OVERVIEW OF PROPOSED CHP PROGRAM SETTLEMENT AGREEMENT

The parties to the proposed CHP Program Settlement Agreement ("Settlement") represent numerous different groups and interests. These parties include the three investor-owned utilities ("IOUs") -- Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("SCE"), and San Diego Gas & Electric Company ("SDG&E"); cogeneration and combined heat and power qualifying facility ("CHP QF") representatives – the California Cogeneration Council ("CCC"), the Independent Energy Producers Association ("IEP"), the Cogeneration Association of California ("CAC"), and the Energy Producers and Users Coalition ("EPUC"); and statewide consumer and ratepayer groups – the Division of Ratepayer Advocates ("DRA") and The Utility Reform Network ("TURN") (the parties are referred to hereinafter collectively as the "Joint Parties").

I. BACKGROUND

A. PURPA and The California Public Utilities Commission's QF Program

In 1978, Congress enacted the Public Utility Regulatory Policies Act ("PURPA"), which was part of a national effort to promote energy independence and efficiency.[1] Under PURPA and the Federal Energy Regulatory Commission's ("FERC") subsequent regulations implementing PURPA, qualifying cogeneration and small power production facilities were provided certain benefits and exemptions. State regulatory agencies were delegated responsibility for developing QF programs and determining avoided cost pricing. The California Public Utilities Commission ("Commission") implemented PURPA in the early 1980s by adopting for the IOUs a number of standard form power purchase agreements ("PPAs") that were available to QFs and established energy and capacity prices to be paid under these PPAs.

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[1] 16 U.S.C. § 796, *et seq.*; *see also Southern California Edison v. PUC*, 101 Cal.App.4th 982, 986-87 (2002) (describing PURPA).

Many QFs signed these PPAs and built cogeneration and small power production facilities to provide energy and capacity to the IOUs.

Since the Commission implemented the QF program in the 1980s, there have been disputes between the QFs, IOUs and ratepayer advocates including: contract terms, Short-Run Avoided Cost ("SRAC") pricing, capacity payments, contract extensions and terminations, and the availability of new contracts. Many of these disputes are still pending at the Commission. Section 14 of the Settlement identifies disputes pending at the Commission regarding several proceedings, including: retroactive adjustments to SRAC pricing; disputes over pricing and ability to execute PPA extensions; motions for prospective QF PPA options; SRAC disputes dating back to the 2000-2001 energy crisis; disputes concerning administrative heat rates ("AHR") used to calculate SRAC; and applications for rehearing and petitions for modification of numerous QF decisions.[2] In addition to these disputes pending at the Commission, there are also disputes pending in the California Court of Appeal.[3]

Not only is the Commission faced with disputes regarding existing QF PPAs and the existing QF program, the Commission is also faced with challenges as to how to implement the QF program going forward. For example, in Decision ("D.") 07-09-040, the Commission recognized that it would need to address the impact of the California Independent System Operator's ("CAISO") Market Redesign and Technology Upgrade ("MRTU") on SRAC and the QF program.[4] The Commission also has before it disputes over the terms and conditions of the

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[2] *See* Settlement, §§ 14.1 – 14.2.

[3] *Id*. at § 14.2.4.

[4] D.07-09-040 at p. 68.

new QF Standard Offer Contract ("SOC")[5] and disputes over the amount of QF capacity to include in the Long-Term Procurement Process ("LTPP").[6]

On the federal level, recently there have been changes to the PURPA purchase obligation. In October 2006, FERC issued Order No. 688:

> ... revising its regulations governing utilities' obligations to purchase electric energy produced by QFs. Order No. 688 implements PURPA section 210(m), which provides for termination of the requirement that an electric utility enter into power purchase obligations or contracts to purchase electric energy from QFs, if the Commission finds the QFs have nondiscriminatory access to markets.[7]

Although the California IOUs have not yet sought from FERC a termination of their PURPA purchase obligation, the changes in PURPA further support a re-examination of California's existing QF program.

Given the numerous outstanding disputes, changes in PURPA, and challenges in determining a QF and CHP Program ("QF/CHP Program") going forward, the Joint Parties, California customers and the Commission will benefit from a Settlement that: (1) resolves the outstanding disputes; (2) sets out a clear path for the implementation of a cogeneration QF and CHP Program in California; and, (3) makes available additional PPA options for QFs under the QF/CHP Program ("CHP PPAs").

B. State Policy Favoring CHP

Public Utilities Code Section 372(a) and Energy Action Plan II both demonstrate that state policy supports the development of "efficient, environmentally beneficial" CHP. In the

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[5] *See e.g.* Draft Resolution E-4242 and comments filed by parties concerning the draft resolution.

[6] *Joint Petition for Modification of D.07-12-052 by Southern California Edison Company (U 338-E), Pacific Gas & Electric Company (U 39-E), and San Diego Gas & Electric Company (U 902-E)*, filed December 17, 2008 in R.06-02-013.

