Brown H-6a

COM/SWH/FLC/rsr*

Decision 88-03-036 March 9, 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Gas and Electric Company for an Expedited Order approving the First Amendment to the Power Purchase Agreement (Interim Standard Offer No. 4) with Bio-Solar Corporation as Assigned to the Madera Power Plant Partnership regarding the purchase of long-term capacity and energy from the Madera Power Plant Project. (U 39 E)	Application 87-11-019 (Filed November 18, 1987)

O P I N I O N

I. Introduction

Pacific Gas and Electric Company (PG&E) requests issuance of an order approving an amendment to an Interim Standard Offer No. 4 Power Purchase Agreement for Long-Term Energy and Capacity (SO4 agreement) between the Madera Power Plant Partnership (Madera) and PG&E. PG&E asks the Commission to find (1) that the amended SO4 agreement is reasonable and prudent and (2) that PG&E may recover all payments made under the amended SO4 agreement, subject only to a review of PG&E's performance of its obligations and exercise of its rights under the agreement.

PG&E executed the amendment with Madera to resolve certain disputes over the parties' rights and obligations under the original SO4 agreement. PG&E and Madera believe that the amendment is a reasonable settlement of their disputes.

The amendment address four areas: (1) it reduces the obligation of Madera to provide capacity and energy from a 50 MW facility to a 25 MW facility, (2) it reduces the firm capacity commitment from 50 MW to 20 MW, (3) it changes the primary energy source from sweet sorghum bagasse to agricultural waste, and (4) it

different from the one specified in the agreement. PG&E and Madera entered into negotiations that resulted in the proposed amended agreement.

PG&E states that the amendment represents a mutually satisfactory settlement of this dispute.

III. DRA's Protest

DRA advocates a "tough but fair" approach to utility renegotiation of power purchase agreements. DRA believes that utilities should agree to contract modifications, even when they benefit the ratepayers, only where it is clear that the project would have made it under the original contract terms, including capacity. If a Qualifying Facility (QF) would fail absent certain concessions, DRA states that it is clearly in the ratepayers interest to let that QF fail rather than grant the concessions.

DRA points out that nowhere in the application is there a showing or declaration that the Madera project would have come on-line by its April, 1989 contract deadline at the full 50 MW size. Absent this showing, DRA believes that the burden then has been thrust upon DRA to determine whether the utility properly negotiated concessions with the QF. DRA recommends that this application should be denied so that utilities will know that future applications will be dismissed unless a showing is made that the project could have gone forward under the original contract terms.

DRA points out that a 50 MW facility would fall under California Energy Commission (CEC) siting jurisdiction even if the facility is to be built in two 25 MW phases. DRA has contacted the CEC and believes that Madera never filed an application with the CEC for this project. DRA then concludes that Madera's project has not been intended as a 50 MW facility for some time.

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extends the energy delivery date to account for the delay resulting from settlement of the disputes between PG&E and Madera and for the delay in obtaining approval of the amendment from the Commission.

The Division of Ratepayer Advocates (DRA) filed a timely protest to the application on December 17, 1987. DRA recommends denial because the application does not make an adequate showing that Madera's project would have succeeded without the proposed contract modifications. If the Commission is not inclined to deny the application, then DRA requests time to conduct discovery to be followed by hearings on the application.

PG&E filed a reply to DRA's protest on January 8, 1988. PG&E states that the application meets all existing standards for judging the reasonableness of renegotiated power agreements and should be approved on an ex parte basis.

DRA filed a response to PG&E's reply on February 11, 1988.

II. The Dispute Between PG&E and Madera

PG&E and Bio-Solar Inc. (Bio-Solar) executed the original SO4 agreement in April, 1984. Bio-Solar later assigned the agreement to Madera on October 15, 1987. Bio-Solar is one of the general partners of Madera.

In several letters to PG&E, Bio-Solar indicated that it intended to develop the 50 MW project in two phases. PG&E acknowledged in one letter Bio-Solar's plan for a phased development. However, PG&E did not formally agree to downsizing of the project from 50 to 25 MW.

