

**DRAFT**

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**ENERGY DIVISION**

**I.D. # 11363  
RESOLUTION E-4490  
June 21, 2012**

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

Resolution E-4490. Southern California Edison Company requests fixed energy price agreements with eight existing Qualifying Facilities.

**PROPOSED OUTCOME:** This resolution approves a request by Southern California Edison to enter into fixed energy price agreements, which will temporarily amend the energy price terms of existing agreements, with eight existing renewable energy qualifying facilities and to recover in rates all payments made under such agreements.

**ESTIMATED COST:** The costs associated with the eight fixed energy price agreements should provide a reduction to payments SCE would otherwise have to make under the eight existing contracts with the same qualifying facility counterparties.

By Advice Letter 2696-E Filed on February 1, 2012.

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**SUMMARY**

On February 1, 2012, SCE filed Advice Letter (AL) 2696-E, which seeks approval of Fixed Energy Price Agreements between SCE and eight existing renewable QFs. This Resolution approves fixed energy price agreements (FEPAs) between Southern California Edison Company (SCE) and eight existing renewable energy Qualifying Facilities (QFs); these FEPAs will amend the energy price terms of existing QF Power Purchase Agreements from Short Run Avoided Cost (SRAC) to fixed prices. Similar to the previous fixed energy price agreement (2011 Spring Fixed Price Agreement) offered to QFs that were approved December 1, 2011, for the FEPAs that are subject to this resolution, SCE conducted a solicitation to identify the most competitive fixed price offers, at or below Edison's estimate of the SRAC pricing the facilities would otherwise receive under their existing contracts over the relevant time period. Eight renewable QFs offered competitive

bids for Fixed Energy Price Agreements under SCE Fixed Energy Price Request for Offers (RFOs). The winning projects will provide SCE renewable energy over the term of the fixed energy price period offered for this solicitation (May 1, 2012 through December 31, 2015). The payments to these facilities under the FEPA are anticipated to provide modest savings to ratepayers relative to SCE's estimate of what these QFs would have otherwise been paid under their existing contracts. In addition to providing modest savings to ratepayers, the eight FEPAs hedge against the volatility of natural gas during the length of the Agreements.

## **BACKGROUND**

### *QF Energy Pricing*

The Public Utilities Regulatory Policy Act of 1978 established provisions whereby qualifying cogeneration and renewable generation facilities (Qualifying Facilities or QFs) are compensated for power delivered to energy utilities at a rate representing the utilities' avoided cost of generation, the price the utilities would have paid to procure power but for the existence of the QF. In April of 2004, the Commission opened Rulemakings (R.) 04-04-003/R.04-04-025 to update the avoided cost of energy pricing, develop new long-term standard offer contracts and address various procurement policies associated with QFs.

In September of 2007, the Commission issued D.07-09-040 adopting an updated Short Run Avoided Cost (SRAC) energy price for QFs and setting capacity payment prices for firm and as-available generation. The SRAC, adopted as the Market Index Formula, was further developed and implemented upon Commission approval of Resolution E-4246 in July of 2009, effective in August 2009. For many QFs, however, the new SRAC established in D.07-09-040 does not apply due to prior Commission approval of fixed energy prices under various settlement agreements.

On December 16, 2010, the Commission adopted the Qualifying Facilities and Combined Heat and Power (QF/CHP) settlement with the issuance of Decision (D.)10-12-035. The settlement resolves a number of longstanding issues regarding the contractual obligations and procurement options for facilities operating under legacy and new QF contracts. Among other things, D.10-12-035 updates methodologies and formulas for SRAC energy price for QFs to be used in standard offer contracts. The SRAC methodology under the QF/CHP settlement includes:

- (1) by January 1, 2015, transitioning SRAC pricing from a formula that is based in part on administratively-determined heat rates to a formula that solely uses market heat rates;
- (2) investor-owned utility (IOU)-specific time-of-use (TOU) factors to be applied to energy prices to encourage energy deliveries during the times when the energy is most needed by customers;
- (3) a locational adjustment based on California Independent System Operator (CAISO) nodal prices; and
- (4) pricing options based on whether a cap-and-trade program or other form of greenhouse gas (GHG) regulation is developed in California or nationally.

### *Renewable QF Contracting with SCE*

In June 2001, in the aftermath of the 2000-2001 energy crisis, the Commission approved D.01-06-015, which allowed QFs to enter into any one of three voluntary contract amendments. The three amendment options were either (a) supplemental payments for one year for QFs demonstrating immediate need for such funds in order to continue operations, (b) fixed energy prices for five-years at 5.37 cents per kilowatt-hour (kWh), or (c) incentive payments for energy produced above normal operating levels.

