over or under compensate AB 1613 CHPs for their GHG compliance costs, and that this would not meet the "ratepayer indifference" requirements of AB 1613.

Given the transition of the AB 1613 program to one implemented pursuant to PURPA, it is now apparent that any compensation for GHG compliance costs must be consistent with avoided cost principles.

There is merit to the Joint Utilities' rehearing arguments that the pass-through mechanism affirmed and elaborated upon in D.10-12-055 is not consistent with avoided cost principles. Among other things, the Joint Utilities are correct that GHG compliance costs are environmental compliance costs that should be included in the generator's costs of production. Consequently, we grant rehearing to the Joint Utilities on this issue. Parties previously had an opportunity to comment on this issue. Based on the record in this proceeding, we modify D.10-12-055 to adopt an earlier proposal made

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[30] *See, e.g.,* the facts discussed in *Ass'n of Irritated Residents, et al. v. California Air Resources Board,* CGC 09-509526, Statement of Decision – Order Granting in Part Petition for Writ of Mandate, issued March 18, 2011 in Superior Court of California, County of San Francisco (reflecting possible delay in AB 32 implementation).

by SDG&E/SoCalGas that was considered, but rejected, in D.09-12-042. (See D.09-12-042 at p. 44 (slip op.).)

In comments responding to the Final Staff Proposal, SDG&E/SoCal Gas agreed that it was appropriate for the Buyer to pay for the GHG compliance costs associated with the excess energy sold to the utility. However, assuming adoption of the MPR-based pricing formula, SDG&E/SoCal Gas suggested that the cost pass-through be capped at the MPR heat rate so that the Seller would bear any GHG compliance costs for emissions associated with less efficient units. (SDG&E/SoCal Gas Opening Comments, filed August 24, 2009, at pp. 8-9.)

In order to comply with avoided cost principles, the costs paid by the utility to the AB 1613 CHP should not exceed the avoided GHG compliance costs of the proxy CCGT the Commission has relied on to establish the avoided costs for energy. The SDG&E/SoCal Gas proposal, by setting a cap at the MPR heat rate, properly caps the costs that may be recovered by an AB 1613 CHP to the proxy CCGT's avoided GHG compliance costs. Adopting the cap will ensure that the price paid to AB 1613 CHPs for GHG compliance will not exceed the utilities' avoided cost. Consequently, the Commission adopts the SDG&E/SoCal Gas proposal, and modifies D.10-12-055 (modifying D.09-12-042) accordingly.

Consistent with this determination, the Commission also modifies D.10-12-055 regarding the seller's right to choose to either procure GHG allowances itself and seek reimbursement from the utility, or have the utility procure GHG allowances for the excess electricity sold it. The Commission retains this election option. However, if the seller elects to have the utility procure GHG allowances for it, the utility's obligation to procure such allowances is capped at the number of allowances necessary to operate the proxy CCGT unit.

The Joint Utilities shall submit supplemental advice letters to amend the tariff sheets and contracts associated with the AB 1613 program consistent with these modifications.

Also consistent with this determination, we will eliminate the discussion in D.10-12-055 comparing GHG compliance costs to RECs (see D.10-12-055 at pp. 19-20), and otherwise modify D.10-12-055 (modifying D.09-12-042) to be consistent with the discussion above.

Traditionally, an avoided cost payment incorporates all elements of energy production into a single payment, and here we have two components that comprise the avoided cost payment to an AB 1613 CHP – the MPR-based energy price, and the GHG compliance cost pass-through capped at the avoided cost of the CCGT proxy unit. Among other things, this cost pass-through approach may be administratively burdensome for the parties. However, given the uncertainty surrounding implementation of California's GHG compliance regime, this two component avoided cost approach is appropriate at this time. It allows for the program to comply with PURPA using a proposal already in the record of this proceeding (by ensuring that actual cost payments not exceed the utility's avoided costs), and will allow AB 1613 CHP project development to move forward, resulting in the environmental benefits intended by AB 1613. While this payment scheme will apply to the life of contracts signed pursuant to the tariffs approved under this decision, the Commission may revisit this issue as to future AB 1613 CHP contracts when the GHG allowance markets have evolved and compliance costs are more easily determined or forecasted.