On October 6, 1987, Madera submitted an interconnection study request to PG&E which stated that the facility size was 25 MW. PG&E then informed Madera that the original SO4 agreement called for development of a 50 MW facility and that PG&E was not obligated to purchase power from a facility that is materially

different from the one specified in the agreement. PG&E and Madera entered into negotiations that resulted in the proposed amended agreement.

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Finally, DRA states that if the Commission believes that Madera is entitled to downsize its project because of reliance upon PG&E's representations, then PG&E's shareholders should bear the cost of the contract not its ratepayers. DRA suggests that shareholders could pay the difference between the contract prices and actual avoided prices. Alternatively, DRA suggests that the prices to be paid to Madera could be reduced below the current levels.

IV. PG&E Reply

PG&E states that DRA's protest raises three policy questions regarding guidelines for renegotiation of standard offer agreements: (1) whether guidelines should be addressed on a case by case basis or in a generic rulemaking proceeding, (2) whether such guidelines should be applied prospectively or retrospectively, and (3) whether the Commission should adopt DRA's proposed guidelines or wait for further refinement through a rulemaking proceeding. PG&E urges the Commission to defer the formulation of generic renegotiation guidelines to a rulemaking proceeding and to apply existing standards to this application.

V. Discussion

This application requests ex parte Commission approval of a renegotiated power purchase agreement. As such, it requires the Commission to make a determination on the reasonableness of the transaction based upon the facts disclosed in the application. Thus, it is particularly important for an application in which ex parte relief is requested to contain all of the information necessary for the Commission to make a sound and reasoned decision.

As pointed out by DRA, there is no showing that the Madera project could have gone forward as contemplated in the original agreement. There is not even an assertion that the QF had some reasonable likelihood of meeting its contract obligations. PG&E states only that the Commission to date has not required such a showing and that its application should be deemed complete. PG&E believes its filed application is consistent with recent Commission decisions. (See D.87-07-023 issued July 8, 1987 for Santa Maria Aggregate, D.87-07-086 issued July 29, 1987 for Basic American Foods, Inc., and D.87-11-063 issued November 25, 1987 for O'Brien Energy Systems, Inc.)

Utilities are held to a standard of reasonableness based upon the facts that are know or should be known at the time. While this reasonableness standard can be clarified through the adoption of guidelines, the utilities should be aware that guidelines are only advisory in nature and do not relieve the utility of its burden to show that its actions were reasonable in light of circumstances existent at the time. Whatever guidelines are in place, the utility always will be required to demonstrate that its actions are reasonable through clear and convincing evidence. (D.87-07-026 issued July 8, 1987 for A.85-09-034, mimeo. at pages 19-20.)

Before a utility enters into any renegotiation of a power purchase agreement, it presumably has evaluated the strength of the other party's position. If the other party does not have a unilateral right to make modifications to the contract, then the utility should determine what reasonable concessions can be obtained in exchange for the contract modification sought by the other party. This is consistent with DRA's principle, wherein downsizing (or even other modifications) requires reasonable proof that the project could have been constructed at the original contracted capacity. Such a principle would seem to be necessary to fully protect ratepayers.

In implementation, however, such a principle demands a certain level of responsibility in communicating changes and contract interpretations between utilities and QF developers. For utilities this means that they must respond quickly and clearly when they become aware that a QF developer may be changing important details of projects. Otherwise, the utility could delay its response to a PPA modification request until the affected QF developer could not possibly undertake the project in its original form before the contractual deadline. Then the developer would be forced to make concessions for a PPA modification that might not have been required if timely notification by a utility had taken place. In this case, PG&E did not express concern with phasing the project, although the possibility that the second phase would not be completed within the contract timeframe would have led to a de facto downsizing. PG&E ought to have communicated these concerns as early as possible in the project development, so that the QF could respond properly to contractual requirements.

