

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

Order Instituting Rulemaking to Establish Policies and
Cost Recovery Mechanisms for Generation Procurement
and Renewable Resource Development.

Rulemaking 01-10-024
(Filed October 25, 2001)

**REPLY BRIEF OF THE CALIFORNIA WIND ENERGY ASSOCIATION,
CALIFORNIA BIOMASS ENERGY ALLIANCE, L.L.C., AND VULCAN POWER
COMPANY ON RPS STANDARD CONTRACT TERMS AND CONDITIONS**

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I. INTRODUCTION

Pursuant to the March 8, 2004 Joint Ruling of Assigned Commissioner and Administrative Law Judge Regarding Procedure for Adoption of Standard Contract Terms and Conditions (“Ruling”), the California Wind Energy Association, California Biomass Energy Alliance, L.L.C., and Vulcan Power Company (“Joint Parties”) submit this reply brief. In this brief, the Joint Parties respond to certain of the proposals of other parties for Renewables Portfolio Standard (“RPS”) standard contract terms and conditions.¹

As discussed below, in adopting standard contract terms from among the alternatives before it, the Commission is faced with a fundamental policy choice: Does it wish to have numerous competitors bidding to supply needed renewable electric power or does it wish to have power concentrated in the hands of a few large renewable developers? If the latter, then the proposals of the utilities, Southern California Edison Company (“Edison”) and the group comprised of Pacific Gas & Electric Company, San Diego Gas & Electric Company, The Utility Reform Network, Center for Energy Efficiency and Renewable Technologies and Independent Energy Producers (“PG&E et al.”), may (and we emphasize “may”) fit the bill.²

¹ The Joint Parties represent a variety of renewable technologies, including wind, biomass, geothermal and solar-thermal generators.

² The Joint Parties emphasize “may” because a number of the utilities’ proposed terms and conditions would render a contract un-financeable. As such, unless the utilities are willing to negotiate

If, however, the Commission desires to have a robust market in which numerous potential sellers compete with each other and strive to innovate, then it is essential that the Commission adopt proposals, such as those of the Joint Parties, that do not unfairly favor entities with more resources and higher credit standings.

II. DISCUSSION

1. Commission Approval

Both Edison and PG&E et al. propose that, in order for “Commission Approval” to have occurred, the Commission must issue a decision that, among other things, finds the utility’s conduct of its solicitation to have been reasonable. This proposed term is over-reaching and should be rejected. A Commission decision approving the specific contract, and payments to be made under the contract, should be sufficient, without taking the further action of sanctioning all of the utility’s conduct in connection with the RFP.

By linking approval of a given contract to approval of all of the utility’s conduct, the utility is effectively holding its proposed contracts hostage for a ruling from the Commission preempting any claims against the utility by third parties for improper conduct, no matter how egregious. If the Commission believes that a given contract is reasonable and should be implemented, there is no reason why the Commission must also find that all other parties are without rights to complain about utility conduct (which complaint might have no bearing at all on the adopted contract) in order for the contract to be accepted.

Edison argues that its proposed term is necessary to ensure that a third party does not collaterally attack an adopted contract through an attack on the utility’s broader conduct. This argument is without merit. If a third party were to seek to overturn an approved contract based upon concerns with the utility’s broader conduct, such action would need to be in the form of an application for rehearing of the initial Commission decision approving the contract. If the third party failed to file an application for rehearing of the decision approving the contract, the third party would not have standing to seek to have the Commission decision

acceptable modifications to these terms, their proposals will severely constrain even large renewable generators from developing projects.

approving the contract vacated. Therefore, the added term that all of the utility's conduct also must be blessed is unnecessary.

Indeed, rather than seeking to have approved contracts vacated, it is far more likely that a third party challenging the utility's conduct will seek to have a contract of its own. The Commission should not be put in the position of delaying the development of projects with valid contracts or rejecting without proper consideration potentially legitimate claims of these third parties. Certainly, such third-party claims should not be rejected due to a desire to implement executed and reasonable contracts.

2. Definition and Ownership of RECs

Edison's proposed language, covering essentially any credit or benefit of any kind associated with the Generating Facility, is far too broad. There also is no reason why the contract should forever preclude unbundling of the REC from the energy, as Edison proposes, if the Commission in the future permits such unbundling. In addition, Edison proposes to take all RECs from the project, even if the project only sells a portion of its output to the utility. These proposals should be rejected. The Joint Parties favor the approach of the Green Power Institute.