On or about June 19, 2001, SCE executed fixed price, five-year agreements with 90 renewable QFs based on the fixed-price amendment approved in D.01-06-015 (First Renewable Fixed Price Agreement or RFPA1). These agreements included an energy price of 5.37 cents per kWh and had contract terms of May 1, 2002 through April 30, 2007.

In May 2006, with approximately one year remaining on the First Renewable Fixed Price Agreements, SCE and QF representatives negotiated terms and reached an agreement in principle on a second five-year, fixed price agreement (Second Renewable Fixed Price Agreement or RFPA2). SCE offered the Second Renewable Fixed Price to all 90 QFs that received the RFPA1 plus one additional facility. Of the 91 QFs that were offered the RFPA2, 61 facilities accepted the agreement. These 61 QFs represented 90 percent of the generation from SCE's non-gas fired QF portfolio in 2005.

This Second Renewable Fixed Price Agreement was approved by the Commission by Resolution E-4026 on October 19, 2006. The terms and conditions of this agreement were similar to the First Renewable Fixed Price

Agreement. The contract term extended from May 1, 2007 to April 30, 2012. The energy price during the five-year period was set at 6.15 cents/kWh, with an escalation factor of one (1) percent per year. In addition, the QFs entering into the RFP2 expressly agreed to convey all Environmental Attributes, Capacity Attributes, and Resource Adequacy Benefits generated or produced during the RFP2 term to SCE.

#### *2011 Spring QF Fixed Price Request for Offers*

In April 2012, the Second Renewable Fixed Price Agreement between SCE and 61 QFs expired. However, all of these facilities will remain under contract with SCE through the term of their original contracts, which expire between 2013 and 2026. Upon expiration of the Second Renewable Fixed Price Agreement, the price paid to these facilities will revert to SRAC as periodically updated by the Commission, unless another agreement to amend the energy pricing terms is reached.

Because the calculation of SRAC fluctuates with the price of natural gas, it tends to be poorly aligned with the operations of renewable generators whose costs do not vary with natural gas price fluctuations. In 2010, SCE contemplated another QF fixed energy price program to replace the Second Renewable Fixed Price Agreements as a hedge against natural gas volatility. After analyzing gas and power market conditions, its procurement needs, and its risk profile, it determined that the most appropriate course of action was to consider QF fixed price agreements in the context of its other gas hedging activities.<sup>1</sup> SCE determined that the most efficient method to determine the most competitive offers was to conduct a solicitation under which projects could bid a fixed energy price that meets that project's specific needs, subject to a price ceiling SCE set based on its forecast of SRAC over the term of the fixed price amendment. In April 2011, under the oversight of its Procurement Review Group (PRG), SCE initiated a Request for Offers (RFO).

On December 1, 2011 in Resolution E-4443, the Commission approved the execution of three FEPAs between SCE and the winning bidders of the 2011 Spring Fixed Price RFO. The Commission found that the agreements between SCE and the three non-gas fired QFs were reasonable and prudent for all purposes, including, but not limited to, SCE's recovery in rates of all payments made under such agreement.

#### *2011 Fall QF Fixed Price Request for Offers*

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<sup>1</sup> Southern California Edison, Advice 2608-E, July 29, 2011 p.3.

In October 2011, SCE decided to continue to offer the fixed energy price agreements as a replacement to the Second Renewable Fixed Price Agreements under the 2011 Fall Fixed Price RFO, concurrently with SCE's Gas RFO hedging efforts. By the instant advice letter, SCE seeks approval of FEPAs with eight QFs that participated in the Fall 2011 RFO.

### **NOTICE**

Notice of AL 2696-E was made by publication in the Commission's Daily Calendar. Southern California Edison states that a copy of the Advice Letter was mailed and distributed in accordance with Section 3.14 of General Order 96-B.

### **PROTESTS**

Advice Letter 2696-E was not protested.

### **DISCUSSION**

#### **SCE requests Commission approval of eight fixed energy price agreements with eight existing QFs.**

On February 1, 2012, SCE filed Advice Letter (AL) 2696-E, which seeks approval of Fixed Energy Price Agreements between SCE and eight existing non-gas fired QFs. SCE executed these contracts with the winning bidders selected after issuing a QF Fixed Price Request for Offers from respondents seeking to temporarily amend the energy price within their existing QF Power Purchase Agreements to a new fixed energy price by entering into short-term Fixed Energy Price Agreements (FEPA) with SCE.