[7] *New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation*, 130 FERC ¶ 61,216 (2010) at P. 3 (footnotes omitted).

2009 Integrated Energy Policy Report ("IEPR"), the California Energy Commission ("CEC") recommended the continued support and development of CHP as a means to meet state green house gas ("GHG") goals and other policy objectives.[8]

C. CARB's GHG Reduction Scoping Plan

On December 11, 2008, the California Air Resources Board ("CARB") issued a Scoping Plan for the implementation of Assembly Bill ("AB") 32 in California (the "CARB Scoping Plan").[9] In the CARB Scoping Plan, CARB noted that,

> [c]ombined heat and power (CHP), also referred to as cogeneration, produces electricity and useful thermal energy in an integrated system. The widespread development of efficient CHP systems would help displace the need to develop new, or expand existing, power plants. This measure sets a target of an additional 4,000 MW of installed CHP capacity by 2020, enough to displace approximately 30,000 GWh of demand from other power generation sources.[10]

Although CARB has not yet issued final GHG regulations, the Scoping Plan issued by CARB indicates support for the development of efficient CHP.

D. Description Of the Settlement Process

Recognizing the need to resolve outstanding disputes and to establish a new CHP program for California going forward, in May 2009, the Joint Parties and Commission representatives met to lay out a settlement framework. Since that time, the Joint Parties have conducted frequent and lengthy meetings and worked diligently to negotiate the Settlement now presented before the Commission. The Joint Parties had divergent interests, many of which had been escalated in proceedings at the Commission and before the appellate court, which had to be accommodated. As a result, the Settlement represents a compromise that should be evaluated as

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[8] *See*, 2009 IEPR at pp. 8-9.

[9] *See*, http://www.arb.ca.gov/cc/scopingplan/document/adopted_scoping_plan.pdf.

[10] CARB Scoping Plan, at pp. 42-43 (footnotes omitted).

an integrated package. The Settlement itself is over 75 pages long and provides a detailed and comprehensive framework for a QF/CHP Program in California. In addition to the Settlement, the Joint Parties also negotiated four *Pro Forma* PPAs and standard amendments for Legacy QF PPAs that will be used as a part of the QF/CHP Program. These agreements shall be submitted as attachments to the Settlement filed with the Commission.

II. SUMMARY OF THE PROPOSED SETTLEMENT

This section includes a summary of the key terms of each section of the Settlement, as well as the *Pro Forma* PPAs and the *Pro Forma* PPA amendments included with the Settlement.[11] Given the length of the Settlement, this section is only intended to be a summary of key Settlement terms.

A. Section 1 – Goals and Objectives

This section outlines the goals and objectives of the Settlement.

B. Section 2 – Settlement Periods

This section describes the three periods covered by the Settlement – the Transition Period, the Initial Program Period, and the Second Program Period. The Transition Period is designed to facilitate the transition from the existing QF Program to the new QF/CHP Program. During the Initial Program Period, which overlaps with the Transition Period, the IOUs have specific Megawatt ("MW") Targets for entering into new PPAs with CHP and other facilities. In the Second Program Period, the IOUs procure any portion of the MW Targets that they did not procure during the Initial Program Period and additional CHP capacity to meet GHG Emission

[11] The fact that a specific Settlement provision is not discussed does not explicitly or implicitly imply that any provision or term of the Settlement is more or less important. Moreover, if there is any unintended ambiguity created by the summary below as compared to specific Settlement terms, the specific provisions in the Settlement or applicable PPAs and amendments are controlling. The Settlement is an integrated package and each provision and term was carefully negotiated as a part of that integrated package.

Reduction Targets or other CHP procurement targets established by the Commission. SDG&E has a target to procure an additional 51 MW during the Second Program Period.

C. Section 3 – Transition PPA

This section describes the eligibility requirements for QF and CHP facilities for a PPA during the Transition Period and the pricing for Transition Period PPAs.[12] The "Transition Standard Contract for Existing Qualifying Cogeneration Facilities" ("Transition PPA") shall be included as an exhibit to the Settlement Term Sheet, which will be attached to the Settlement.

D. Section 4 – CHP Procurement Process

This section describes the various aspects of the CHP procurement process under the new QF/CHP Program. First, Section 4.2 describes the new CHP Request for Offers ("CHP RFO") process under which the IOUs will procure generation from CHP facilities to meet MW Targets and GHG Emissions Reduction Targets specified in the Settlement.[13] Section 4.2 includes eligibility requirements for CHP participating in the RFOs (Section 4.2.2), the delivery terms of PPAs resulting from the RFOs (Section 4.2.3), pricing (Section 4.2.4), and RFO evaluation and selection criteria (Section 4.2.5). In addition, the Joint Parties developed a Pro Forma power purchase agreement for CHP RFOs ("CHP RFO PPA") that will be attached as an exhibit to the Settlement Term Sheet.