3. SEP Awards, Contingencies

No comment at this time.

4. Confidentiality

No comment at this time.

5. Contract Term

Edison and PG&E et al. both propose a check-the-box approach to the contract term provision. PG&E et al., however, seeks to clarify that the period specified, 10, 15 or 20 years, is actually the period over which the relevant product will be delivered and not necessarily the term of the contract. The Joint Parties agree with PG&E et al. on this. Because many RPS contracts can be expected to involve project development and construction, it may be a few years after contract execution before any product will actually be delivered.

PG&E et al., however, while clarifying that the period at issue is really the delivery period, fails to define when this period begins. This is a critical term and is not necessarily intuitive. PG&E et al. also fail to acknowledge that, even though the delivery period is the critical time period for the contract, the contract must be valid and binding upon execution (subject to applicable conditions precedent and/or subsequent). There will be no way to obtain financing, for example, without a binding contract. As such, the Commission should adopt the following language as part of the standard term for Contract Term.

The term of the contract shall commence upon execution by both parties and shall expire, unless terminated early, at the end of the Delivery Period specified above. The Delivery Period shall commence upon the later of (i) substantial completion of the last generating unit to be installed as part of the project (which follows any test deliveries to the buyer), or twelve months after substantial completion of the first generating unit to be installed as part of the project, whichever is earlier, or (ii) synchronization of the project with the transmission grid.

This language is needed to ensure that the seller obtains contract payments for its project (and not just a subset of it project in the case of one, like a wind farm, that has multiple generating units) for the correct number of years.

6. Eligibility

Edison proposes that the Seller represent that, for the entire term of the contract, it will meet all renewable eligibility requirements under current and future RPS legislation and interpretations of such legislation. If the representation turns out not to be true, this will be an event of default entitling the utility to contract termination or damages, or perhaps both. Because this puts the Seller at risk for future changes of law, this proposal is over-reaching.

The Seller should be required to represent that it will, for the entire term of the contract, meet the eligibility requirements in effect at the time of contract execution. These requirements should be known to the Seller and the Seller should be required to meet them. However, the Seller can neither control nor predict how the eligibility requirements might be changed over time, and it should not be liable for damages or contract termination as a result of forces beyond its foresight or control. The Joint Parties would not oppose, in addition to the more limited representation set forth above, however, a covenant that the Seller must use

good faith efforts to comply with any future eligibility requirements. That is a more appropriate allocation of risk.

7. Performance Standards / Requirements

A. Firm Products.

For firm products, it appears that Edison and PG&E et al. have taken different approaches. Edison proposes an Interim Standard Offer #4 type of “Firm Capacity” product, and PG&E et al. proposes an EEI type of “Unit Firm” product. The Joint Parties, on the other hand, propose both Firm Capacity and Unit Firm products. There is no reason why the Commission should not allow both types of firm products.

In addition, the actual performance requirements imposed by Edison and PG&E et al. on their firm products are unreasonable and should be rejected. For example, there is no reason why a developer should get full credit for delivering Firm Capacity if it only delivers 80% of the product during the peak hours, as Edison proposes. If a developer is not confident in its ability to meet a Firm Capacity commitment, it should provide an inferior product, either the Unit Firm product or the As Available product. The Joint Parties propose that to get full credit for a Firm Capacity product, the seller must meet a 95% capacity factor over the interval of time specified in the contract for the relevant product (e.g., monthly, annually, designated peak periods, etc.).³

In addition, the Joint Parties oppose Edison’s proposal to subject sellers to a routine annual demonstration test. If the seller is in compliance with its capacity factor requirement, and there is no unusual fact or circumstance that would cause the utility reasonably to doubt the ability of the facility to meet its performance requirements in the current period, there is no reason to subject the seller to any further demonstration test. After all, the real performance sought by the utility under a firm contract is not an instantaneous capacity rating; rather it is sustained deliveries during peak periods consistent with the capacity factor requirement. The annual demonstration test only serves to impose an undue risk to the seller

³ Although it is critical to note that the Joint Parties also would propose that the contract payments for delivering Firm Capacity should be significantly higher than the payments for the inferior products.

that it will not be able to perform adequately at the designated time (even though it might meet its capacity factor requirement) and will suffer the severe consequences of deration and damages. Experience under the standard offer contracts has demonstrated that this provision is unnecessary and unduly burdensome.

