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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for an extended order approving a Second Amendment to the Power Purchase Agreement with Crockett Cogeneration regarding the deferral of the purchase of long-term capacity and energy from the Crockett Cogeneration Project.	Application 88-07-022 (Filed July 15, 1988)

OPINION ON PROPOSED SETTLEMENT

Pacific Gas and Electric Company (PG&E) and Crockett Cogeneration (Crockett) have entered into a settlement of a dispute regarding Crockett's qualifying facility (QF) project. By this application, PG&E seeks our approval of the settlement and prospective finding that PG&E's payments to Crockett pursuant to the settlement are reasonable. The following parties have filed protests: the Division of Ratepayer Advocates (DRA); the California Energy Commission (CEC) staff; Ruth Blakeney; and the Crockett Power Plant Committee (CPPC). Only CPPC requests a hearing; DRA and CEC staff indicate no objection to the expedited treatment of the application requested by PG&E and Crockett.

We reject the settlement but indicate certain modifications that would make the settlement acceptable to us.

I. Background

A. Project History

Crockett holds an interim Standard Offer 4 contract with PG&E for 240 megawatts of gas-fired cogeneration at the California and Hawaiian Sugar Company's (C&H) refinery under the Carquinez Straits bridge. The contract was executed in December 1983. Under the terms of the contract, it is effective as of the last date

signed by either of the parties, and it terminates if energy deliveries do not start within five years. Crockett claims, and PG&E disputes, that various delays, especially in the permitting processes at the Bay Area Air Quality Management District and the CEC, constitute force majeure events that should extend the deadline for starting energy deliveries.

All parties agree that this project has experienced delays. A complete narrative would run for pages and would leave no one the wiser because the controversy, if and when the merits are reached, turns not so much on the events themselves as on questions of who caused (or was at fault for) the delays and what legal force the delays have. We remind all parties that in considering this proposed settlement, we do not reach the merits of the force majeure dispute, nor do we consider (much less resolve) the issues before the CEC in its certification proceeding.

For present purposes, two events stand out. The June 23, 1986 Presiding Member's Report at the CEC had recommended that certification be denied on the grounds that this project does not comply with the relevant test of need. However, the report suggested that a dispatchability agreement could resolve the CEC's concerns; PG&E and Crockett have since negotiated a dispatchability agreement. Crockett also has a letter from PG&E granting the project a force majeure extension due to PG&E's delay in completing the interconnection study (210 days) and to local opposition that apparently delayed the CEC's finding of data adequacy for Crockett's Application for Certification (another 29 days). The effect of the letter is that PG&E accepts Crockett's right under its contract to come on-line as late as August 9, 1989, instead of the original December 1988 deadline.

B. Settlement Summary

PG&E and Crockett have reached a settlement of the force majeure claim. The settlement would defer project construction at

least until April 1, 1994. In return for the deferral, PG&E asks that the Commission approve:

- An up-front payment of $17 million to Crockett
- An increase in capacity payments for the first five years from $196 to $216 per kilowatt-year (kW-yr); this increase has a net present value (NPV) of $25.9 million
- Capacity payments of $196/kW-yr[1] after the first five years
- Payments to the steam host (C&H) to compensate the host for the unavailability of project steam during the deferral (NPV = $2.9 million)

PG&E claims total ratepayer benefits as a result of the settlement (compared to the existing power purchase agreement) equal to between $26 million and $103 million. The different estimates are based on differing assumptions of (1) when Crockett would have gone on-line in the absence of the settlement, and (2) what capacity price Crockett would be entitled to, based on the force majeure claim (see footnote one). PG&E's scenarios are shown in the Appendix.

The projected savings derive entirely from a better fit (because of the deferral) between PG&E's capacity needs and the

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1 Under the standard offer, capacity payments are fixed for the life of the contract according to the year (in the first five years following contract execution) in which the QF demonstrates firm capacity availability. Had Crockett done this in 1988, the price would have been $172/kW-yr; in 1989, $184/kW-yr; in 1990, $196/kW-yr. All of these figures assume that Crockett's force majeure claim would entitle the project not only to come on-line after the five-year deadline but also to have an escalating capacity price over the period of delay. This is disputed by PG&E and DRA, whose position is that a QF may be eligible for an on-line extension as a result of force majeure, but not for an escalation in the capacity price.

timing of the project's on-line date. The dispatchability agreement has apparently taken care of prior concerns over potential energy overpayments under the contract.