SCE specifically requests that the Commission find the Fixed Energy Price Agreements reasonable and prudent for all purposes, including but not limited to, SCE's recovery in rates of all payments made under such agreements, subject only to Commission review of the reasonableness of SCE's administration of the agreements.

In addition, SCE requests any other and further relief as the Commission finds just and reasonable.

Energy Division evaluated the QF Fixed Energy Price Agreements on multiple grounds:

- Consistency with D.07-09-040
- Consistency with D.10-12-035 (QF/CHP Program Settlement)
- Reasonableness of the procurement process
- Cost reasonableness
- Consistency with the Emissions Performance Standard
- Consistency with D.02-08-071, which requires Procurement Review Group (PRG) participation

In considering these factors, Energy Division also considered the analysis and recommendations of the Independent Evaluator.<sup>2</sup>

### **Consistency with D.07-09-040**

The filing of AL 2696-E is consistent with Commission procedures for contract changes to existing QF contracts. Approval for QF contract changes was previously addressed in D.98-12-066, which authorized the advice letter process to be used for restructured QF contracts that are supported by the utility, the QF and DRA, and the application process to be used for controversial QF contract restructurings. More recently, D.07-09-040 states, “We encourage any renewable resources to negotiate and bring before us applications for such five-year, fixed price amendments whenever possible, and will consider such applications as we have other negotiated agreements in prior decisions, keeping in mind the direction provided by 390.1<sup>3</sup>.”

The Fixed Energy Price Agreements are consistent with D.07-09-040 allowing modifications to existing QF contracts.

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

On December 16, 2010, the Commission adopted the QF/Combined Heat and Power (CHP) Program Settlement with the issuance of D.10-12-035. The Settlement resolves a number of longstanding issues regarding the contractual obligations and procurement options for facilities operating under legacy and new QF contracts. Among other things, it establishes methodologies and formulas for calculating SRAC to be used in new QF standard offer contracts. Furthermore,

<sup>2</sup> Per D.04-12-048 and D.06-05-039, SCE retained Sedway Consulting as an Independent Evaluator to monitor the RFO, independently evaluate SCE’s process, ensure that it was conducted fairly, and that the best products were acquired. Their IE Report assesses the RFO from initial development to final offer selection.

<sup>3</sup> D.07-09-040, mimeo, p.133.

the Settlement allows for bilaterally negotiated contracts with QFs to determine alternative energy and capacity payments mutually agreeable by relevant parties and subject to CPUC approval. Finally, it establishes specific CHP procurement targets and greenhouse gas (GHG) reduction targets for each named utility.

The QF/CHP Settlement became effective on November 23, 2011. The Settlement neither approves nor prohibits bilaterally negotiated changes to existing QF agreements. Thus, the QF Fixed Energy Price Agreements that are the subject of this resolution are consistent with and not in conflict with the Settlement. We note that because the QFs executing FEPAs are not CHP resources, they do not count towards SCE's MW and GHG reduction targets under the Settlement. Upon expiration, the eight FEPAs approved by this resolution will revert back to the SRAC energy price paid to the QFs, as defined by the Settlement or updated by the CPUC, for any remaining term of the contracts.

The QF Fixed Energy Price Agreements are consistent with, and not in conflict with, the QF/CHP Settlement and do not count towards SCE's MW or GHG reduction targets thereunder.

## **Reasonableness of the procurement process**

### *Overview of the 2011 Fall QF Fixed Price RFO*

Similar to the RFO from the spring of 2011, SCE conducted a solicitation in October of 2011 to identify the most competitive fixed price offers for the Fall Fixed Energy Price Agreements that are subject to this Resolution. The RFO process was conducted using a process similar to both SCE's all-source and natural gas RFOs.

The RFO was designed and executed to promote competition and elicit the lowest price bids from participants. SCE intended to decrease its exposure to fluctuations in the price of natural gas evident in SRAC energy payments, either by fixing the price of selected QF contracts or by selecting gas price swaps that could offer additional price reductions. To this end, SCE sought bids that were at or below the projected SRAC energy payments that SCE would make over the period for which SCE is seeking a fixed price, specifically May 1, 2012 to December 31, 2015 based on the Legacy Agreement Option A of the QF/CHP Settlement. The Independent Evaluator found that the process SCE used complies with the CPUC's Least Cost Best Fit criteria. Energy Division agrees with the strategy that securing a fixed price in lieu of the floating SRAC lowers the utility's overall gas exposure. Energy Division's detailed analysis of the

process used is in the Confidential Appendix A. In that regard, we find that the QF Fixed Price RFO is an appropriate natural gas hedging strategy.