D. The Motion for Stay Is Denied

Ordering Paragraphs 9, 10, and 11 of D.10-12-055 direct each of the Joint Utilities to file supplemental advice letters to implement the standard and simplified AB 1613 contracts adopted in D.09-12-042 as modified by D.10-12-055 within forty-five days of the its December 17, 2010 mailing date.

As described above, the Joint Utilities filed their initial motion to stay D.10-12-055 on January 6, 2011, and this was dismissed as premature by Assigned Commissioner's Ruling on January 12, 2011.

The Joint Utilities then filed a joint motion to stay with their rehearing applications. In this stay motion, they requested a stay of D.10-12-055 until the latter of resolution of the their Enforcement Petition at FERC or the effective date of a Commission decision on the Joint Utilities' respective applications for rehearing of D.10-12-055.

The Joint Utilities argue that a stay is appropriate because: (1) they are likely to prevail on the merits of their FERC Enforcement Petition, resulting in a changed AB 1613 pricing formula; (2) they will suffer serious and irreparable harm if the stay is not granted; (3) the balance of hardships supports a stay; and (4) there are other relevant factors in their favor, such as the certainty of pricing for AB 1613 generators. (Joint Utilities' Motion for Stay, at p. 3.)

The Joint Utilities filed their supplemental advice letters on January 31, 2011, in compliance with Ordering Paragraphs 9, 10, and 11 in D.10-12-055. Energy Division issued a notice of suspension on February 18, 2011 staying Energy Division action on those supplemental advice letters for up to 120 days for further staff review.

As an initial matter, this order disposing of the Joint Utilities' rehearing applications renders the first portion of the motion for stay moot. FERC's March 31, 2011, "Notice of Intent Not to Act," declining to initiate an enforcement action against the Commission, arguably renders the second portion of the motion for stay moot. Nevertheless, we address the merits of the motion for stay here and deny the motion.

First, given the modifications and clarifications to the AB 1613 program ordered herein, the Joint Utilities are not likely to prevail on the merits of a FERC Enforcement Petition.

Second, there is no irreparable harm to the Joint Utilities if the stay is not granted. Energy Division's suspension of the supplemental advice letters filed by the Joint Utilities under Ordering Paragraphs 9, 10, and 11 for up to 120 days ensures that the AB 1613 program will not be implemented until these modifications and clarifications are made. No AB 1613 contract may be executed until the tariffs are approved. (See CPUC General Order 96-B, General Rule 7.3.5 and Energy Industry Rule 5.3.) And even if contract execution were imminent, there is no issue of utility shareholders being at risk for stranded costs because AB 1613 expressly provides that the costs of the contracts will be allocated to "benefiting customers." (Pub. Util. Code, § 2841 subd. (e).)

Third, the balance of hardships is strongly in favor of the public interest. AB 1613 was enacted to further environmental objectives, particularly the reduction of GHG emissions. President Obama and the U.S. Environmental Protection Agency ("EPA") have recognized the overwhelming scientific consensus, which now confirms that climate change is unequivocal and due primarily to human-induced GHG emissions, which come mainly from the burning of fossil fuels. (See, e.g., EPA Endangerment Finding, 74 Fed. Reg. 66496 at 66497 (December 2009).) AB 32,[31] and the Commission's D.10-04-055 and D.07-01-039, recognized the serious threats posed by GHG emissions and global warming, such as the exacerbation of air quality problems, the reduction in California water supplies, a rise in sea levels resulting in displacement of coastal businesses and residences, and increases in human health-related problems.