II. Positions of the Parties

A. PG&E

PG&E explains the derivation of the various payment terms of the settlement. The justification of these payments, from the ratepayer standpoint, is that they buy a more favorable on-line date and avoid the risks of litigation.

PG&E and Crockett attach briefs on the force majeure issue to the application, by way of showing the intensity of their dispute. DRA, in its protest, confesses that it has not performed independent legal analysis; PG&E responds that this omission vitiates DRA's economic analysis and has the effect of discounting to zero the risks of litigation:

> "If the dispute is not resolved, the parties will litigate. DRA fails to attach any value to the risk associated with the litigation." (PG&E Response to DRA Protest, p. 2.)

> "DRA ignores that if Crockett prevails in court the economic threat to the ratepayers is substantial." (Id., p. 8.)

> "If there had been no dispute over Crockett's force majeure claims, PG&E would not have made this deal. The only reason PG&E made this deal was to resolve the dispute." (Id., p. 9, emphasis in original.)

B. Crockett

Crockett supports the application. Crockett believes the ratepayer benefits are even greater than those calculated by

PG&E.[2] Crockett also suggests that, in the event of litigation, PG&E might be held liable for "compensatory or greater damages, payable even without the capacity being built and energy being available during that period of additional delay." (Crockett Memorandum Supporting Application, p. 6, emphasis added.)

C. DRA

DRA protests the settlement on the following grounds:

1. The CEC may require deferral of the project, meaning that the benefits of the deferral would be had without the costs.

2. The project might not be viable without the deferral. DRA asserts that the project lacks CEC and air quality permits, has not gotten committed financing or paid the interconnection fee, and depends on a steam host (C&H) facing serious financial difficulties.

For these reasons, DRA suspects that the project would not be built without the settlement (that is, the settlement really saves the project). DRA believes that, on the whole, ratepayers would be better off financially without the project under either the existing contract or the proposed settlement. DRA (relying, for this purpose only, on capacity values shown in PG&E's data) calculates a net ratepayer benefit of $146 million, in the form of lower capacity payments, if we were to reject the settlement and the project were to fail before coming on-line.

DRA disputes PG&E's calculation of ratepayer benefits if the project is viable without the settlement. DRA's comparison of its own estimates with PG&E's is contained in the Appendix.

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2 In Exhibit C to the application, Crockett shows a net present value to ratepayers of $73.4 million to $94.9 million, depending on the capacity value assumptions.

DRA's corrected comments show a range of likely outcomes between a net ratepayer loss of $13 million and a gain of $37 million as a result of the settlement. DRA emphasizes throughout that these figures assume that the project is viable without the deferral and that Crockett would win its force majeure claim--both of which DRA regards as questionable.

D. CEC

The CEC staff notes that a final CEC decision on project certification could not be issued until late December at the earliest. The CEC staff recommends denial of CEC certification, on grounds that the project does not pass two of the five conditions of the relevant "need" test.

The CEC staff also indicates that it would dispute Crockett's force majeure claim, were that claim to be fully litigated.

E. Crockett Reply to DRA Protest

Crockett's reply raises two substantive disagreements with DRA: (1) DRA assumes that PG&E will not need capacity until the late 1990's in arguing that the CEC will reject certification, yet assumes need in the early 1990's in calculating ratepayer benefits, and (2) Crockett argues that DRA's base-case capacity price ($172/kW-yr, which implies firm capacity in 1988) is less likely than PG&E's ($184/kW-yr, 1989), or Crockett's ($196/kW-yr, 1990). Both disagreements affect the calculated ratepayer benefits. Also, Crockett indicates that the project has now received its air quality permit.

