

Decision **88 08 021** AUG 10 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Second application of Pacific Gas and Electric Company for approval of certain standard offers pursuant to Decision 82-01-103 in Order Instituting Rulemaking No. 2.

) Application 82-04-44
) (Filed April 21, 1982;
) amended April 28, 1982,
) July 19, 1982, July 11, 1983,
) August 2, 1983,
) and August 21, 1986)

) Application 82-04-46

) Application 82-04-47

) Application 82-03-26

And Related Matters.

) Application 82-03-37

) Application 82-03-62

) Application 82-03-67

) Application 82-03-78

) Application 82-04-21

**OPINION APPROVING SETTLEMENT AND DISMISSING
PETITION FOR MODIFICATION OF DECISIONS
85-04-075, 85-06-163, AND 85-07-121**

I. Introduction

Southern California Edison Company (Edison) and West Coast Cogeneration, Inc. (WCC) jointly request our approval of a settlement conditionally reached between Edison and WCC. The settlement is set forth in a Power Purchase Agreement (PPA) between

WCC and Edison, and is attached to their joint stipulation and motion filed June 15, 1988.¹

The settlement PPA represents the negotiated solution of the parties' dispute over whether this Qualifying Facility (QF) developer is entitled to increase the contract capacity in an existing five megawatt interim Standard Offer 4 (SO 4) contract. The increase, an additional six megawatts, allows the developer to expand the landfill gas conversion electricity generating facility now operating at its West Covina site. Subject to the settlement being approved and payments under it found reasonable for recovery in Edison's rates, the parties desire that the developer's Petition for Modification (Petition) be dismissed with prejudice.

II. Background

The stipulation summarizes the history of this dispute as follows.

On October 10, 1986, BKK filed a Petition requesting the Commission to order Edison to increase the contract capacity of BKK's existing five megawatt SO 4 contract for Phase 1 of its landfill gas conversion electric generation project (Phase 1 Project). This facility captures and generates electricity from gas naturally produced by BKK's landfill operations. The gas would

¹ The stipulation recites that BKK Corporation (BKK) assigned its power purchase agreement for Phase 1 of the project at issue to WCC on July 31, 1986. Edison consented to this assignment on September 3, 1986. Kris Kazarian, an officer of BKK, is president of WCC. WCC is a separate corporation but is still affiliated through its management with BKK. References to the petitioner in the course of this proceeding consistently have been to BKK; however, the settlement PPA will be entered into between WCC and Edison. Today's decision will generally refer to BKK in discussing the history of the dispute (Section II) and summarizing the proposed settlement (Section III).

otherwise be incinerated under current air quality regulations. BKK desired to increase its existing SO 4 contract capacity by an additional 12.3 megawatts to permit development of Phase 2 of its project (Phase 2 Project). The Petition stated that BKK was entitled to SO 4 prices for Phase 2 based on alleged representations made by Edison in telephone conversations with BKK during April 1985, shortly before the Commission's suspension of SO 4 by Decision (D.) 85-04-075.²

In Edison's Reply, filed on November 14, 1986, Edison denied that any acceptance of an amendment to BKK's existing SO 4 contract took place in April 1985, and asserted that BKK therefore was not entitled to SO 4 prices for Phase 2. In addition, Edison alleged that BKK had not adequately defined its project so that an SO 4 contract could be signed for Phase 2 prior to Commission suspension of SO 4 in D.85-04-075. BKK denied Edison's allegations in a Response filed on January 12, 1987.

In response to encouragement by the presiding administrative law judge (ALJ)³ to work out a compromise

² Petition, p. 5. BKK believed it was entitled to increase its contract capacity regardless of whether the Commission suspended SO 4. (Id., p. 7.)