Section 4 also describes the procurement processes for CHP other than through CHP RFOs that will count towards meeting MW and GHG Reduction Targets. Specifically, Sections 4.3 - 4.6 describe bilaterally negotiated CHP PPAs, PPAs under the AB 1613 feed-in tariff, PPAs for QFs under 20 MW under PURPA, and Optional As-Available PPAs for certain large CHP facilities that have significant on-site load and specific operating characteristics. Section 4.7

[12] Settlement, §§ 3.1 – 3.2.

[13] The MW Targets and GHG Emissions Reduction Targets are described in Sections 5 and 6 of the Settlement, respectively.

addresses utility-owned CHP and limits the contribution of utility-owned facilities to ten percent (10%) of each IOU's GHG Emissions Reduction Target. IOU-owned facilities will not count toward the MW Target in the Initial Program Period. Section 4.8 describes "utility prescheduled facilities" which are existing QF facilities that convert to IOU-dispatchable generating facilities.[14] Finally, Section 4.9 addresses new behind-the-meter CHP facilities as one of the procurement options under the QF CHP Program.

Section 4.10 specifies the Commission approval process required for new PPAs arising from the procurement options in the QF/CHP Program. This includes Tier 2 advice letter filings for existing CHP facilities that execute the CHP RFO PPA without material modification, and a Tier 3 advice letter process for all other CHP PPAs. CHP PPAs that are less than five years in duration do not require Commission pre-approval but will be reported in the IOUs' Quarterly Compliance Reports and CHP Program Semi-Annual Report.

Section 4.11 specifies information that CHP facilities must provide to the IOUs on an annual basis for monitoring purposes and Section 4.12 specifies the timing for commencement of deliveries from a CHP facility that has entered into a new CHP PPA.

E. Section 5 – MW Targets

Section 5 establishes a total MW Target for the IOUs of 2,949 MW during the Initial Program Period and a total MW Target of 3,000 MW for the entire QF/CHP Program. Section 5.1.2 includes a chart allocating this target to three target periods for each of the IOUs. For example, the first MW Target for SCE, PG&E, and SDG&E are 630 MW, 630 MW, and 60 MW, respectively. SDG&E has a specified MW Target during the Second Program Period, and if the other IOUs have not fulfilled the MW Targets assigned to them for the Initial Program Period they will also need to procure MWs during the latter period to fulfill those targets.

[14] This provision in the Settlement is described in more detail in Section III.A.9, below.

Section 5.1.4 provides that the IOUs are required to conduct three CHP RFOs during the Initial Program Period to seek CHP PPAs to meet the MW Targets. The number of CHP RFOs during the Second Program Period will be established in the LTPP proceedings.[15]

Section 5.2 includes detailed counting rules as to how CHP PPAs executed during the Initial Program Period, whether through a CHP RFO or another procurement process, count toward the MW Targets. Section 5.3 clarifies the appropriate use of the MW counting procedure.

Section 5.4 addresses justifications for an IOU's failure to meet its MW Target. These justifications include lack of sufficient offers in the RFOs, the efficiency of CHP participating in the procurement programs, excessive offer prices[16], and the amount of GHG reductions.

F. Section 6 – GHG Emissions Reduction Targets

One of the key benefits of the Settlement is the implementation of a CHP Program designed to reduce GHG, consistent with the CARB Scoping Plan. Section 6.1 describes the Settlement strategy for reducing GHG, including maintaining existing, efficient CHP facilities, adding new, efficient CHP resources and achieving the GHG Emissions Reduction Targets by December 31, 2020. Section 6.2 addresses maintaining the GHG emissions reductions from existing CHP and establishing new targets for GHG reductions from new facilities. In particular, the Settlement establishes a GHG Emissions Reduction Target of 4.3 million-metric tons ("MMT") for the IOUs and 0.5 MMT for Energy Service Providers ("ESPs") and Community Choice Aggregators ("CCA").[17] These targets are based on the 6.7 MMT GHG reduction attributable to CHP in the CARB Scoping Plan.[18] Based on the current percentage of retail sales

[15] *Id*., § 5.1.4.7.

[16] An IOU claiming that RFO offer prices are excessive must support its claim with information from independent or publicly available sources. *Id*., § 5.4.1.

[17] *Id*., § 6.3.1.

[18] *Id.*, §6.2.2.1.

in California, the 6.7 MMT would be allocated as follows: (1) 4.3 MMT to the IOUs; (2) 0.5 MMT to ESPs and CCAs; and (3) 1.9 MMT to publicly-owned utilities ("POUs").[19] The Commission does not have jurisdiction over POUs, but can set GHG Emissions Reduction Targets for the IOUs, ESPs and CCAs.