F. Blakeney

Blakeney endorses the conclusions of CEC staff. She asserts that many of the regulatory delays are of Crockett's own making (because of various changes to the project as originally presented to the regulators) and that this factor diminishes the credibility of Crockett's force majeure claim. She also quotes extensively from Order Instituting Rulemaking 88-06-007 (where we

propose guidelines for utility/QF negotiations such as those leading to this settlement), and asserts that the settlement does not comply with the proposed guidelines.

G. CPPC

CPPC says that the project is not viable without an extension of the current August 9, 1989 deadline. CPPC objects to the ratepayers' assumption of development risk inherent in the settlement, noting that there appears to be no recourse for recovery of the up-front payments "if Crockett decides to walk away from the project" after receiving the payments. (CPPC Protest, p. 8.) CPPC also believes that PG&E exaggerates the risks of litigation: "No liability results from doing nothing now that is any greater than the liability already imposed by the existing contract." (Id., pp. 11-12.)

CPPC asks for a hearing, although the only material fact claimed to be in dispute is the different calculations, among the parties, of ratepayer impact. CPPC also notes that the record presently is incomplete on C&H's acceptance of (1) the schedule for pre-operational payments and (2) the steam sales agreement. The proposed settlement is expressly conditioned on such acceptance. CPPC would hold the record open for receipt of this material.

III. Discussion

A. Should the Proposed Settlement Be Considered?

We are aware that our proposed guidelines for utility/QF negotiations over modified power purchase agreements say that, for paid deferrals and buyouts, the QF should "conclusively demonstrate" the viability of its project. In this case, the key question surrounding viability is CEC certification. Our proposed guideline is impracticable here. We would either have to find that the CEC would certify the project, which involves us in litigating matters properly before the CEC, or we would have to postpone

considering a settlement until after action by the CEC. This would also be undesirable, both because this settlement expires before then on its own terms and because CEC action would fundamentally affect the bargaining power of the parties.

Another factor that inclines us to consider this settlement on its merits is the dispatchability agreement previously reached by Crockett and PG&E. We have frequently urged QFs and utilities to work on ways to better integrate QF deliveries into utility operations. Most of the settlements that we have previously approved have involved some type of load-following feature provided by the QF. The dispatchability agreement here is estimated by DRA to result in substantial savings to ratepayers and seems to go farther than any of the negotiated load-following features we have yet seen in ensuring economic dispatch of the resources of the purchasing utility.

In light of these factors, we think the proposed settlement at least deserves our consideration.

B. What Scenarios Are Relevant to the Reasonableness of the Settlement?

PG&E, Crockett, and DRA all offer multiple scenarios, with differing capacity prices and on-line dates, to evaluate the reasonableness of the proposed settlement. We find, however, that for purposes of calculating costs and benefits under the existing contract, a capacity price of $172/kW-yr and a 1990 on-line date should be assumed.

We agree with PG&E and DRA that $172/kW-yr is the valid capacity price under the facts of this case. When PG&E and Crockett executed this interim Standard Offer 4 contract (December 1983), the relevant capacity price table contained a price series for each of the five years when Crockett was entitled to come on-line. We later directed PG&E to extend the table to include 1989 and 1990 (Decision (D.) 86-10-038, as modified in D.86-12-013 and D.86-12-104), but this was only for the purpose of completing the

table for QFs that signed interim Standard Offer 4 contracts in 1984 and 1985. Such QFs (unlike Crockett) were entitled to capacity prices fixed for 1989 and 1990 under the planning assumptions current when they and PG&E signed. Even if Crockett were to win its force majeure claim and so extend its permissible on-line date, we reject the proposition that it also would be entitled to escalated capacity prices.

We also find implausible the suggestion that Crockett's force majeure claim could justify a deadline as late as 1991 for starting energy deliveries. Many of the delays listed by Crockett were happening concurrently in different regulatory processes, so the delays are not all additive even if some or all of them were held to constitute force majeure. Furthermore, we reject the proposition that a QF is entitled to a force majeure extension every time it changes its project design (and possibly lengthens the regulatory process) in order to get required permits.