Correspondingly, QFs should be in constant communication with utility representatives, informing the utility of the progress of its project, including operational modifications that are planned. This is consistent with our interest in improving the integration, on a planning and operational basis, of independent

generation sources with utility systems. This communication should include an honest description of the status and conditions of the project at all stages of development. Such early communication is just as necessary to the proper implementation of these projects as is utility oversight.

In this case, the level of communication between PG&E and Madera was poor. Madera informed PG&E of ownership modifications, fuel source changes and project phasing, but neglected to communicate that the second 25 MW of capacity might not be completed by the time the five-year deadline expired. This poor communication on Madera's part appears to be due to its belief that language in the PPA gave them the right to downsize the plant (i.e., not build the second 25 MW unit). However, as discussed above, it is our belief that any PPA modification, including downsizing, must be in the ratepayer's interest; in some circumstances this may require concessions of some sort from the QF developer.

PG&E must share the blame in this case as well. Had PG&E investigated the project's change in plans at the time they were first communicated to PG&E, it could have tested the QF's ability to perform. PG&E could have challenged Madera's position that it was entitled to SO4 payments for the remaining 25 MW of capacity. Madera could then have either substantiated its position or commenced negotiations with PG&E for appropriate amendments to the contract. Because of the delays that took place, it was October of 1987 before Madera was aware that there was a problem. Madera has apparently proceeded on the assumption that it would receive the contract price for the reduced capacity and intends to come on line in April, 1989. Due to the lack of communication between the utility and the QF, there was never any opportunity for the utility to question, and the QF to substantiate, the development's viability at the original capacity rating. The question of viability is crucial because the QF's inability to

perform as required by a material term of the contract would excuse the utility's obligation to perform. The contract terms would then be subject to renegotiation. At that point, we would expect the utility to obtain concessions that would place ratepayers in a better position than existed under the original standard offer contract. In this case, the utility never undertook negotiations to modify the terms of purchase from the QF. It merely accepted the downsizing of capacity.

We do not by providing this discussion wish to prejudge the guidelines that we will be considering after the issuance of our report in response to SB 1970. In that proceeding we will consider the reasonableness of all guidelines, including the one described above. We are simply concerned that, given our attitudes as expressed in earlier decisions, this vital area was not addressed at all in this filing.

Given the fact that the utility neglected to evaluate the viability of the project, it would be inequitable to the QF to reject the downsizing at this time. We should accept the modification. Our action should not be construed to condone a possible utility oversight, however.

While the Commission has encouraged parties to settle disputes rather than proceed to litigation, the Commission has also stated that it will not automatically accept all settlements. Each settlement will be examined for reasonableness since it is the Commission's duty to protect the interest of ratepayers, who are not parties to the settlement. D.87-11-063, mimeo at page 20. Both the utility and the QF must keep this objective in mind with respect to any contract modifications.

In this case, given our interest in both fairness to the QF and protecting ratepayer interests, we believe it is appropriate to approve the amended agreement. While we would prefer to have more proof that this project could have gone forward as originally intended, further investigation would delay the project with no

appreciable proof that evidence would be uncovered to change our decision. Any other position would give a utility an improper incentive to delay responses to developer requests in the hope of eliminating projects. While the QF in this case is not without some blame, on the whole Madera's misinterpretation of the standard offer contract language was not unreasonable, given the lack of precedent in the matter of contract modifications. As the settlement of potential litigation caused by the mutual misunderstanding, the amended agreement appears reasonable.

As mentioned above, there are a number of principles, objectives, and guidelines which have yet to be discussed in a comprehensive fashion. While past Commission precedents offer some guidance in these areas, we recognize that there is some, not unjustified, confusion in CPUC policies on the reasonableness of standard offer contract modifications. The proceeding to develop guidelines for administering QF contracts has been unavoidably delayed; the CPUC will attempt to accelerate this proceeding in the interest of assisting parties in this complex area.

Findings of Fact

1. PG&E and Bio-Solar executed the original SO4 agreement for development of a 50 MW facility.

2. Madera, Bio-Solar's assignee, planned to develop the project in two 25 MW phases.

3. Had PG&E investigated the project's change in plans at the time they were first communicated to PG&E, it could have tested the QF's ability to perform.