Section 6.2.2.3.3 provides for the adjustment of the allocation of the GHG Emissions Reduction Targets based on changes in retail sales during the term of the Settlement.[20] Thus, for example, if customers depart utility service for ESPs or CCAs, the GHG Emissions Reduction Targets for the IOUs will decrease and the targets for the ESPs and CCAs will increase. The GHG Emissions Reduction Targets can also be adjusted among the IOUs.

Section 6.3 identifies the GHG Emissions Reduction Target allocated to ESPs and CCAs and indicates that it is the preference of the Joint Parties that these load-serving entities ("LSEs") achieve these targets by entering into CHP PPAs. However, if these non-IOU LSEs are not required to enter into CHP PPAs, the IOUs will procure the appropriate amount of CHP for these LSEs to meet their GHG Emissions Reduction Target and the costs of this procurement by the IOUs will then be allocated to the customers of non-IOU LSEs. The allocation of CHP PPA costs is addressed in Section 13 of the Settlement. Section 6.4 describes the methodology for establishing the GHG Emissions Reduction Target for each of the IOUs. Section 6.5 requires each IOU to report its GHG Emissions Reduction Target to be submitted to the Commission in their semi-annual CHP Program Reports; Section 6.6 states that the Target for the Second Program Period is subject to review and revision in the LTPP process.

Section 6.7 provides for revisions to the GHG Emissions Reduction Target if CARB modifies its CHP reduction goals and provides for GHG Emissions Reduction Targets to be

[19] *Id*., §6.2.2.3.

[20] *See also id*., § 6.3.3.

established in the LTPP if AB 32 compliance is suspended or delayed. In Section 6.8, the Joint Parties agree to advocate at CARB in support of the Settlement, subject to certain conditions.

Finally, Section 6.9 sets out the justifications for failing to meet the GHG Emissions Reduction Targets, including the efficiency of CHP facilities participating in the IOUs' procurement programs, excessive offer prices and a lack of need for CHP resources.

G. Section 7 – GHG Emission Accounting Methodology

Section 7 establishes the accounting principles for determining the IOUs' progress toward the GHG Emissions Reduction Targets. This section adopts a Double Benchmark methodology for determining GHG reductions and provides detailed accounting procedures for new, repowered, and existing CHP facilities to determine the amount of GHG emissions reductions that are attributable to these different types of facilities.

H. Section 8 – Commission Jurisdictional Entities' Reporting Requirements

Section 8 establishes reporting requirements for Commission-jurisdictional LSEs (*i.e.*, the IOUs, ESPs and CCAs). Each LSE must prepare a semi-annual report detailing progress toward the MW Targets and GHG Emissions Reduction Targets.[21] Sections 8.2 – 8.5 describe the contents of the semi-annual reports, and specify report content for different categories of CHP generation (*e.g.*, new, legacy, terminated).

I. Section 9 – CHP Auditor

Section 9 provides for a CHP auditor who is to act as an advocate for CHP interests regarding the implementation of the QF/CHP Program ("CHP Auditor").[22] The CHP Auditor is used in situations where an IOU provides notice that it does not anticipate meeting the MW or GHG Emissions Reduction Targets during a particular RFO. CHP parties requesting an auditor

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[21] *Id*., § 8.1.1.

[22] *Id*., § 9.1.2.

bear the costs[23] and the CHP Auditor is provided with an opportunity to receive and review confidential IOU information regarding the relevant QF/CHP RFO. Section 9 includes provisions for execution of a non-disclosure agreement by the CHP Auditor (Section 9.1.4), when an IOU notice triggers an audit (Section 9.2), the time period for an audit review (Section 9.3), receipt and review of confidential information (Section 9.4), and the number of CHP Auditors, as well as rules regarding any potential conflicts of interest (Section 9.5).

J. Section 10 – SRAC Energy Pricing Structure

Section 10 establishes methodologies and formulas for SRAC to be used in Transition PPAs, Legacy PPAs, other existing QF PPAs and Optional As-Available PPAs.[24] Section 10.2 includes a methodology for transitioning, by January 1, 2015, SRAC from a formula that is based in part on an administratively-determined heat rate to a formula that uses solely market heat rates. Section 10.4 includes a process for addressing market disruptions that may impact the market heat rate to be used in SRAC. Section 10.2 also includes 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. The SRAC formula also includes a locational adjustment based on CAISO nodal prices. Section 10.2 also includes pricing options based on whether a cap-and-trade program or other form of GHG regulation is developed in California or nationally.

When such a cap-and-trade program is initially developed that applies to California, Section 10.2 establishes a floor test which compares an energy price developed with a market-based heat rate to an energy price developed with either a negotiated heat rate, or a heat rate from a period prior to the start of a cap and trade program, plus the market price of GHG allowances.

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[23] *Id*., § 9.1.3.

[24] Prices for RFO PPAs are based on competitive bids in the RFO process and bilateral PPA prices are based on negotiated prices between the IOU and the CHP party.

