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17
18 **UNITED STATES DISTRICT COURT**
19 **NORTHERN DISTRICT OF CALIFORNIA**
20 **SAN FRANCISCO DIVISION**

21 WINDING CREEK SOLAR LLC,

22 Plaintiff,

23 v.

24 MICHAEL PEEVEY, MICHAEL FLORIO,
CATHERINE SANDOVAL, CARLA
25 PETERMAN, and MICHAEL PICKER, in
their official capacity as Commissioners of
26 the California Public Utilities Commission,

27 Defendants.

Case No. 3:13-cv-04934-JD

**PRETRIAL BRIEF OF PLAINTIFF
WINDING CREEK SOLAR LLC**

Trial Date: April 4, 2017
Time: 9:00 a.m.
Courtroom: 11, 19th Floor
Judge: Hon. James Donato

1 **I. Introduction**

2 In its January 26, 2017 order, this Court identified a single question for trial: “[W]hether
3 the CPUC’s standard contract complies with 18 C.F.R. § 292.304(d)(2)?” ECF No. 117. The
4 answer to that question is no. As discussed in greater detail below, 18 C.F.R. § 292.304(d)(2)
5 contains the applicable legal standard for assessing this question. That section provides that a
6 Qualifying Facility (“QF”), such as Winding Creek Solar LLC (“Winding Creek”), must be
7 given the option to sell its energy “pursuant to a legally enforceable obligation,” *i.e.*, a contract,
8 “over a specified term.” *Id.* § 292.304(d)(2). When it elects this option, the QF must also be
9 given the choice of whether the rate at which it will sell its energy is “calculated at the time of
10 delivery” of the energy, *or* instead is “calculated at the time the [contractual] obligation is
11 incurred.” *Id.* § 292.304(d)(2)(i)-(ii).

12 The California Public Utility Commission’s (“CPUC”) Standard Contract does not
13 comply with these requirements because it does not provide a QF with the option of selling its
14 energy at a rate “calculated at the time the obligation is incurred.” Indeed, even CPUC’s own
15 expert Michael Colvin acknowledges that under the Standard Contract, a QF cannot know, at the
16 time the contract with the utility is signed, the rate that the QF will be paid for its energy.
17 Instead, that rate will change each month, and the QF will only learn what the rate is for a given
18 month during the preceding month. For this simple reason the Standard Contract does not
19 comply with § 292.304(d)(2), and Winding Creek should prevail.

20 **II. Statutory and Regulatory Background**

21 In enacting the Public Utility Regulatory Policies Act of 1978 (“PURPA”), Congress
22 established a framework designed to make it easier for certain small renewable generators—
23 QFs—to sell their electricity to utilities, and to provide economic incentives for parties to
24 develop such generation facilities. *See generally Am. Paper Inst., Inc. v. Am. Elec. Power Serv.*
25 *Corp.*, 461 U.S. 402, 404-05 (1983).

26 In order to achieve this goal, Congress provided that electric utilities *must* purchase *any*
27 electricity produced by QFs. *See* 16 U.S.C. § 824a-3(a); 18 C.F.R. § 292.303(a)(1). However,
28 Congress also specified that the price to be paid by a utility to a QF should not “exceed[] the

1 incremental cost to the electric utility of alternative electric energy.” 16 U.S.C. § 824a-3(b).
2 Pursuant to this directive, FERC adopted a regulation—18 C.F.R. § 292.304(b)(2)—requiring
3 that utilities pay QFs at a rate “equal[to] the avoided costs” of the utility, *i.e.*, the rate the utility
4 would have paid to another generator had it not purchased the electricity from a QF. *See* Small
5 Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the
6 Public Utility Regulatory Policies Act of 1978, 45 Fed. Reg. 12,214, 12,216 (Feb. 25, 1980)
7 (“PURPA Rulemaking”).

8 Critically for this case, FERC also adopted a rule providing that when a utility purchases
9 from a QF pursuant to a legally enforceable obligation—typically a contract, like the Standard
10 Contract at issue in this trial—the QF may choose between two different ways of calculating a
11 utility’s avoided costs. *See* 18 C.F.R. § 292.304(d)(2). Specifically, FERC provided:

12 [T]he rates for such purchases shall, *at the option of the qualifying facility*
13 exercised prior to the beginning of the specified term, be based on *either*: (i) The
14 avoided costs calculated at the time of delivery; or (ii) The avoided costs
15 calculated at the time the obligation is incurred.

16 18 C.F.R. § 292.304(d)(2) (emphasis added).