In addition, Edison's probation and deration proposal initially seems to be structured to allow a seller that misses its capacity factor in a given period to serve out a probationary period. It appears that if the seller rectifies the problem experienced in the bad year and demonstrates its ability to perform during the next year, the facility's capacity amount will not be derated. Only if the seller misses the requirement while on probation will the facility's capacity be derated. However, the language of Edison's proposal could actually result in deration for a failure to meet the monthly performance requirements in two consecutive months. This is unduly strict, as a single event that spans two months could cause the seller to miss the performance requirements in both months. In other words, the seller would not get the benefit of a probationary period during which it can rectify the problem and demonstrate its ability to perform again. As such, Edison's proposal should be rejected.

In addition, Edison proposes that a seller must meet a 100% capacity factor during a system emergency or face deration and damages, unless the utility believes that there are reasonable justifications for failing to do so. This is unduly strict and gives too much discretion to the utility. Like the standard offers, the seller should be required to use commercially reasonable efforts to deliver at a 100% capacity factor during an emergency.

With respect to PG&E et al.'s Unit Firm product, the notion that a project must meet a capacity demonstration test over a two-week period each year (at a time determined by the utility upon two weeks notice) or face a default and damages is unacceptable. The project might be down for maintenance or experiencing a forced outage and would, under the proposal, be severely penalized. The facility also might be suffering from a physical derate of some kind and be penalized as well. Yet these are exactly the kinds of things that are designed to be excuses from delivery requirements for Unit Firm products. That is why Unit Firm products are less valuable to buyers than Firm Capacity products.

Moreover, PG&E et al. propose to truncate deliveries towards meeting the performance test on an hourly basis. Without knowing more about the MW limits for the truncation (the numbers are not filled in) it is impossible to evaluate this proposal, but it is possible that it will be unduly harsh.

In addition, PG&E et al. propose an annual Availability Adjustment Factor test. The failure to meet this test would be an event of default subjecting the seller to potentially severe penalties. It is impossible to evaluate this proposal, as there is no description of what the test involves (except we know that a forced outage or derate does not serve as an excuse) and what percentage must be met.

As discussed in the Joint Parties' opening brief and earlier pleadings, the Joint Parties' simple capacity factor requirement is an adequate and appropriate performance requirement for a firm capacity product, either Firm Capacity and/or Unit Firm. There is no reason to layer on unnecessary and potentially punitive requirements such as those proposed by Edison and PG&E et al.

B. As-Available Products.

Edison's annual kWh delivery performance requirement for As-Available resources is far too strict. Intermittent technologies, those most likely to elect to provide as-available capacity, should not be subject to annual delivery requirements as Edison proposes. If performance requirements require the project to keep its facilities operational and available (as proposed by the Joint Parties), the annual delivery requirement essentially guarantees the resource (e.g., wind or hydro resource). Of course, no one can guarantee the rain or the wind. The maintenance and availability requirements proposed by the Joint Parties should be sufficient for As-Available resources.

If the Commission adopts a minimum kWh delivery requirement, the project should be allowed to average deliveries over two years. In addition, requiring developers to come within 20 percent of their expected annual deliveries is too difficult (particularly in light of the draconian penalties for a failure in this regard, as discussed below). If the Commission desires a kWh requirement, 60 percent annually, measured over two years, is a more reasonable measure.

Further, Edison's proposed liquidated damages for failure to meet the requirements is over-reaching. In essence, Edison would require the generator to pay damages over the full remaining term of the contract, even though the failure to perform only occurred in two years and may only result from short-term circumstances (e.g., weather patterns). Because there may have been a wind drought in two consecutive years, for example, does not necessarily mean that the facility will be unable to deliver up to its expectations in future years. Edison should not be over-compensated for a failure of an As-Available project to meet its requirement. This is particularly egregious when compared to Edison's proposal for its Firm product. Edison proposes that a Firm product receive 100% of its capacity payment for 80% deliveries, yet proposes that an As-Available project will be subject to catastrophic damages for deliveries of 1 kWh below the 80% threshold. These proposals seem to have the dependability of Firm and As-Available mixed up.

PG&E et al.'s as-available performance requirements also should be rejected. The primary and obvious problem, is that PG&E et al. do not propose the actual requirement. They seem to propose that there will be either an annual or a biennial delivery threshold, but they do not propose which, or what it will be. This is not compliant with either applicable legislation or Commission precedent requiring the establishment of standard performance requirements.