The higher of the two energy prices is the one chosen as SRAC.

Section 10.3 requires the Seller under a CHP PPA to provide certain information to the IOU regarding GHG information that it has reported to CARB or another governmental authority, and information concerning the operation of its facility. Finally, Section 10.5 addresses the responsibility for GHG-related costs.

K. Section 11 – Legacy PPA Matters for Existing QFs

Under Section 11.1, QFs with existing standard offer or other PPAs ("QF PPAs") at the time of the Settlement effective date[25] will be paid for energy based on the SRAC formula specified in Section 10 (unless the QF PPA specifies a different price) or may elect to amend their standard offer QF PPA to choose one of the energy price options described in the Legacy QF Amendments, which will be an exhibit to the Settlement. Unless otherwise specified in the QF PPA, capacity payments for QF PPAs will be based on the capacity price established by the Commission in D. 07-09-040. Section 11.2 provides for the transition from a QF PPA to a new CHP PPA and ensures that delivery from an existing CHP facility continues uninterrupted during that period. The amendments are not available to QFs participating in the Renewable Portfolio Standard program.

Section 11.3 provides that the Seller under an existing QF PPA shall make a good faith effort to provide forecasting information to the IOU so that the IOU can more accurately schedule QF generation in the CAISO markets. This section provides specific forecasting submittal procedures.

L. Section 12 – CAISO Tariff Compliance

Section 12 provides that all CHP facilities subject to the CAISO Tariff shall comply with CAISO requirements when the facility begins deliveries under a CHP PPA. Section 12 also

[25] The Settlement Effective Date is described in Section 16 of the Settlement.

includes requirements for the installation of metering and telemetry equipment at existing CHP facilities within six (6) months of the execution of a CHP PPA. The Joint Parties also acknowledge that the CAISO may condition, waive or modify certain requirements for QF and CHP facilities.

M. Section 13 -- IOU Cost Recovery For CHP PPAs

Section 13 addresses cost allocation if the Commission determines that IOUs should purchase CHP generation on behalf of ESPs and CCAs.[26] In this circumstance, the IOUs are authorized to recover "net capacity costs" from all bundled, direct access ("DA") and CCA customers on a non-by-passable basis. Net capacity costs are the total costs paid by the IOU under the QF/CHP Program less the value of the energy and ancillary services supplied to the IOU under the program.

Section 13.1.1 recognizes that PPAs under the QF/CHP Program may be greater than ten (10) years and requires that the Commission affirmatively supersede the ten (10)-year limitation for stranded cost recovery established in D. 04-12-048 and D. 08-09-012 and instead determine that all above-market or net capacity costs associated with the QF/CHP Program can be recovered for the entire duration of any CHP PPA.

Section 13.1.2.1 provides that if the Commission determines that ESPs and CCAs are responsible for procuring CHP generation for their customers, any above-market costs associated with the QF/CHP Program can be allocated to future departing load customers who depart for DA or CCA service.

In Sections 13.1.3 and 13.1.4, the Joint Parties agree that they will not advocate the imposition of QF/CHP Program costs on CHP customer generation departing load, and in Section 13.1.5 the Joint Parties agree to advocate that CHP PPAs entered into as a result of the

[26] *Id*., § 13.1.2.2.

QF/CHP Program not be included in the existing Competition Transition Charge.

Finally, Section 13.2 provides that all payments made by the IOUs under the QF/CHP Program can be recovered in the IOUs' respective Energy Resources Recovery Account.

N. Section 14 -- Settlement Of Pending And Anticipated Litigation

Section 14 addresses the settlement of pending, as well as anticipated, litigation. In Section 14.1, the IOUs agree under certain conditions to withdraw with prejudice all SRAC retroactive price adjustment claims. The Joint Parties mutually agree not to raise any new SRAC retroactive adjustment claims as long as the PURPA purchase obligation remains suspended (as described in more detail in Section 15).

In Section 14.2, the Joint Parties agree to release or withdraw a number of pending claims, rehearing applications, or motions including claims and motions at the Commission (Sections 14.2.1 – 14.2.3, 14.2.5 – 14.2.12) and pending appeals at the California Court of Appeal (Section 14.2.4). Section 14 does not affect the Joint Parties' rights to advocate their respective position regarding the confidentiality of IOU procurement information.[27]

O. Section 15 – FERC 210(m) Application

Under Section 15, after the Commission approves the Settlement, the IOUs will submit an application to FERC requesting termination of the IOUs' PURPA purchase requirement from QF facilities with net capacity in excess of 20 MW, consistent with Section 210(m) of PURPA. Section 15.1 establishes a process for the CHP representatives to review the IOUs' application and provides that these parties can intervene and comment on, but not protest, the IOUs' application. Under Section 15.1.10, the CHP representatives can file at FERC for reinstatement of the PURPA purchase obligation if an IOU breaches its obligations under the Settlement or fails to meet is targets without justification.