4. Because of the delays that took place, it was October of 1987 before Madera was aware that there was a problem.

5. Due to the lack of communication between the utility and the QF, there was never any opportunity for the utility to question, and the QF to substantiate, the development's viability at the original capacity rating.

6. PG&E and Madera disagreed as to how the rights and obligations of the parties under the original SO4 agreement are affected by the phased development of the project.

7. PG&E and Madera have settled their dispute through an amended SO4 agreement which essentially reduces the facility size from 50 MW to 25 MW.

8. Given the fact that the utility neglected to evaluate the viability of the project, it would be inequitable to the QF to reject the downsizing at this time.

9. Ratepayers should be protected from future liability for standard offer-level payments where a QF seeks a material alteration of contract terms due to its inability to meet contract obligations by closer utility monitoring of QF activities in the future.

10. Due to the need for Madera to proceed expeditiously with its project, this order should be made effective immediately.

Conclusion of Law

The amended SO4 agreement between PG&E and Madera is reasonable.

O R D E R

Therefore, IT IS ORDERED that (1) the First Amendment to the Power Purchase Agreement with Bio-Solar Corporation as assigned to the Madera Power Plant Partnership is approved and (2) Pacific Gas and Electric Company shall recover payments made under this

amended agreement through its Energy Cost Adjustment Clause subject only to a review of the exercise of its rights and the performance of its obligations under the agreement.

This order is effective today.

Dated March 9, 1988, at San Francisco, California.

STANLEY W. HULETT,
President
DONALD VIAL
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

I will file a written dissent.

/s/ FREDERICK R. DUDA
Commissioner

I will file a written concurring opinion.

/s/ G. MITCHELL WILK
Commissioner

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Victor Weisser, Executive Director

A.87-11-019
C.88-03-036

FREDERICK R. DUDA, Commissioner, Dissenting:

The Commission is currently involved in drafting the SB 1970 report to the Legislature and will soon be involved in more specifically defining guidelines for dealing with existing QF contracts such as the one here with Biosolar.

Our basic themes have been to adopt a "tough but fair approach" to contract administration, and possibly most important, to stand by the existing contracts in the sense that "a deal is a deal." In a situation where there are major changes to the terms of the contract, whether by lack of performance or by actual changes to the agreement, we should not consider that the original deal has been sustained. Where there have been major changes or lack of performance, we have requested that concessions be made in the interests of ratepayers.

I believe that this case presents clear facts that may reflect that major changes to the original agreement have occurred, and we should request some valued concessions for ratepayers. The problem is that the Commission is asked to make a decision in this case without a full set of relevant facts. In short, it is not clear that this case presents us with a deal that we should ratify. Accordingly, I respectfully dissent from the majority in this case.

/s/ Frederick R. Duda
Frederick R. Duda, Commissioner

March 9, 1988
San Francisco

A.87-11-019
D.88-03-036

G. MITCHELL WILK, Commissioner, Concurring:

On July 8, 1987, I reluctantly joined the majority in approving an agreement between PGandE and the Santa Maria Aggregate Corporation (D.87-07-023). That agreement was similar in many ways to the Bio-Solar / PGandE agreement before us today.

I filed a concurrence to the Santa Maria decision in which I stressed the ambiguities injected into the process by the Commission's failure up to that date to adopt guidelines for re-negotiating QF agreements. Unfortunately, we have still not adopted such guidelines, though I am hopeful we will do so shortly.

Two circumstances concern me deeply with respect to the Bio-Solar contract. First, as I wrote in the Santa Maria case, I believe that the Commission should foster aggressive utility management of QF contracts; approval by the Commission of each and every re-negotiated contract would simply weaken the competitive environment we hope to nurture.