³ See ALJ Ruling of August 17, 1987; subsequent rulings granted requests by the parties for additional time to complete their negotiations. The ALJ noted:

"The Commission has strongly encouraged negotiated resolution of disputes between utilities and qualifying facilities. There are several policies that are furthered by such negotiations. One often-overlooked policy is that settlements are often preferable, from a societal standpoint, to adjudication. A tribunal must generally reach an all-or-nothing result, with losses or even bankruptcy for one of the parties, whereas the

(Footnote continues on next page)

solution, the parties explored the possibility of settling this case by negotiating a mutually acceptable contract for the sale of power from BKK's Phase 2 Project to Edison. BKK and Edison negotiated for over eight months, from August 1987 to April 1988. These efforts ultimately resulted in agreement on the settlement PPA.

III. The Proposed Settlement

The parties summarize the features of their proposed settlement as follows:

1. The PPA will be a firm capacity contract with a 15-year term.
2. In years 1 through 5, inclusive, the PPA will incorporate a fixed \$121 per kilowatt-year capacity payment.
3. In years 1 through 5, inclusive, energy payments will be based on 85% of SO 4 forecasted energy costs.

(Footnote continued from previous page)

parties themselves might have negotiated a result that both could live with.

"In this dispute, litigation is clearly risky for both parties, and for Edison's ratepayers: a proven but capital-intensive project may be lost altogether, or it may go forward at interim Standard Offer 4 prices. Hence, the statement in the prior ruling that 'the parties are really better able than the Commission to work out an "optimal" solution, i.e., one that provides for the realization of the full power potential of petitioner's project consistent with the resource needs of the purchasing utility.'" (ALJ Ruling of November 19, 1987, p. 2.)

4. The unit will be fully curtailed for 150 hours per year based on an annual dispatch schedule provided by Edison for years 6 through 15.
5. In years 6 through 15, inclusive, the energy and capacity payments will be based on Edison's posted short-run avoided cost, equivalent to payments under Standard Offer 1 (SO 1).
6. The settlement PPA is conditioned upon the Commission finding that the terms and conditions of the settlement PPA are reasonable and that the payments made by Edison under the PPA shall be deemed reasonable and recoverable in rates.
7. The firm contract capacity shall be six megawatts.

According to the parties, the settlement PPA provides significant ratepayer benefits. The parties, therefore, request that the Commission determine that all amounts to be paid to WCC under it will be reasonable and recoverable for Edison's ratemaking purposes.

Comparing the settlement PPA with the relief that BKK requested in its Petition, the parties point out the following concessions by BKK in the process of negotiating:

- o Reduced contract term from 20 to 15 years.
- o Reduced requested firm capacity increase from 12.3 megawatts to six megawatts.
- o Reduced energy payments to:
 - 85% of SO 4 energy forecast for the first five years.
 - Posted avoided cost for years 6 through 15.
- o A 15-year firm capacity commitment with capacity payments lower than SO 4 firm capacity levels:

- \$121 per kilowatt-year of firm capacity for the first five years.
- SO 1 as-available capacity payments for years 6 through 15.
- o Full dispatch for 150 hours per year for years 6 through 15.
- o Firm operation date deferred from 1989 to 1990.

The parties calculate that, compared to BKK's requested relief, the settlement saves Edison's ratepayers \$24 million (present value 1988 dollars) over the contract life. The total payments over the contract life are projected to be \$6 million (present value 1988 dollars) above current projections of avoided cost.

In addition to relieving Edison's ratepayers of the possibility of higher energy and capacity payments if the Petition were granted, the settlement PPA provides valuable dispatchability to Edison. The parties note that equivalent dispatchability would not be provided in the existing SO 4 contract under which Phase 1 is operating. They say that, to the extent that Edison is able to curtail deliveries from the facility and purchase less expensive economy energy from off-system resources during off-peak hours, its ratepayers will derive further benefits from the settlement PPA.