SCE asserts that the Fixed Price RFO process was transparent and fair. SCE posted the pro forma contract, RFO schedule, eligibility requirements, detailed RFO instructions, and other documents on its website at <http://www.sce.com/energyprocurement/renewables/qf-fixed-price-rfo.htm>. SCE promoted the program to its QF projects and held a web conference to answer questions from potential bidders. SCE also contracted with an Independent Evaluator (IE) to review the process. The IE notes in his report that “SCE conducted a fair and effective solicitation for offers received in response to its 2011 Fall QF Fixed Price RFO. All submitted offers were treated consistently, appropriately, and without bias.”<sup>4</sup> Detailed findings from the IE are below and in the following sections.

Energy Division reviewed SCE’s plan for the QF Fixed Price RFO, documents regarding the RFO available on SCE’s website, the bids submitted by QFs and SCE’s evaluation and selection of final winners. In addition, Energy Division considered SCE’s development of hedging targets as part of the Fixed Price RFO.

After reviewing these materials, SCE’s advice letter filings including confidential workpapers, and the report of the Independent Evaluator, we find that the QF Fixed Price RFO and determinations of final Fixed Energy Price Agreements were conducted in a fair and reasonable manner.

### **Cost reasonableness**

Upon receiving bids through the RFO, SCE evaluated bid prices up to a levelized energy price limit. This price limit was based on the forecasted monthly Short Run Avoided Cost payment to QFs based on the QF Settlement, Option A from May 2012 to December 2015. SCE accepted all projects that bid fixed energy payments that were below the projected SRAC energy payments over the term of the proposed fixed price amendment.

As detailed in the FEPA contracts, by accepting the pricing under the FEPA, the Seller is electing to be paid a fixed price in lieu of receiving payment based on the short run avoided cost methodology established by the CPUC for energy payments by SCE to QFs. FEPA prices are adjusted by Time-of-Delivery (TOD)

<sup>4</sup> Independent Evaluator Report for Southern California Edison’s Fall 2011 Qualifying Facility Fixed Price Request for Offers (Public Version), January 23, 2012, p.6.



factors set forth in SCE's Time-of-Use rate schedule "TOU-8."<sup>5</sup> Throughout the term of the FEPA, capacity payments remain unchanged from their current contract and are unaffected by the Agreement.<sup>6</sup> Following the term of the fixed price period, the Seller will be paid at the energy price in accordance with SRAC for the remainder of the contract.<sup>7</sup>

While SCE projects savings to ratepayers resulting from the RFO, after adjustments to reflect time-of-day for the QF energy deliveries, the savings are relatively modest. The potential risk to ratepayers is due to the inherently imperfect nature of gas forecasts. If the price of natural gas decreases significantly over the term of the Fixed Energy Price Agreements relative to what was forecast, the projected savings from the Agreements may decrease and may, in fact, result in higher costs to ratepayers than they might otherwise pay under SRAC. However, we believe that SCE's gas forecasts are reasonable as further detailed in Confidential Appendix A.

SCE provided Energy Division with workpapers related to the bid evaluation process and final selection of winners. Energy Division reviewed SCE's levelized price limit, including gas forecasts, QF bids for a Fixed Energy Price Agreement, SCE's determination of ratepayer savings, and final selection of winning projects. A more detailed discussion of cost reasonableness is included in Confidential Appendix A of this Resolution.

After reviewing the cost related components, the Commission determines the prices under Fixed Energy Price Agreements will likely result in savings to ratepayers and are reasonable and prudent.

### **Consistency with the Emissions Performance Standard**

California Public Utilities Code §§8340 and 8341 require that the Commission consider emissions costs associated with new long-term (five years or greater) power contracts procured on behalf of California ratepayers. D.07-09-039 adopted an interim Emissions Performance Standard (EPS) that establishes that the greenhouse gas emissions rate for obligated facilities be no greater than the emissions rate of a combined-cycle gas turbine power plant.

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<sup>5</sup> Southern California Edison, Pro Forma Fixed Energy Price Agreement, Section 2.1.