Second, I regret the lack of a record with which to examine the viability of the originally-planned 50 MW project. In the absence of a convincing showing that the choice here is between a 50 MW unit and a 25 MW unit, the Commission is unable to dispel doubts that the original unit was infeasible. If the 50 MW project was in fact not a viable option at the time the agreement was signed, what appears to be a down-sizing is in fact an up-sizing -- from zero to 25 MW -- during a period of excess generating capacity.

I join the majority today largely because I believe that the lack of adopted guidelines contributed materially to the misunderstandings and lack of communication between Bio-Solar's developers and PGandE. I for one do not regard today's decision as determinative of the basic issues raised here, but only as the least inequitable of the various options open to the Commission.

/s/ G. Mitchell Wilk
G. Mitchell Wilk, Commissioner

March 9, 1988
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March 9, 1988
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COM/SWH/rsr

Item 11
Agenda 2/24/88

Decision 88 03 036 MAR 09 1988

ORIGINAL

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PG&E and Madera did not agree that Madera had a contractual right to reduce its obligation to deliver power from a 50,000 kW facility as specified in the original agreement to a 25,000 kW facility without first obtaining PG&E's consent and amending the agreement. The parties also did not agree that Madera had a contractual right to develop the facility in two phases and receive the fixed energy prices specified in the agreement for the first 25,000 kW phase if energy deliveries from the first phase but not the second phase start before the on-line date.

PG&E emphasizes that this application neither requests nor requires the Commission to resolve these questions. Rather PG&E states that the amendment represents a mutually satisfactory settlement of these disputes.

Attached to the amendment executed by the parties is an unfiled draft complaint prepared by Madera. In this complaint, Madera alleges that PG&E on several occasions acknowledged Madera's plan to develop two 25,000 kW facilities rather than one 50,000 kW facility. Thus, Madera apparently believes that it had the right to construct a 25,000 kW facility not only under the terms of the original SO4 agreement but also because of PG&E's acknowledgement that a phased development was acceptable.

III. DRA's Protest

DRA advocates a "tough but fair" approach to utility renegotiation of power purchase agreements. DRA believes that utilities should agree to contract modifications that benefit the

ratepayers only where it is clear that the project would have made it under the original contract terms. If a Qualifying Facility (QF) would fail absent certain concessions, DRA states that it is clearly in the ratepayers' interest to let that QF fail rather than grant the concessions.

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V. Discussion

This application like others that request ex parte Commission approval of a renegotiated power purchase agreement requires the Commission to make a determination on the reasonableness of the transaction based upon the facts disclosed in the application. Unlike an Energy Cost Adjustment Clause (ECAC) reasonableness review, the Commission must look just to the utility's representations on the reasonableness of the action without the benefit of discovery, testimony, hearings and review by other parties. Thus, it is particularly important for an application, in which ex parte relief is requested, to contain all of the information necessary for the Commission to make a sound and reasoned decision.

That is not the case here. As pointed out by DRA, there is no showing that the Madera project could have gone forward as

contemplated in the original agreement. There is not even an assertion that the QF had some reasonable likelihood of meeting its contract obligations. PG&E states only that the Commission to date has not required such a showing and that its application therefore should be deemed complete. PG&E believes its filed application is consistent with recent Commission decisions. (See D.87-07-023 issued July 8, 1987 for Santa Maria Aggregate, D.87-07-086 issued July 29, 1987 for Basic American Foods, Inc., and D.87-11-063 issued November 25, 1987 for O'Brien Energy Systems, Inc.)

Utilities are held to a standard of reasonableness based upon the facts that are known or should be known at the time. While this reasonableness standard can be clarified through the adoption of guidelines, the utilities should be aware that guidelines are only advisory in nature and do not relieve the utility of its burden to show that its actions were reasonable in light of circumstances existent at the time. Whatever guidelines are in place, the utility always will be required to demonstrate that its actions are reasonable through clear and convincing evidence. (D.87-07-026 issued July 8, 1987 for A.85-09-034, mimeo at pages 19-20).