Under a $172/kW-yr and 1990 on-line scenario, DRA and PG&E both find that ratepayers are better off under the proposed settlement than under the existing contract. They calculate a benefit to ratepayers of $12.7 million (DRA) and $59.8 million (PG&E).[3]

C. Is the Proposed Settlement Reasonable?

We decline to find reasonable the terms of the settlement as presently before us, but we describe a variant of the settlement that we would find reasonable. PG&E and Crockett may choose to re-negotiate the settlement, at their option, to comply with the requirements we will describe below.

Our rejection of the settlement is based on two factors: first, our conviction that a cornerstone of the QF program is

3 Benefit is in net present value, 1988 dollars. Crockett does not perform any calculation of benefits for this scenario.

insulation of the ratepayers from development risk, a great deal of which would be borne by ratepayers under the terms of the settlement; and second, our judgment that the project's viability is uncertain. The two factors are inter-related. If the project is not viable, then the ratepayers save it by their assumption of development risk. If the project is not viable and the settlement is not approved, the ratepayers will avoid large overpayments, based on current planning assumptions (both DRA's and PG&E's).

Under the terms of this settlement, PG&E is apparently entitled to recover from ratepayers the entire amount of the pre-operational payments, both the $17 million payment to Crockett and at least part of the payments to C&H,[4] even if the Crockett project is never built and never comes on-line. This assumption of development risk by the ratepayers greatly concerns us; we have never before authorized up-front payments to a QF.

Viability of the project hinges primarily on two events: certification by the CEC and granting a force majeure delay to Crockett, enabling the project to extend its on-line date. We regard both events as uncertain. In addition to our unwillingness to appear to presume that our sister agency either will or will not certify the project, we understand that active opposition to the Application for Certification exists and will be considered by the CEC. Unless we broaden the scope of PG&E's application to us, we do not reach the merits of Crockett's claim of force majeure.

Since we cannot be certain of the project's viability, we must consider the possibility that our finding the settlement reasonable would revive an otherwise defunct project and subject the ratepayers to overpayments during a period of excess capacity.

4 We are unclear whether payments to C&H would continue in the event, for instance, of a CEC refusal to certify the project.

Avoiding these same overpayments is the potential ratepayer benefit in the negotiated deferral.

On balance, we judge that the potential ratepayer benefits claimed for the settlement do not, because of their uncertainty, justify the ratepayers' assuming the risk of losing the $17 million up-front payment to Crockett and the $2.9 million payments (NPV) to C&H if the project never comes on-line. We therefore decline to find the proposed settlement reasonable.

However, the question is close, and the settling parties might be willing to make changes to the proposed settlement that would cause us to reverse our decision. The strongest factor pressing for rejection is the requirement that ratepayers assume development risk. We are convinced, however, that sufficient likelihood of ratepayer benefits exists, were this assumption of risk reduced, for us to find a revised settlement reasonable. The question, then, is: under these circumstances, what level of development risk would reasonably be in the ratepayers' interest?

In answering, we find DRA's calculation of ratepayer benefits under different scenarios helpful in providing a plausible worst-case estimate. As discussed above, we consider $172/kW-yr and 1990 the proper capacity price and on-line date to use in examining possible ratepayer benefits of the settlement. DRA calculates the ratepayer benefit of the settlement if the project is assumed to come on-line in 1990, absent the settlement, to be $12.7 million.

This suggests that a symmetrical allocation of the risk of the up-front payments would call for the ratepayers' assuming $12.7 million while PG&E shoulders the risk of losing payments above that figure in the event that the project never comes on line. We find this an appropriate revision to the proposed settlement, in that the claimed benefits to ratepayers would at least equal the portion of development risk assumed by the ratepayers.

Another problem with the proposed settlement is that it is contingent on acceptance by C&H of certain arrangements under it. The effect of this is unclear. If C&H were to back out or demand more money, what is the impact on PG&E's $17 million payment to Crockett? The fewer contingencies, the better. The proposed settlement requires two confirmations by C&H that (so far as the record shows) have not yet been made. We expect these confirmations to be supplied for the record before we approve a settlement in this matter.