AB 1613 is an important part of the State's attempt to be part of the GHG solution, instead of part of the problem. Yet the Joint Utilities have taken action at every step to delay its implementation. A stay will further delay the implementation of the program, and the environmental benefits it was intended to produce.

In sum, there are no relevant factors in favor of a stay. The AB 1613 Program will not be implemented until we take action to ensure compliance with PURPA. A stay of D.10-12-055 to await final resolution of the Enforcement Petition in federal court (or to await resolution of a subsequently filed enforcement petition) will unnecessarily delay implementation of the AB 1613 program (including the Advice Letter submittal and review process) and harm CHP developers who are prepared to commit to construction under the program, resulting in further delay of the environmental benefits anticipated to result from this program, including GHG emission reductions. Consequently, the Joint Utilities' motion for stay is denied.

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[31] *See* fn 6, *supra.*

IV. CONCLUSION

Rehearing is granted on the limited issue of GHG compliance costs, and modifications to D.10-12-055, as described herein, shall be made: (1) modify our treatment of GHG compliance costs to be consistent with avoided cost principles; (2) clarify why the MPR-based energy price adopted by D.09-12-042 and affirmed in D.10-12-055 is consistent with avoided cost principles; (3) clarify why the 10% Location Bonus is consistent with avoided cost principles, and (4) conform D.09-12-042 with the modifications ordered by D.10-04-055 and D.10-12-055, as modified herein. Rehearing of D.10-12-055, as modified, is denied. We also deny the Joint Utilities' motion for stay as without merit.

THEREFORE, IT IS ORDERED that:

1. Rehearing of D.10-12-055 is granted for the limited purpose of addressing greenhouse gas compliance cost issues.

2. D.10-12-055 shall be modified as follows:

   a. The discussion in Section 1 "Summary" on pages 1 and 2 is replaced with the discussion at Section 1 "Summary" in the Conformed Version of D.10-12-055, attached hereto as Attachment A.

   b. The first full paragraph on page 3 starting "On January 20, 2010, …" is replaced with the first full paragraph starting "On January 20, 2010, …" on page 3 of the Conformed Version of D.10-12-055, attached hereto as Attachment A.

   c. The text of Section 7.1 "Discussion" on pages15 and 16 is replaced with the discussion at Section 7.1 "Discussion" in the Conformed Version of D.10-12-055, attached hereto as Attachment A.

   d. The title of Section 8 - "Remove Language Requiring IOUs to Purchase GHG Allowances" - on page 16 is modified to "GHG Compliance."

   e. A new heading "8.3.1 The Pricing Terms Established By The QF Settlement Do Not Apply To The AB 1613 Program" is added underneath the heading "8.3 Discussion" at page 18.

f. A new footnote is added to the end of the partial paragraph at the top of page 19 that reads:

"The QF Settlement decision, D.10-12-035, expressly declined to apply the QF Settlement price to AB 1613 CHPs:

The Proposed Settlement is comprehensive, but it does not resolve issues in numerous Commission proceedings implementing recent statutory requirements that pertain to QFs of 20 MW or less, such as new CHP systems under Assembly Bill 1613 (codified as Pub. Util. Code sections 2840-2845), except to acknowledge that the megawatt (MW) and GHG reductions will count toward the investor-owned utilities' MW and GHG reduction targets."

g. A new heading "8.3.2 Modification to Provision Regarding Procurement of GHG Allowances" is added above the first full paragraph on page 19 that begins "In addition, the FERC Clarification Order explains that compensation for …."

h. The first full paragraph on page 19 that begins "In addition, the FERC Clarification Order explains that compensation for …." is deleted.

i. The first sentence of the first full paragraph on page 20 that begins "However, the Joint Utilities make a reasonable request …." is modified to read:

"The Joint Utilities make a reasonable request in their Petition for Modification regarding which entity is best positioned to actually purchase the GHG allowances needed for an AB 1613 facility."