PG&E here has not made any showing on the viability of Madera's original project and instead points to the substantial uncertainty about the rights of the parties under the original SO4 agreement. PG&E also argues that a change to the "blanks" in the standard offers which is consented to by both parties should be presumed reasonable. This argument does not address the obligation that a utility bears to exercise its rights under an executed standard offer agreement including the obligation to make the best deal it can for the ratepayer.

Before a utility enters into any renegotiation of a power purchase agreement, it presumably has evaluated the strength of the other party's position. If the other party does not have a unilateral right to make modifications to the contract, then the utility should determine what reasonable concessions can be obtained in exchange for the contract modification sought by the other party. PG&E already has stated that it did not believe Madera had a unilateral right to downsize its facility from 50,000 kW to 25,000 kW. In light of this position, if Madera did not have a good chance of building its original project within the contract deadline, then PG&E should have surmised that its bargaining position was strong enough to obtain some concessions from Madera.

On the other hand, the utility and the QF are entering into a long-term business arrangement. It is in the interest of both that a businesslike relationship be established and maintained. We expect the utility to make a businesslike effort to keep the QF informed of actual and potential problems with the project, from the utility's point of view. This requires project monitoring, and certainly includes communication and clarification of matters such as whether downsizing, or other operational modifications, are acceptable or will require renegotiation of the contract. The QF, for its part, should keep the utility informed of the progress of its project, including operational modifications that are being made. We fully expect that relationship to exist in the future, to prevent situations such as this one.

While the Commission has encouraged parties to settle disputes rather than proceed to litigation, the Commission also has stated that it will not automatically accept all settlements. Each settlement will be examined for reasonableness since it is the Commission's duty to protect the interests of ratepayers, who are not parties to the settlement. D.87-11-063, mimeo at page 20.

Both the utility and the QF must keep this consideration in mind with respect to any contract modifications.

Although this application does not meet our usual standard of review for utility transactions for a project of this type, i.e. one fueled with agricultural waste, we will apply a less rigorous standard of review. We will approve the amended agreement in part because we are committed to encouraging the development of alternative energy resources such as Madera's proposed project. See D.87-07-023 mimeo at pages 3-4. Also, although it is possible that PG&E might have been able to negotiate some concessions, there is no evidence that this agreement is actually detrimental to the ratepayers.

Our approval also recognizes the need of the developers to proceed with the delayed project as quickly as possible. We do not wish to extend the waiting period any further for Madera. Both the utility and small power producers, however, should recognize that it is not acceptable to expect this Commission to issue decisions on each and every renegotiated power purchase agreement to conform to their construction schedules. The parties to those agreements possess the necessary information to enter into binding renegotiations without Commission oversight rendering prior approval unnecessary. As is evident with this application, the insistence upon Commission advance approval of renegotiated agreements expends scarce staff resources and can also delay the development of projects. We expect the utilities to defer the review of all but the most extraordinary renegotiations to the ECAC reasonableness reviews.

Findings of Fact

1. PG&E and Bio-Solar executed the original SO4 agreement for development of a 50,000 kW facility.

9. Ratepayers should be protected from future liability for standard offer-level payments where a QF seeks a material alteration of contract terms due to its inability to meet contract obligations by closer utility monitoring of QF activities in the future.

10. Due to the need for Madera to proceed expiditiously with its project, this order should be made effective immediately.

Conclusions of Law

The amended SO4 agreement between PG&E and Madera is reasonable.

O R D E R

Therefore, IT IS ORDERED that (1) the First Amendment to the Power Purchase Agreement with Bio-Solar Corporation as assigned to the Madera Power Plant Partnership is approved and (2) Pacific Gas and Electric Company shall recover payments made under this amended agreement through its Energy Cost Adjustment Clause subject only to a review of the exercise of its rights and the performance of its obligations under the agreement.

This order is effective immediately.

Dated MAR 09 1988, at San Francisco, California.

I will file a written dissent.

FREDERICK R. DUDA
Commissioner

STANLEY W. HULETT,
President.
DONALD VIAL

JOHN B. OHANIAN
Commissioners

I will file a concurring opinion.

G. MITCHELL WILK
Commissioner