[27] *Id*., § 14.3.2.

Section 15.2 addresses a circumstance where FERC reinstates the PURPA purchase obligation. In this case, SRAC pricing established under the Settlement stays in place until changed by the Commission (Section 15.2.1.1), although Joint Parties may advocate for a change to SRAC (Section 15.2.1.3). Joint Parties may also advocate for retroactive adjustments to SRAC pricing (Section 15.2.1.4). If the PURPA purchase obligation is reinstated, the IOUs' obligations to conduct CHP RFOs or to engage in alternative procurement processes are suspended. Any procurement target to be established by the Commission in the LTPP remains in place unless and until modified by the Commission in a subsequent proceeding. The Joint Parties also agree in Section 15.2.1.8 that for purposes of Section 210(m), designated CHP PPAs constitute "legally enforceable obligations."

P. Section 16 – Conditions Precedent and Settlement Effective Date

Section 16.2 specifies that the Settlement becomes effective upon satisfaction of the following conditions precedent: (1) a final and non-appealable FERC order approving the IOUs' application to terminate their PURPA purchase obligation (Section 16.2.1); (2) a final and non-appealable Commission decision approving the Settlement, including a determination that the Settlement supersedes certain Commission decisions (Sections 16.2.2 and 16.2.4 – 16.2.6); and (3) CARB support, in written form, for the Settlement (Section 16.2.3).

Section 16.3 provides that after the Settlement becomes effective, if CARB adopts regulations directly imposing a MW Target or GHG Emissions Target that differs from the Settlement for the Second Program Period, the IOUs' obligations to purchase from CHP to meet these targets will remain in place until such time as the Commission is able to consider such change in an LTPP or other pertinent proceeding.

Q. Section 17 – Glossary

The section includes a glossary of the defined terms used in the Settlement.

R. Attachments

The following four *Pro Forma* PPAs and a *Pro Forma* Legacy QF PPA amendment, one for each IOU, are appended to, and made a part of the Settlement:

- Transition PPA for Existing Qualifying Cogeneration Facilities;
- PPA for CHP Facilities Participating in Solicitations;
- Standard PPA for eligible As-Available CHP Facilities;
- Standard PPA for Qualifying Facilities that are equal to or less than 20 MW; and,
- Amendment to Legacy QF PPAs for each IOU.

1. The *Pro Forma* PPAs and Legacy QF PPA Amendment.

The Commission has previously approved the use of *Pro Forma* PPAs for QFs, as well as for use in RFOs for conventional and RPS resources. The Settlement includes the following four *Pro Forma* PPAs that were developed for specific circumstances and a *Pro Forma* Legacy QF PPA Amendment:

- Legacy QF PPA Amendment -- These *Pro Forma* Amendments offer QFs under unexpired Legacy QF PPAs as of the Settlement Effective Date ("Legacy QFs") the option of amending the energy payment terms of their QF PPAs by selecting one of several payment options and executing the Legacy Amendment within 180 days of the Settlement Effective Date.

- Transition PPA – This *Pro Forma* PPA offers an existing CHP facility whose existing QF PPA or extension thereof is scheduled to expire prior to 2015 the option to continue existing deliveries until July 1, 2015.

- CHP RFO PPA – This *Pro Forma* PPA will be issued in the CHP RFOs to procure deliveries from CHP generators larger than five (5) MW.

- Optional As-Available CHP PPA – This *Pro Forma* PPA offers gas-fired CHP facilities with nameplates greater than 20 MW, but annual average deliveries less than 131,400 MWh, the option to make as-available deliveries to meet criteria specified in the Settlement.

- PPA for QFs of 20 MW or Less – This *Pro Forma* PPA offers QFs of 20 MW or less, including small power producers and renewable energy resources, the option to make firm or as-available sales to the IOU.

a. **Legacy QF PPA Amendments.**

The Legacy PPA Amendments allow a QF under a currently effective PPA, excluding those executed in the Renewable Portfolio Standard ("RPS") program, to amend the energy price formula by selecting one of the defined energy pricing options within 180 days of the effective date of the Settlement Agreement. Each of the energy price options is generally based on the SRAC energy pricing structure established by the Settlement ("Settlement SRAC"), as described in Section II.J, above. Settlement SRAC is calculated with an administratively-determined annual heat rate through 2014, and from 2015 through the remainder of the contract term, a market heat rate proxy is used to calculate market-based energy prices. The energy pricing options differ in terms of the negotiated heat rates and the risk assumed by Seller for the recovery of GHG costs:

- **Option A:** Option A is identical to the Settlement SRAC pricing structure described in Section II.J, above.
- **Option B:** Option B employs the same formula for calculating the energy price as used for Option A. However, the negotiated heat rate is maintained at a higher level until it becomes market-based in 2015. All GHG compliance costs and all other costs associated with implementation and regulation of GHG emissions with respect to the Seller or the Generating Facility are the responsibility of the Seller.
- **Option C1:** The Seller's selection of Option C1 triggers a 90-day negotiating period, following the Amendment Effective Date, where parties may agree to a tolling agreement pursuant to which Seller will cause the generating facility to be dispatchable, and Buyer will purchase dispatchable electricity. If Option C1 is selected, the Seller must check a fallback option which shall apply in the absence of a Tolling Agreement.
- **Option C2:** In addition to making energy payments to the Seller based on a negotiated heat rate that is 265 Btu/kWh lower than in Option B, in the event of a cap-and-trade GHG control program is established, the Buyer will make payments of $20 per metric ton ("MT") to Seller based on a fixed emission rate for GHG compliance costs. In exchange, the Seller is solely responsible for all GHG compliance costs.
- **Option C3:** The energy pricing terms of C3 are identical to those of C2, except that GHG costs are based on facility-specific emissions, capped at Base Year emissions, and an allowance price capped at $12.50/MT. Annual heat rates are

identical to those in Option C2.

The availability of the Legacy QF PPA Amendments is subject to the Commission Approval of the Settlement and FERC approval of the California IOUs' request to waive the PURPA must-take procurement obligation. This *Pro Forma* amendment incorporates the Joint Parties' settlement of the SRAC pricing issues and offers QFs a great deal of flexibility to manage the risk of GHG compliance cost.

b. **Transition PPA.**

The Transition PPA is available to CHP facilities currently selling to an IOU under a Legacy PPA or an extension thereof that is due to expire during the Transition Period. A CHP facility may only enter into a Transition PPA with the same IOU that it currently delivers electricity to under a Legacy PPA or an extension thereof. The term of the Transition PPA begins upon the expiration of the CHP facility's existing PPA and may be terminated upon 180 days' notice when a CHP facility has executed a PPA resulting from either a solicitation or bilateral negotiation. The Seller may provide firm, as-available, or both forms of capacity. The Transition PPA provides firm capacity payment at the rate of $91.97/kW-yr and as-available capacity payment at $41.22/kW-yr escalating at a rate of about 4% per year. Energy is priced at the Settlement SRAC.

The Transition PPA requires a delivery schedule, the installation of a CAISO-approved meter within 180 days of contract execution, and agreements to curtail power production upon notification of CAISO or transmission owner instruction.

Although deliveries are generally limited to historic levels under the Legacy PPA, both capacity and energy levels may be modified through negotiation, provided that any CHP facility modification does not increase the Buyer's GHG costs. Certain CHP facilities with unique operational constraints may negotiate an amendment to the Transition PPA to deliver a standard additional capacity product that meets Commission and /or CAISO requirements for resource adequacy and CAISO protocols.

c. **CHP RFO PPA.**

The CHP RFO PPA is used to solicit competitive offers from CHP generators. Within 90 days of the Settlement Effective Date, each IOU will initiate a CHP RFO and issue this CHP RFO PPA to establish the terms and conditions by which existing, new or expanded CHP facilities located within California may offer to sell firm or as-available capacity to the IOU.[28] The CHP facility must, among other things, be larger than five (5) MW, must meet the definition of "cogeneration" under Cal. Pub. Util. Code §216.6, must satisfy the Emissions Performance Standard established by Cal. Pub. Util. Code §8341, and must satisfy the definition of "cogeneration facility" under 18 CFR §292.205 in order to submit an offer in response to the CHP RFO.

Under the CHP RFO PPA, the delivery term for existing facilities and expanded facilities that elect not to satisfy the credit and collateral requirements of the RFO is seven (7) years; for new, repowered or expanded facilities that elect to meet the credit and collateral requirements in the RFO, the term is 12 years. Terms in the CHP RFO PPA may be modified on a bilateral basis during negotiations for a particular CHP PPA. If the Seller's offer is accepted, the offer will establish the terms of the PPA.

d. **Optional As-Available CHP PPA.**

The As-Available CHP PPA is one of several commercial alternatives available to new, existing, or repowered gas-fired CHP facilities with nameplates greater than 20 MW that meet certain requirements, including the following: the CHP facility's average annual deliveries may not exceed 131,400 MWh; the project host(s) must consume at least 75% of the total electricity generated by a Topping Cycle CHP Facility or at least 25% of the total electricity generated by a

[28] The same CHP RFO PPA will be used in subsequent CHP solicitations as well.

Bottoming Cycle CHP Facility; and for Topping Cycle or Bottoming Cycle with supplemental firing, the facility must meet a 60% efficiency standard.[29]

Seller will be paid an as-available capacity price set forth in Exhibit D, Section 3, and a time of delivery ("TOD") energy price set forth in Exhibit D, Section 2. If the generating facility is a new CHP facility, it must maintain Development Security and Performance Assurance in accordance with scheduled amounts or as negotiated between Seller and Buyer. Seller may terminate the Agreement if Seller's facility is selected in a competitive solicitation.