In addition, it is improper to hold every wind developer to "the best wind speed and direction standards" of other project developers. Technology will improve over time and there is no reason to punish older projects for using technology that may stop being state of the art at some point.

In addition, the PG&E et al. proposal refers numerous times to dispatch-down or curtailment periods. Without understanding what these are, as PG&E et al. do not explain these provisions, the Joint Parties are unable to comment upon them.

Finally, the PG&E et al. proposal seems to mix together a mechanical availability standard with an energy delivery standard, as forced outages are not considered to be excuses from meeting the guaranteed energy production amount (whatever it may be) but lack or renewable energy resource is an excuse. The Joint Parties' approach of a separately stated and reasonable strict mechanical availability standard (80% annual availability required),

coupled with a reasonably liberal energy delivery requirement (60% of expected annual deliveries measured over two years) is a better approach.

8. Product Definitions

The Joint Parties' proposed product definitions for Firm Capacity, Unit Firm and Unit As-Available products correspond to the performance requirements set forth above and should be adopted.

9. Non-Performance or Termination Penalties and Default Provisions

At the outset, the Joint Parties correct an oversight from their opening brief. Although not stated in the proposed language in the Joint Parties' opening brief (but stated in the accompanying text), a failure of the seller to meet performance requirements in any single or two consecutive periods should entitle the buyer to replacement damages as set forth in Article Four of the EEI Master Agreement. As stated in the Joint Parties' opening brief, failure to meet these requirements in three consecutive periods would constitute an event of default.

Not surprisingly, Edison's proposed events of default and remedies are too onerous on sellers. First, allowing only five Business Days to cure a miscellaneous default before it becomes an event of default is too little time. Project lenders will want time to intervene and cure defaults before the contract is subject to termination by the utility. Thirty days, as proposed by both the Joint Parties and PG&E et al. is more reasonable.

Second, failure to miss a milestone should not be an event of default entitling the utility to full contract damages. As proposed by the Joint Parties, the only remedy for a missed milestone should be contract termination and forfeiture of the project fee. Otherwise, projects will be unduly discouraged.

Third, Edison's articulated list of specific items that it believes should be an event of default of seller starting with (l) should be rejected. It is not necessary to articulate every covenant that, when breached, would constitute an event of default. That is the purpose of the catch-all default provision contained in the EEI and in Edison's proposed language as term (c). Edison argued for less standardization of terms and is now trying to have all of its

preferred covenants standardized through the default provisions. Not surprisingly, Edison does not articulate any covenants of the buyer that would constitute events of default if breached. Rather than respond to each item, the Joint Parties recommend that the Commission simply strike Edison's wish list.

Finally, Edison proposes to employ the EEI provision that would allow the defaulting party, under certain circumstances, to obtain payment from the non-defaulting party upon contract termination. The Joint Parties object to this as not being appropriate for one-off power purchase agreements. This concept was created under the ISDA documentation for financial swaps and was grafted into the EEI when electricity contracts were to be traded as financial instruments. This is not the normal measure of contract damages and creates perverse incentives that encourage parties to default so as to accelerate their expected benefits. As proposed in the Joint Parties' opening brief, the Joint Parties agree with PG&E et al., that the EEI should be modified to provide that the non-defaulting party should not pay the defaulting party upon termination.

The Joint Parties object to PG&E et al.'s proposal that any failure by the seller to meet the performance requirements should be an event of default entitling the buyer to terminate the contract and receive damages. Along with Edison, the Joint Parties believe that a failure to meet the performance requirements should entitle the buyer to replacement damages to cover the harm suffered by the buyer. As proposed in the Joint Parties' opening brief, only repeated failure to meet these requirements should be considered an event of default entitling the buyer to terminate.

10. Milestones

This term was indicated in the Ruling as one that would not be standardized.

11. Pricing Structures, Restrictions

This term was indicated in the Ruling as one that would not be standardized.

12. Credit Terms

Both Edison and PG&E et al. embrace the standard EEI credit provisions. These involve primarily either guarantees from investment-grade parent companies or letters of

credit to cover mark-to market exposures. Credit is the primary area in which large developers, that have investment-grade parents or are investment grade themselves, can squeeze out their competition by agreeing to unnecessarily strict provisions.

Small developers, for example, are not likely to have investment-grade parent companies and will not be able to afford potentially large letters of credit. This does not mean that they lack the creditworthiness necessary to develop and operate projects and should be excluded from the RPS market. This, however, is the likely effect of including EEI credit provisions in RPS contracts.