17 In other words, a QF can elect to have the utility’s avoided costs (and thus its rate)
18 calculated on an ongoing basis, as energy is physically delivered to the utility; *or* the QF can
19 instead elect to have the utility’s avoided costs (and thus its rate) calculated when the contract is
20 entered, so that the utility can “establish a fixed contract price for its energy and capacity at the
21 outset of its obligation.” PURPA Rulemaking, 45 Fed. Reg. at 12,224.

22 FERC has explained that affording QFs the option of choosing a rate under Section
23 292.304(d)(2)(ii)—a price “calculated at the time the [utility’s] obligation is incurred,” *id.*—is
24 central to achieving the statutory objective. “FERC has stated that the purposes behind PURPA
25 are furthered by allowing a QF to establish a fixed contract price for its energy and capacity at
26 the outset of its obligation. A fixed contract price provides a potential investor in a QF with
27 reasonable certainty about the expected return on a potential investment.” *Allco Renewable*
28 *Energy Ltd. v. Mass. Elec. Co.*, No. CV 15-13515-PBS, --- F. Supp. 3d ---, 2016 WL 5346937, at
*8 (D. Mass. Sept. 23, 2016). FERC understood that “in order to be able to evaluate the

1 financial feasibility of a [QF], an investor needs to be able to estimate, with reasonable certainty,
2 the expected return on a potential investment before construction of a facility.” PURPA
3 Rulemaking, 45 Fed. Reg. at 12,218.

4 FERC also understood that the utility’s avoided costs calculated at the time the obligation
5 is incurred, which are based upon forecasts of future costs, may turn out to be quite different
6 than the utility’s avoided costs at the time the energy is actually delivered. PURPA Rulemaking,
7 45 Fed. Reg. at 12,224. But FERC believed that “in the long run, ‘overestimations’ and
8 ‘underestimations’ of avoided costs will balance out,” and it emphasized “the need for certainty
9 with regard to return on investment in new technologies.” *Id.*; see also *JD Wind*, 130 FERC
10 ¶ 61,127, at para. 23 (2010) (“[FERC] has ... consistently affirmed the right of QFs to ... rates
11 determined at the time the obligation is incurred, even if the avoided costs at the time of delivery
12 ultimately differ from those calculated at the time the obligation is originally incurred.”).

13 Thus, 18 C.F.R. § 292.304(d)(2) makes it the “*option of the qualifying facility*” to decide
14 whether its rate will be “based on *either*: (i) The avoided costs calculated at the time of delivery;
15 or (ii) The avoided costs calculated at the time the obligation is incurred.” 18 C.F.R.
16 § 292.304(d)(2) (emphasis added).

17 PURPA directed state regulatory agencies, such as the CPUC, to adopt rules that comply
18 with and implement FERC’s regulations. See 16 U.S.C. § 824a-3(f)(1); see also PURPA
19 Rulemaking, 45 Fed. Reg. at 12,216 (“each State regulatory authority ... must implement these
20 rules.”). And because States’ only authority to regulate wholesale electricity sales is derived
21 from PURPA, see 16 U.S.C. § 824(b) (generally giving FERC exclusive jurisdiction over
22 wholesale sales of electricity in interstate commerce); *Nantahala Power & Light Co. v.*
23 *Thornburg*, 476 U.S. 953, 966 (1986), a state rule or program that conflicts with PURPA is
24 necessarily preempted, as this Court has previously recognized. See ECF No. 39 at 2.

25 **III. Plaintiff’s Witnesses**

26 Plaintiff will present testimony in its case-in-chief from the following three individuals:

- 27 • Michael Colvin (by deposition designation): Mr. Colvin is a Senior
28 Regulatory Analyst in the Policy and Planning Division at CPUC.

- 1 • Jonathan Lesser (by pre-submitted direct testimony): Dr. Lesser is the
2 President of Continental Economics, an economic consulting firm specializing
3 in regulated industries. His testimony explains why the Standard Contract
4 does not give QFs the option of choosing a rate for energy calculated at the
5 time the contractual obligation is incurred. In reaching that conclusion, he
6 analyzes the elements of the formula that determines the rate paid for energy
7 under the Standard Contract.
- 8 • Christopher Whitman (by pre-submitted direct testimony): Mr. Whitman is
9 Chief Executive Officer of Solomon Energy Inc., a company that invests in,
10 and arranges financing for, renewable energy projects and companies
11 throughout the United States. He is also President of US Solar Finance LLC,
12 a company that advises banks and other financial institutions with respect to
13 financing renewable energy electric generating facilities. Mr. Whitman also
14 will testify that the Standard Contract does not comply with § 292.304(d)(2)
15 because it fails to give QFs the option to sell energy at a rate based on avoided
16 costs calculated at the time the utility incurs the contractual obligation. He
17 explains why, as a business matter, QFs need such a pre-determined rate in
18 order to be able to secure financing.