Finally, PG&E has repeatedly emphasized the importance of the settlement to avoid litigation risks. We are not convinced that these risks fall entirely or even mostly on ratepayers. Crockett's existing contract entitles it to certain payments, subject to certain conditions. If, as Crockett suggests, a court might find it entitled to damages in excess of such payments, that would at least raise an issue for us of whether any PG&E imprudence had occurred in the administration of this contract. In any event, we are not convinced that the proposed settlement actually avoids litigation risks. We do not find any provision that Crockett accepts the settlement as a complete resolution of the dispute described in the various recitations at the start of the settlement; nor do we find a provision by which Crockett expressly waives any further recourse or cause of action against PG&E that might be based on the events to date. We believe both provisions are necessary to an acceptable settlement.

Thus, our order today is to deny the application, but we will hold the proceeding open, pending receipt of a status report from PG&E. The status report is due no later than 15 days from the effective date of this order. The report will indicate acceptance or rejection of the additional and revised terms set forth above. In the case of an acceptance, the report shall attach proposed language implementing these terms and documents confirming C&H's acceptance of the payment schedule and steam sales agreement. In

the case of a rejection, we would dismiss the application and close the proceeding.

We will approve the revised settlement if it fully complies with our terms. In that event, we would make a prospective finding that payments by PG&E pursuant to the settlement are reasonable and fully recoverable from ratepayers to the same extent as payments pursuant to standard offer power purchase agreements. This finding would be subject to the condition that pre-operational payments by PG&E exceeding $12.7 million are refundable to ratepayers if the the project fails to come on-line pursuant to the terms of the settlement.

Findings of Fact

1. By this application, PG&E seeks approval of a settlement of Crockett's force majeure claim and a prospective finding of reasonableness of payments pursuant to the settlement. DRA, CEC, CPPC, and Ruth Blakeney have protested the application.

2. The viability of Crockett's project is uncertain. The chief remaining obstacle is CEC certification. Such certification is opposed by CEC staff and others.

3. The proposed settlement would further amend Crockett's existing interim Standard Offer 4 contract with PG&E. Crockett would get pre-operational payments and an increased capacity price when it comes on-line, while PG&E would avoid capacity overpayments over the near term.

4. The contract has previously been amended so that the project would follow load on PG&E's system. This load-following feature eliminates potential energy overpayments and will actually provide net energy savings to PG&E.

5. This Commission has actively promoted the negotiation of load-following features between utilities and QFs.

6. The net present value of payments under the proposed settlement is lower than that under the existing contract, according to PG&E's calculations. This is also the case according to Crockett's calculations, and under all but one scenario for which DRA performed calculations. However, both the proposed settlement and the existing contract involve substantial capacity overpayments, based on the current resource planning assumptions of DRA and PG&E. This suggests that a settlement that revives the project would not be to the benefit of ratepayers.

7. The most reasonable scenario for purposes of calculating PG&E's costs under the existing contract is to assume a capacity price of $172/kW-yr and a 1990 on-line date.

8. This Commission has not previously authorized pre-operational payments by a utility to a QF. Such payments would constitute an assumption of development risk by ratepayers. This is an antithetical to one of the fundamental purposes of the QF program.

9. If the proposed settlement is rejected, and Crockett gets an extension of its on-line date through successful pursuit of its force majeure claim, then ratepayers would have been better off had the settlement been approved. The estimated advantage to ratepayers of approval under the most reasonable scenario ranges from $12.7 million (DRA) to $59.8 million (PG&E).

10. Considering the various uncertainties, the proposed settlement is unreasonable because it does not fully mitigate litigation risks and exposes ratepayers to an unacceptable amount of development risk. Also, contingencies related to C&H's acceptance of certain settlement provisions affecting the steam contract should be eliminated.

11. Assuming that PG&E and Crockett were able to revise their settlement to allay the concerns noted in finding 10, the revised settlement would be reasonable.

12. There is no one "correct" estimate of ratepayer savings under the proposed settlement. The fact that PG&E and DRA show different amounts for these savings is a function, in part, of different resource planning assumptions, over which reasonable people might disagree. The difference does not require examination in a public hearing.

Conclusions of Law

1. Crockett would not be entitled to a capacity price greater than $172/kW-yr, even if it were to prevail on its force majeure claim.