The EEI credit provisions were, like the ISDA-derived termination payment provision discussed above, developed to fit a different set of facts; namely, trades between marketers that have little, if any, hard assets in the ground. The Joint Parties have objected to these provisions in numerous prior pleadings and will not restate all of their objections again. One example will suffice to highlight the bizarre effect of these provisions.

Under the “collateral threshold” EEI credit provision, the seller is essentially required to post security (e.g., a letter of credit or surety bond) to cover the positive difference between the market price and the contract price, as it may change over time, over the remaining life of the contract (the buyer must cover the difference between the contract price and the market price). Thus, if a seller agrees to sell at 5 cents/kWh for 20 years and the market price jumps to 7 cents/kWh, it will need to post collateral equal to the present value of the 2 cent/kWh difference over the remaining life of the project. Under this approach, the more valuable the project, the more collateral the developer must post. And, if the project is really valuable (e.g., the market price climbs high above the contract price) the developer may be unable to afford the collateral and the utility will be able to place the developer in default under the contract. A system in which projects risk default the more valuable they become is certainly not one that the Commission should embrace for the RPS market.

As proposed in the Joint Parties’ opening brief, credit should be limited to a project fee to ensure that the developers are serious about their projects. Then, once the project is complete and operational, the utility should be secure that the developer’s incentive is to run the project as well and as long as possible to recover its investment.

13. Power Delivery

This term was indicated in the Ruling as one that would not be standardized.

14. Delivery Point

This term was indicated in the Ruling as one that would not be standardized.

15. Contract Modifications

No further comment at this time.

16. Assignment

Both Edison and PG&E et al. seek to modify the standard EEI assignment provision in inexplicable ways. The EEI, which is considered by both to reflect the state of the art in contract provisions, contains an appropriate provision both restricting assignment and permitting assignment where appropriate. The utilities' provisions are unduly restrictive. If anything, the standard EEI provision should be supplemented with a requirement that the buyer, upon request, enter into a commercially reasonable consent to assignment for the benefit of project lenders, including a reasonable estoppel certificate attesting to the presence or absence of any defaults by the seller.

17. Applicable Law

No comment at this time.

18. Dispute Resolution

This term was indicated in the Ruling as one that would not be standardized.

19. Representations and Warranties

This term was indicated in the Ruling as one that would not be standardized.

20. Indemnity

This term was indicated in the Ruling as one that would not be standardized.

21. Force Majeure

This term was indicated in the Ruling as one that would not be standardized.

22. Scheduling Coordination

This term was indicated in the Ruling as one that would not be standardized.

23. Imbalance Issues

This term was indicated in the Ruling as one that would not be standardized.

24. Prevailing Wage, Minority and Low-Income Issues

This term was indicated in the Ruling as one that would not be standardized.

25. Project Modifications

This term was indicated in the Ruling as one that would not be standardized.

26. Flow Down of Provisions

This term was indicated in the Ruling as one that would not be standardized.

III. CONCLUSION

The Joint Parties urge the Commission to adopt the proposals set forth in their opening brief. Counsel for the California Wind Energy Association is authorized to execute this opening brief on behalf of the Joint Parties.

Respectfully submitted,


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April 14, 2004

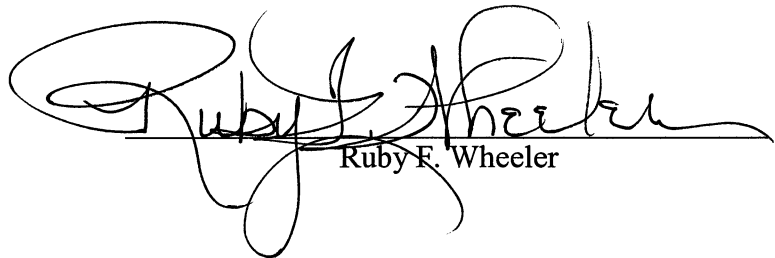
Certificate of Service

I hereby certify that I have this day served a copy of the

Reply Brief of the California Wind Energy Association, California Biomass Energy Alliance, L.L.C., and Vulcan Power Company on RPS Standard Contract Terms and Conditions

On all known parties to R.01-10-024 by mailing a properly addressed copy by first-class mail with postage prepared to each party named in the official service list.

Executed on April 14, 2004, at San Francisco, California.



Ruby F. Wheeler