j. A new Section 8.3.3 "Modification to GHG Compliance Cost Pass-Through To Be Consistent With Avoided Cost Principles" is added at the end of Section 8.3 "Discussion" as set forth in the Conformed Version of D.10-12-055, attached hereto as Attachment A.

k. The title of Section 12 - "Changes Needed to Contracts in Light of Subsequent FERC Orders" - on page 27 is modified to

"Additional Changes and Clarifications Required in Light of Subsequent FERC Orders."

l. A new heading "12.1 Overview" is added underneath the heading "12. Changes Needed to Contracts in Light of Subsequent FERC Orders" at page 27.

m. A new heading "12.2 Amended Scoping Memo and Party Comments" is added underneath the second full paragraph starting "The significance of the FERC's Clarification Order …." at page 28.

n. The three paragraphs starting with the last paragraph on page 28 that reads "In consideration of the FERC Declaratory Order, …" and ending with the second full paragraph on page 29 that reads "Regarding the event that a QF loses its AB 1613 certification …" are replaced with the discussion in Section 12.2 of the Conformed Version of D.10-12-055, attached hereto as Attachment A.

o. A new section 12.3 "The Record Reflects That The MPR-Based Price Is An Avoided Cost" as set forth in the Conformed Version of D.10-12-055, attached hereto as Attachment A, is added after the second full paragraph on page 29 that reads "Regarding the event that a QF loses its AB 1613 certification …"

p. Section 12.1 "Discussion" at pages 29 to 32 is replaced with Section 12.4 "QF Status and Two Tier Pricing Structure" as set forth in the Conformed Version of D.10-12-055, attached hereto as Attachment A.

q. The following new sections are added to the end of Section 12.1 at page 32, as set forth in the Conformed Version of D.10-12-055, attached hereto as Attachment A: (1) Section 12.5 "A PURPA Contract May Include Sanctions For Non-Compliance With State Efficiency Requirements"; (2) Section 12.6 "The 10% Location Bonus Is Based On The Utilities' Avoided Costs"; (3) Section 12.6.1 "Record On The 10% Location Bonus"; and (4) Section 12.6.2 "Analysis Of The 10% Location Bonus."

r. The discussion in Section 13 "Comments on Proposed Decision" on pages 32 and 33 is replaced with the discussion at Section 13

"Comments on Proposed Decision" in the Conformed Version of D.10-12-055, attached hereto as Attachment A.

s. The Findings of Fact, Conclusions of Law, and Ordering Paragraphs are modified as set forth in the Conformed Version of D.10-12-055, attached hereto as Attachment A.

3. Rehearing of D.10-12-055, as modified herein, is denied.

4. The motion for stay of D.10-12-055 is denied.

5. The Joint Utilities shall submit supplemental advice letters to amend the tariff sheets and contracts associated with the AB 1613 program consistent with the holdings in this order within 30 calendar days of the effective date of this order.

6. For clarity and for the convenience of the parties and the general public, we hereby adopt the "Conformed" Versions of D.10-12-055 and D.09-12-042, attached hereto as Attachments A and B, respectively. These conformed versions of D.10-12-055 and D.09-12-042 incorporate all modifications ordered by subsequent decisions in this proceeding, including this order, with the exception of those modifications ordered by D.10-04-055 to D.09-12-042 which are superseded here. To the extent modifications ordered result in express conflicts among the decisions in this proceeding, the holdings of the last in time decision shall control with the exception that the discussions set forth in Sections 5, 9, 10, and 11 of D.10-12-055 are not intended to be modified and stand as written.

7. To the extent that the AB 1613 contracts require further amendments to be consistent with the Commission's decisions in this proceeding, Energy Division is authorized to address such amendments through the resolution and advice letter process.

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This order is effective today.

Dated April 14, 2011, at San Francisco, California.

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

Commissioner Michel Peter Florio, being necessarily absent, did not participate.