<sup>6</sup> Id. Section 6.6.

<sup>7</sup> Id. Section 2.1.

The EPS applies to all energy contracts that are at least five years in duration for baseload generation, which is defined as a facility with a capacity factor greater than 60 percent. In most cases, generating facilities using renewable resources are deemed compliant with the EPS.<sup>8</sup>

Because the underlying facilities at issue here are renewable and furthermore, because the amendments for which SCE seeks approval are themselves less than five years in duration and do not extend the term of the existing contracts under which these facilities operate, the EPS does not apply.

The Fixed Energy Price Agreements are not subject to the EPS under D.07-01-039 as the Agreements are with renewable energy resources and are less than five years in duration.

**Consistent with D.02-08-071, SCE's Procurement Review Group (PRG) was notified of the QF Fixed Energy Price RFO.**

SCE's PRG consists of representatives from: the Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN), California Department of Water Resources-California Energy Resources Scheduling (CDWR/CERS), the Independent Evaluator, and the Commission's Energy and Legal Divisions.

SCE reviewed the QF Fixed Energy Price RFO with its PRG on October 12, 2011. Furthermore, SCE discussed the results of the RFO with the PRG on December 7, 2011.

With regard to the Fixed Energy Price Agreements, SCE has complied with the Commission's rules for involving the PRG.

### **Independent Evaluator Review**

SCE retained Independent Evaluator (IE) Alan Taylor of Sedway Consulting, Inc. to oversee SCE's QF Fixed Price RFO and to evaluate overall merits for Commission approval of the Agreements. AL 2696-E included a public and confidential Independent Evaluator's report. In its report, the IE determined that:

- i) SCE conducted a fair and effective solicitation for offers and treated all offers consistently and appropriately, without bias.
- ii) SCE's evaluation process was reasonable and sound.

<sup>8</sup> The EPS decision states that "Small power production facilities that use solar thermal electric, wind, geothermal, or certain biomass technologies are pre-approved as compliant under this decision." D.07-09-039, Finding of Fact 83.

iii) SCE's evaluation process was free from anti-competitive behavior.<sup>9</sup>

Sedway Consulting concludes that SCE selected the appropriate bids from the 2011 Fall QF Fixed Price RFO and therefore recommends Commission approval of all Fixed Energy Price Agreements. More information on the findings of the IE Report is included in Confidential Appendix A.

The Independent Evaluator concurs with SCE's decision to execute the eight winning Fixed Energy Price Agreements and finds that these agreements merit Commission approval.

## **COMMENTS**

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

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from today.

## **FINDINGS AND CONCLUSIONS**

1. The Fixed Energy Price Agreements are consistent with D.07-09-040 allowing modifications to existing QF contracts.
2. The QF Fixed Energy Price Agreements are consistent with and are not in conflict with the QF/CHP Settlement and do not count towards SCE's MW or GHG reduction targets thereunder.
3. The QF Fixed Price RFO is an appropriate natural gas hedging strategy.
4. The QF Fixed Price RFO and the determinations of the final Fixed Energy Price Agreements were conducted in a fair and reasonable manner.

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<sup>9</sup> Independent Evaluator Report for Southern California Edison's Fall 2011 Qualifying Facility Fixed Price Request for Offers (Public Version), January 23, 2012, p.6.

5. The prices under the Fixed Energy Price Agreements will likely result in savings to ratepayers and are reasonable and prudent.
6. The Fixed Energy Price Agreements are not subject to the EPS under D.07-01-039 as the Agreements are with renewable energy resources and do not extend the existing term of the underlying contracts.
7. With regard to the Fixed Energy Price Agreements, SCE has complied with the Commission's rules for involving the PRG.
8. The Independent Evaluator concurs with SCE's decision to execute the eight winning Fixed Energy Price Agreements and finds that these agreements merit Commission approval.

**THEREFORE IT IS ORDERED THAT:**

1. The request of the Southern California Edison Company (SCE) in Advice Letter 2696-E for the Commission to find that the Fixed Energy Price Agreements executed with eight existing Qualifying Facilities, and SCE's entry into the Fixed Energy Price Agreements, are reasonable and prudent including SCE's recovery in rates of all payments made under each such agreement, subject only to Commission review of the reasonableness of SCE's administration of the agreements is approved.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on June 21, 2012; the following Commissioners voting favorably thereon:

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Paul Clanon  
Executive Director

Confidential Appendix A

Analysis of QF Fixed Price RFO and Agreement

**REDACTED**