As-available capacity payments will be paid for deliveries of up to 20 MW in any hour. The Seller is required to schedule all deliveries with the IOU on a day-ahead basis sufficiently in advance to allow the IOU to schedule energy into the CAISO day-ahead market. Energy scheduled on a day-ahead basis and delivered up to 20 MW per hour will be priced at Settlement SRAC. Energy scheduled on a day-ahead basis and delivered at a rate in excess of 20 MW per hour will be priced at the MRTU Day-Ahead market PNode energy price. Unscheduled energy incremental to scheduled energy will be purchased by the IOU at the MRTU real time PNode price, while the Seller will bear CAISO charges and receive all CAISO revenues for such deliveries.

The Seller may designate a delivery term of up to seven (7) years.

e. PPA for QFs of 20 MW or Less.

The PPA for QFs of 20 MW or Less will be available to QFs with firm or as-available capacity of 20 MW or less under the Commission's continuing PURPA program, regardless of whether the QF has submitted an offer in the CHP RFO or seeks alternative contracting options. The PPA for QFs of 20 MW or Less contains standard terms and conditions and incorporates the capacity prices established in D.07-09-040, and employs the Settlement SRAC price for energy.

[29] There is no efficiency requirement for a Bottoming Cycle CHP Facility with no supplemental firing.

There are few terms subject to negotiation. New, repowered, or enhanced facilities must post project development security and performance assurance.

III. RATIONALE FOR THE COST RECOVERY PROPOSAL

The Commission has determined that where DA and CCA customers benefit from IOU procurement, these customers should pay their fair share of the procurement costs. For example, the Commission authorized the allocation of new generation resource costs to DA and CCA customers because these customers benefitted from the system reliability provided by the new generation resources.[30] The Commission also allocated GHG compliance costs and certain locational costs associated with small CHP facilities developed under AB 1613 to DA and CCA customers because these customers benefitted from the AB 1613 program.[31]

Here, one of the purposes of the Settlement is to develop a QF/CHP Program that can facilitate meeting CARB's CHP goal as specified in its Scoping Memo. The CARB CHP goal is not limited to the IOUs, but applies to all LSEs in California. Section 365.1(c)(1) of the Public Utilities Code, enacted as part of Senate Bill 695 (2009), requires this Commission to "ensure" that ESPs and CCAs "are subject to the same requirements that are applicable to the state's three largest electrical corporations under any programs or rules adopted by the Commission to implement the requirements for the electricity sector adopted by the State Air Resources Board."   Under the Settlement, the CARB CHP goal is equitably allocated among Commission-jurisdictional LSEs based on their respective percentage of total retail sales.[32] This allocation is used to establish GHG Emissions Reduction Targets for all LSEs, including the IOUs, ESPs and CCA.

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[30] D.06-07-029 at p. 7.

[31] D.09-12-042 at pp. 21-25, *aff'd*, D.10-04-055 at pp. 11-18.

[32] Settlement, §§ 6.2 – 6.3.

As part of its decision on this Settlement, and based upon input from the parties, including ESPs and CCAs, the Commission will decide whether these entities will be required to meet their portion of the GHG Emissions Reduction Target by procuring CHP resources, which is the approach the Joint Parties prefer.[33] However, if the Commission determines that ESPs or CCAs are unable or unwilling to meet their portion of the GHG Emissions Reduction Targets by contracting with CHP facilities, the IOUs have agreed under the terms of the Settlement to procure CHP resources on behalf of these entities. In this case, however, ESP and CCA customers will be responsible for the net capacity costs of CHP resources procured on their behalf by the IOUs.[34] This is consistent with the Commission's recent decisions on cost allocation when ESP and CCA customers benefit from IOU procurement on their behalf.

As an alternative to the allocation of net capacity costs for CHP resources procured on behalf of ESP and CCA customers, if these entities are required to procure their own CHP resources, then the Settlement provides for the allocation of any stranded CHP costs to *future* DA and CCA departing load customers.[35] This allocation of costs is consistent with the Commission's recent departing load cost allocation decisions.[36] However, because PPAs under the Settlement can have up to a 12-year duration, the Joint Parties are requesting that the Commission affirmatively supersede the 10-year limitation in D. 08-09-012[37] and determine that CHP PPA above-market costs can be recovered from departing load customers for the entire 12-year term.

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[33] *Id*., § 6.3.2.

[34] *Id*., § 13.1.2.2.

[35] *Id*., § 13.1.1.

[36] *See e.g.* D.04-12-048 at pp. 56-58; D.08-09-012 at p. 37 (allocating new QF contract costs to DA and CCA departing load customers).

[37] D.08-09-012 at pp. 52-55 (discussing 10-year limitation).