11 IV. The Standard Contract

12 In an attempt to meet its PURPA obligations, the CPUC has made the Standard Contract
13 available to QFs of less than 20 megawatts, like Winding Creek. A QF can enter the Standard
14 Contract to sell its energy to a utility for up to 12 years. This Court has framed the question for
15 trial as whether the Standard Contract complies with § 292.304(d)(2).

16 As trial testimony and exhibits will show, the Standard Contract does not comply with
17 Section 292.304(d)(2). The Standard Contract does not give QFs the option to select between
18 two different methods of calculating avoided costs, as Section 292.304(d)(2) requires. Instead,
19 it imposes a single method for calculating the rate at which QFs may sell energy: a rate based on
20 avoided costs calculated at or near the time of delivery. Thus, under the Standard Contract, a QF
21 has *no* ability to opt to sell its energy at a rate based on “avoided costs calculated at the time the
22 obligation is incurred,” contrary to 18 C.F.R. § 292.304(d)(2)(ii).

23 Winding Creek will submit the Standard Contract and energy pricing formula as exhibits
24 at trial, and will also submit testimony in its case-in-chief from three witnesses explaining the
25 rate paid for energy under the Standard Contract. All three witnesses, including Mr. Colvin, the
26 CPUC’s own expert, will testify that the Standard Contract’s rate for energy is calculated at or
27 near the time the energy is delivered, not at the time the utility incurs the contractual obligation.
28

1 As Dr. Lesser explains in his pre-submitted direct testimony: “The Standard Contract uses a
2 formula, known as the ‘SRAC’ or ‘short run avoided cost,’ intended to capture the cost that the
3 utility would incur, but for its purchase from the QF, in purchasing power from a natural gas-
4 fired power plant, *as calculated at the time the QF delivers that power.*” Lesser Direct 7:14-17
5 (emphasis added). The SRAC formula is set forth in Section 10 of the Settlement Agreement
6 Term Sheet, attached to Dr. Lesser’s testimony as Exhibit JAL-3.

7 Dr. Lesser notes that he “largely agree[s] with Mr. Colvin’s explanation of the various
8 components of [the] formula,” and he goes on to identify the six basic components: Burner Tip
9 Gas Price; Market Heat Rate; Variable Operations and Maintenance; Greenhouse Gas
10 Compliance Costs; Time of Use Factor; and Location Adjustment Factor. Lesser Direct 7:1-20;
11 *see also* Colvin Decl. 8:26-9:26. Dr. Lesser and Mr. Colvin each explain each of these
12 components. But for purposes of addressing the Court’s question, the key fact—on which Dr.
13 Lesser and Mr. Colvin both agree—is that two components of the formula fluctuate and change
14 month-to-month over the life of the utility’s contractual obligation to the QF. Specifically, both
15 Mr. Colvin and Mr. Lesser agree that the Burner Tip Gas Price—which is simply the monthly
16 market-based price for natural gas—changes monthly. *See* Lesser Direct 8:6-23; Colvin Dep.
17 54:3-56:156. They likewise agree that the Market Heat Rate, which is a measure of efficiency of
18 gas-fired generating units that are displaced by purchases from QFs, varies over time and thus
19 cannot be known at the time a utility and a QF enter into a contract. *See* Lesser Direct 7:4-5;
20 Colvin Dep. 76:1-11.

21 As a result, the rate received by the QF under the Standard Contract *cannot* be calculated
22 at the time the obligation is incurred; instead, it is calculated anew each month and applied to
23 energy delivered during that month. On this point too, both Dr. Lesser and Mr. Colvin agree.

24 As Dr. Lesser’s testimony states:

25 [T]he rate to be paid to QFs for energy under the Standard Contract is a formula
26 based on variables that change over time such as natural gas prices and the
27 wholesale market price of electricity. The value of these variables will change
28 each month that the QF’s electricity is delivered under the contract. As a result,
the rate under the Standard Contract can only be calculated at or near the time that
electricity is *delivered* to the utility in the future. The rate *cannot* be calculated at
the time the utility’s obligation to purchase the electricity is incurred—i.e., when

1 a QF signs a contract with the purchasing utility.