These settlement terms are the outcome of prolonged and intensive negotiations between the parties. A critical step in the process of negotiations (according to the stipulation) was BKK's willingness to open its financial books to Edison. The parties say that they have arrived at terms which leave the developer with the minimum of assured cash flow essential to finance the project while minimizing the cost to Edison's ratepayers. Thus, the "front-loading" of capacity and energy payments in the first five years is required to permit project financing and repayment of debt. Capacity and energy payments during the final ten years of the

contract term will be based upon SO 1 (i.e., short-run marginal cost) payments.

The parties say that the stipulation and settlement PPA present a final resolution of a bona fide dispute, thereby conserving this Commission's time and resources as well as those of the parties. The parties regard as possibly the most important benefit of the settlement PPA the resulting efficient use of BKK's landfill gas (a resource which would otherwise be wasted), thereby conserving other fuels for future use. Finally, Edison's ratepayers avoid the risk inherent in the "all or nothing" results of a Commission decision after a contested hearing. The parties assert that the \$24 million savings (in comparison to the relief initially sought) justify full recovery by Edison of all sums paid WCC pursuant to the settlement PPA.

The Division of Ratepayer Advocates (DRA) filed comments on the settlement. DRA recommends that we approve the settlement on the basis that it is a reasonable compromise between full SO4 prices for 12.3 megawatts (to which BKK claims to be entitled) and Standard Offer 1 prices (which in DRA's view should be Edison's starting point in the negotiations).

IV. Discussion

Our review of the record confirms the parties' representation that this Petition concerns a good faith dispute. Moreover, it is not a dispute that we feel can be resolved on the basis of the pleadings. For example, there are issues as to material facts. These issues would require evidentiary hearings to resolve. As noted by the presiding ALJ (see footnote 3 above), such hearings could result in more megawatts at SO 4 prices or the waste of potentially useful landfill gas. Either result would be unfortunate under current circumstances. We think the parties rightly chose to pursue a more optimal result through negotiation.

From the standpoint of Edison and its ratepayers, the settlement has the detriment of payments to WCC that are somewhat higher than Edison's current projections of short-run marginal cost. We must balance this detriment with the settlement's benefits for Edison and its ratepayers. These benefits include: additional firm capacity from a proven project; better timing of the additional capacity; a modest amount of dispatchability; and the avoidance of a potential payment obligation far higher than current projections of short-run marginal cost, should WCC prevail on the merits of its Petition. We also note, from the societal standpoint, that the settlement avoids waste of landfill gas and allows full build-out of a project that has successfully completed its demonstration phase. (WCC's Phase 1 unit is now operating.)

We cannot precisely quantify all of these benefits and detriments. Nevertheless, the record in this proceeding, and our review of prior decisions, give us confidence in making a qualitative judgment that the proposed settlement is reasonable and should be approved.

We have accepted settlements with front-loading or payments above current projections of avoided cost in two major categories of QF/utility disputes: settlements according relief to "pioneer" QFs (those coming on-line before the existence of standard offers); and settlements with "orphan" QFs (those projects that, arguably, were entitled to a standard offer contract at the time of the offer's suspension). WCC's Phase 2 Project fits in the latter category. The settlement PPA in this proceeding has many features that we found to justify prior settlements.

Obviously, WCC has made substantial price concessions. Moreover, these concessions appear to be the maximum possible, consistent with financing the Phase 2 Project. This is established by WCC's sharing of information on its costs and financial requirements with Edison. In D.87-08-047 (our chief decision on "pioneers"), we noted that the QFs there had opened their books to

the utility, which made it possible to design solutions that sustained those projects without exposing ratepayers to undue risk. We applaud WCC's candor and are satisfied with the parties' joint representation that the settlement PPA goes as far as possible to accommodate ratepayer interests and the financial requirements of the QF.

The dispatchability feature is more modest, as we would expect with this type of project. We do feel it is significant that the QF has yielded some operating flexibility to the utility. Our decisions in this proceeding have incorporated greater operating flexibility in final SO 4 and reinstated Standard Offer 2, and have identified the quantification and valuation of performance features (including dispatchability) as major analytical goals. Moreover, most settlements that we have approved have involved the grant to the utility of rights to curtail or dispatch the facility in question beyond what the utility would be entitled to under the standard offers. See, e.g., D.86-09-040; D.87-03-068; D.87-07-086; and D.87-09-080. Thus, the settlement PPA is consistent with established Commission policy on performance features.