2. In considering the merits of a proposed settlement, the Commission does not reach the merits of the underlying legal or factual disputes.

3. In considering the merits of a proposed settlement, the Commission does not pre-judge the outcome of matters properly before another regulatory agency, such as the CEC.

4. This order should be made effective immediately so as to resolve (if possible) the long-standing dispute between PG&E and Crockett short of litigation, and to give timely information to the CEC regarding the status of the proposed settlement.

O R D E R

IT IS ORDERED that:

1. The application of Pacific Gas and Electric Company (PG&E) is denied.

2. The request for hearing by the Crockett Power Plant Committee is denied.

3. The proceeding shall be held open pending receipt of a status report from PG&E. The report shall be filed and served in

this proceeding no later than 15 days from the effective date of this order, and shall indicate whether PG&E and Crockett Cogeneration accept or reject the additional and revised terms described in Section III.C of the opinion. In the case of acceptance, the report shall attach proposed language implementing these terms and documents confirming the California and Hawaiian Sugar Company's acceptance of the payment schedule and steam sales agreement.

This order is effective today.

Dated August 24, 1988, at San Francisco, California.

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

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

Victor Weisser, Executive Director

APPENDIX
(From DRA Protest, p. 10; estimates are in millions of 1988 dollars)

TABLE 1

Comparison of DRA and PG&E Savings Estimates

Scenario	DRA	PG&E
1990 Start Date/ $172/kW Base Capacity Price (PG&E scenario No. 5)	12.7	59.8
1991 Start Date/ $172/kW Base Capacity Price (PG&E scenario No. 6)	-13.2	25.8
1990 Start Date/ $184/kW Base Capacity Price (PG&E scenario No. 1)	36.5	81.2
1991 Start Date/ $184/kW Base Capacity Price (PG&E scenario No. 2)	8.1	45.1
1990 Start Date/ $196/kW Base Capacity Price (PG&E scenario No. 3)	60.6	102.7
1991 Start Date/ $196/kW Base Capacity Price (PG&E scenario No. 4)	29.7	64.3

the case of a rejection, we would dismiss the application and close the proceeding.

Should PG&E and Crockett accept the above terms, then we would allow the other parties an opportunity to file comments. Such comments would be due no later than 30 days from the effective date of this order and would be limited to review of the report for compliance. We would approve the revised settlement if it fully complies with our terms. In that event, we would make a prospective finding that payments by PG&E pursuant to the settlement are reasonable and fully recoverable from ratepayers to the same extent as payments pursuant to standard offer power purchase agreements. This finding would be subject to the condition that pre-operational payments by PG&E exceeding $12.7 million are refundable to ratepayers if the the project fails to come on-line pursuant to the terms of the settlement.

Findings of Fact

1. By this application, PG&E seeks approval of a settlement of Crockett's force majeure claim and a prospective finding of reasonableness of payments pursuant to the settlement. DRA, CEC, CPPC, and Ruth Blakeney have protested the application.

2. The viability of Crockett's project is uncertain. The chief remaining obstacle is CEC certification. Such certification is opposed by CEC staff and others.

3. The proposed settlement would further amend Crockett's existing interim Standard Offer 4 contract with PG&E. Crockett would get pre-operational payments and an increased capacity price when it comes on-line, while PG&E would avoid capacity overpayments over the near term.

4. The contract has previously been amended so that the project would follow load on PG&E's system. This load-following feature eliminates potential energy overpayments and will actually provide net energy savings to PG&E.

this proceeding no later than 15 days from the effective date of this order, and shall indicate whether PG&E and Crockett Cogeneration accept or reject the additional and revised terms described in Section III.C of the opinion. In the case of acceptance, the report shall attach proposed language implementing these terms and documents confirming the California and Hawaiian Sugar Company's acceptance of the payment schedule and steam sales agreement. Other parties may file and serve comments on the report, if the report indicates acceptance. Such comments shall be filed and served no later than 30 days from the effective date of this order, and shall only address the compliance of PG&E's report with the terms set forth in Section III.C of the opinion for revision of the proposed settlement.

This order is effective today.

Dated AUG 24 1988, at San Francisco, California.

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