2 Lesser Direct 2:17-24.

3 Mr. Colvin likewise testified at his deposition: "I think it is correct to say that the
4 commission has determined that the short run avoided costs, the costs that the qualifying facility
5 would be paid, should be best represented by what the individual generator unit would have been
6 paid that a utility would have procured but for the QF *at the time that the energy is delivered.*"
7 Colvin Dep. 62:24-63:5 (emphasis added). Mr. Whitman agrees as well. Whitman Direct 2:15-
8 3:3.

9 Thus, if Plaintiff entered the Standard Contract today, it would know the rate it will
10 receive for the energy it sells this month, but would not know what rate it will receive for its
11 energy next month, let alone next year or five years from now. The rate is re-calculated
12 monthly. Whitman Direct 3:14-4:7. PG&E's rate sheets for energy under the Standard Contract
13 are revealing in this regard. The rate sheets for December, 2016 through March, 2017 will be
14 submitted as exhibits at trial, and are attached to Mr. Whitman's testimony as Exhibit CW-2. As
15 is evident from the plain face of these exhibits, the energy rate changes monthly, and there is
16 currently no energy rate for any period after March 2017, because the natural gas price for April
17 2017 and beyond has not yet been determined, and thus the rate cannot yet be calculated. The
18 PG&E rate summary shown in Exhibit CW-3, attached to Mr. Whitman's testimony, likewise
19 shows the rate paid for energy under the Standard Contract for each month in the past. But there
20 is no rate sheet showing the rate for energy under the Standard Contract next month, because that
21 cannot yet be calculated. As Mr. Colvin admitted at his deposition:

22 Q So if I want to enter into the contract today as a QF, there's no way for me to
23 calculate the rate I'm going to receive for the energy I sell under the contract
24 today; I have to wait until the end of March 2017 to find out the rate for March
2017 and the end of February 2018 to find out the rate for February 2018. Is that
right?

25 A For the energy portion of its payment.

26 Q You agree with me with respect to the energy portion of this payment?

27 A I agree with you that the short run avoided cost formula is tied to the monthly
28 price of natural gas, and you need to know what that monthly price of natural gas
is in order to be able to calculate the actual physical check that is written to the
qualifying facility. The formula is known at the time of contract execution.

1 Q *But the rate isn't yet calculated, right?*

2 A *Correct.*

3 Colvin Dep. 72:23-73:18 (emphasis added).

4 Moreover, as Mr. Lesser will testify, due to month-to-month fluctuations in
5 natural gas prices, the energy price paid under the Standard Contract is quite volatile:
6 “For example, over the 14-month period from January 2016 through February 2017, the
7 Burner Tip Natural Gas Price varied from a low of \$2.37 per Dekatherm (in March 2016)
8 to a high of \$5.39 per Dekatherm (in January 2017), a difference of 127%. As a result of
9 this volatility in gas prices, the SRAC prices have also varied substantially, from 2.27
10 cents/kWh (\$22.70 per megawatt-hour (MWh)) in March 2016 to 3.76 cents/kWh
11 (\$37.60 per MWh) in January 2017, a difference of 65%.” Lesser Direct 9:11-16.

12 **V. The Standard Contract Does Not Comply With 18 C.F.R. § 292.304(d)(2)**

13 As discussed above, Section 292.304(d)(2) requires that QFs selling energy have the
14 *option* to choose *either* (i) a rate “calculated at the time of delivery” *or* (ii) a rate “calculated at
15 the time the obligation is incurred.” 18 C.F.R. § 292.304(d)(2). Because the Standard Contract
16 *only* offers the first type of rate, it does not comply with PURPA, under the plain language of the
17 regulations.

18 A federal District Court recently invalidated a Massachusetts standard contract under
19 PURPA due to the same flaw Plaintiff identifies here. In *Allco*, 2016 WL 5346937, at *2-*3,
20 Allco sought to enter a contract with National Grid, a Massachusetts electric utility, to energy
21 generated by solar QFs based in Massachusetts. National Grid offered to purchase electricity
22 from the QFs pursuant to Massachusetts’s standard power purchase contract. That standard
23 contract provided that energy would be compensated at a “Short-run Rate” based on the “hourly
24 market clearing price for energy,” *i.e.*, the market price for energy each hour. *See id.* at *2
25 (quoting 220 Mass. Code Regs. § 8.02). Allco challenged the Massachusetts Department of
26 Public Utilities (“MDPU”) rule containing this rate on the same basis that Winding Creek brings
27 the instant challenge: a rate based on the hourly market price for energy—just like a rate based
28 on the monthly market price for gas in California—is variable and cannot be calculated until the