This case is also significant for what it does not involve. Many QF/utility disputes are clouded by uncertainty over the developer's site control, technology, fuel source, or other matters that, individually or taken together, suggest that the developer might never have been able to perform under its contract if the contract were not modified. WCC's Phase 1 Project is operating, the record shows that the parties always contemplated that there would be a subsequent phase, and there is no argument over any of the factors mentioned above.

On this record, we cannot quantify WCC's likelihood of prevailing on the merits of its claim (nor could we do so absent further litigation of the claim); and of course we decline to draw any inferences adverse to Edison, based on Edison's willingness to

negotiate and to enter into the proposed settlement. For present purposes, we must note, however, that WCC's claim is colorable and raises substantial issues of law and fact. This means, from the ratepayers' standpoint, that litigating WCC's claim is risky, and this factor should be weighed in judging the reasonableness of a compromise settlement.

We conclude, in light of the disputed and undisputed facts in this matter, and considering the tradeoffs discussed above, that we should approve the settlement PPA, as requested in the parties' stipulation and motion.

Findings of Fact

1. WCC claims in its Petition that it is entitled to increase the firm capacity under an interim SO 4 contract assigned to it by BKK, in order to accommodate Phase 2 of a landfill gas electric generation project at West Covina. Edison, which purchases electricity under the contract, disputes the claim.

2. WCC and Edison have negotiated a settlement of WCC's claim. They jointly request that the Commission approve the settlement and find that Edison's payments pursuant to the settlement are reasonable. They also jointly request that, if the Commission approves the settlement, WCC's petition be dismissed with prejudice.

3. Under the settlement, WCC would reduce its claim of entitlement to additional firm capacity, bring the Phase 2 Project on-line at a later date, grant a specified amount of dispatchability, and make substantial price concessions, compared to what WCC would be entitled to if it were to prevail on the merits of its claim.

4. Edison's payments under the settlement would somewhat exceed its current projections of short-run marginal cost during the period of the settlement PPA. However, Edison's payments if WCC were to prevail on the merits of its claim would greatly exceed Edison's payments under the settlement PPA.

5. WCC has disclosed information about its project financing to Edison. WCC and Edison indicate that the payment stream under the settlement is the minimum necessary for the financing of the Phase 2 Project.

6. The proposed settlement is a reasonable balance of the ratepayer and societal interests, litigation risks, and needs of the QF developer.

7. The proposed settlement is consistent with other settlements previously approved by the Commission to resolve QF/utility disputes.

Conclusions of Law

1. WCC's Petition states a colorable claim to increase the firm capacity under an existing interim SO 4 contract with Edison.

2. The proposed settlement should be approved. Edison's payments pursuant to the settlement should be found reasonable and recoverable through Edison's rates, subject only to review of Edison's performance of its rights and obligations under the settlement PPA. WCC's Petition should be dismissed with prejudice.

3. This order should be made effective immediately so as to resolve the uncertainty created by this longstanding dispute.

ORDER

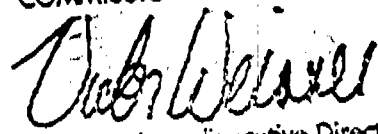
IT IS ORDERED that the stipulation and settlement between Southern California Edison Company (Edison) and the Petitioner, West Coast Cogeneration, Inc. (WCC), is approved. All payments by Edison under the settlement power purchase agreement shall be deemed reasonable and recoverable through Edison's rates, subject only to review of Edison's performance of its rights and obligations under the agreement. WCC's Petition for Modification is dismissed with prejudice.

This order is effective today.

Dated AUG 10 1988, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
C. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

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


Victor Weiss, Executive Director

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