1 time that energy is delivered. Thus, the QF does not have the option of choosing a rate
2 “calculated at the time the obligation is incurred,” as Section 292.304(d)(2) requires. *Id.* at *3.
3 As in this case, FERC declined to initiate an enforcement action. *Id.*

4 Allco moved for summary judgment, arguing that the MDPU rule was invalid “because it
5 conflicts with FERC’s regulations implementing PURPA.” *Id.* at *6. The District Court agreed.
6 It found, first, that “the only standard contract rate available to such QFs is the spot market price
7 for wholesale energy.” *Id.* at *7. Next, the court observed:

8 Allco contends that because the spot market rate fluctuates hourly with market
9 conditions and cannot be determined in advance of the actual delivery of
10 electricity, the rate is necessarily “calculated at the time of delivery.” 18 C.F.R.
11 § 292.304(d)(2)(i). But under FERC’s regulations, if a QF chooses to provide
12 electric energy pursuant to a “legally enforceable obligation,” the QF must have
13 the option to receive the avoided costs “calculated at the time of delivery” or
14 “calculated at the time the obligation is incurred.” *Id.* § 292.304(d)(2). *The*
15 *MDPU rule, by providing only the spot market rate, eliminates the QF’s ability to*
16 *choose the latter pricing option. As such, the MDPU rule fails to properly*
17 *implement FERC’s regulations, as mandated by PURPA section 210(f)(1).* 16
18 U.S.C. § 824a-3(f)(1).

19 *Id.* (emphasis added).

20 Allco is on all-fours with this case. As in *Allco*, the Standard Contract made available by
21 CPUC offers *only* a rate for energy that fluctuates with market conditions and cannot be
22 determined in advance—in this case the monthly market for natural gas. And, as in *Allco*,
23 because the market in natural gas varies monthly, the price QFs will be paid under the Standard
24 Contract by utilities likewise will vary monthly and thus cannot be known at the time the QF and
25 the utility sign their contract. Thus, just as in *Allco*, CPUC’s Standard Contract fails to comply
26 with FERC’s regulations.

27 The Standard Contract not only violates the plain terms of Section 292.304(d)(2), but also
28 frustrates the FERC policy reflected in that regulation. As discussed above, FERC gave QFs the
option of choosing a rate that could be calculated at the time the utility entered the contract with
the QF, because it understood that “in order to be able to evaluate the financial feasibility of a
[QF], an investor needs to be able to estimate, with reasonable certainty, the expected return on a
potential investment before construction of a facility.” PURPA Rulemaking, 45 Fed. Reg. at
12,218. While the avoided costs at the time of delivery may be different than the avoided costs

1 calculated at the time the contractual obligation is incurred, “the utility making a purchase under
 2 a long-term forecasted rate bears the risk that prices will drop in the future and the QF bears the
 3 corresponding risk that prices will rise.” *Allco*, 2016 WL 5346937, at *8; *see also* PURPA
 4 Rulemaking, 45 Fed. Reg. at 12,224. In sum, “[a] fixed contract price provides a potential
 5 investor in a QF with reasonable certainty about the expected return on a potential investment,”
 6 *Allco*, 2016 WL 5346937, at *8, and FERC wanted a QF to be able to choose that certainty if it
 7 wished.

8 As Mr. Whitman will testify, “In order to obtain financing to construct an electric
 9 generating facility, the bank or other financing party needs sufficient certainty that the revenue
 10 generated by the electric generating facility will cover the periodic financing payments, taking
 11 into account a typical debt service coverage ratio.” Whitman Direct 5:16-19. And “[i]n the case
 12 of an independent power producer like Winding Creek or other developers of QFs, the revenue
 13 certainty comes from being able to select a rate that is calculated when the contractual obligation
 14 is incurred, and thus is known at the start of the contract for the duration of the contract term.”
 15 *Id.* at 5:23-26. Because the Standard Contract fails to offer that revenue certainty, however, it is
 16 unsurprising that “there are no solar facilities in PG&E territory delivering power based upon the
 17 QF Standard Contract that have been built since the QF Standard Contract was implemented (as
 18 opposed to having been grandfathered into that contract).” *Id.* at 6:10-12.

19 CONCLUSION

20 For the foregoing reasons, the Court should determine that the Standard Contract does
 21 not comply with 18 C.F.R. § 292.304(d)(2).

22 Dated: March 22, 2017

Respectfully submitted,

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JENNER & BLOCK LLP

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